THE FINANCIAL PROBLEM

Measures for the Promotion and
Appropriate Canalisazion of Savings

1. The industrialization of an under-developed country from her own resources requires that a high proportion of her real productive resources must be devoted to capital formation as against production for current consumption, i.e. investment must form a high proportion of total output. The financial counterpart of this is that a high proportion of income must be saved. For if on account of an insufficient rate of saving, bifurcation of income into consumption and saving does not parallel the bifurcation of output into consumption goods and investment goods output, consumption expenditure will exceed the amount required to buy the current flow of consumption goods and services at prevalent prices. And this means inflationary pressures. The basic financial problem raised by India's industrialization would, therefore, be how to cause a high enough proportion of income to be saved**. The Plan has found that in most advanced countries, doubling of per capita income within a generation or so (25-30 years) required a rate of net investment of the order of 12-15 % of national income. It has, therefore, concluded that 'in under-developed countries with low standards of living and rapidly increasing population, a rate of growth commensurate with needs cannot be achieved until the rate of capital formation comes up to around 20 % of the national income'.*** We endorse the Plan's conclusion but would suggest

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* Consumption goods include services.

** A rise in the proportion of income saved does not necessarily mean a fall in absolute consumption. If measures to raise the average propensity to save coincide with increase in income, absolute consumption may increase even as higher proportion of income is saved. 10 % saved out of 200 mean higher absolute consumption than 5 % out of 100. Since such increase in income is feasible in India through employing idle labour-power, even a substantial increase in the percentage of income saved need not involve a reduction in absolute consumption.

*** Chapter I, Para. 18.
that if possible the target may be set somewhat higher, say at 22-25 per cent. of the national income. The fact that in 1950-51 the rate of domestic saving was only 5 per cent. of the national income underlines the intensity of the effort required to attain the desired rate of capital formation. It has been estimated that, for a population growing at the rate of 1½ per cent. per annum, a rate of investment equal to 4-5% of the national income would barely keep per capita income constant**. Again, to ensure the internal consistency of the development plan, the direction of savings must be brought into line with the disposal of real investible resources under the production plan. The financial problems then are: (a) how to raise sufficiently the propensity to save, and (b) how to canalize the savings? The two problems are discussed separately in this Chapter.

2. As a rule, the smaller the income, the lower the proportion of it saved. Accordingly, in India, where per capita income is very much smaller than in advanced countries, in the absence of a measure of compulsion, the proportion of national income saved is bound to be very much lower. It has been estimated that net voluntary savings in India are just 2-3 per cent. of national income, as compared to 10-15 per cent. in highly advanced countries like the United Kingdom, Canada and the United States***. If India continues to save a lower proportion of a smaller income, the per capita rate of investment in India will remain very much below that in advanced countries, and the gap in the levels of development between the advanced countries and India will always tend to widen. If India wants this gap to be progressively narrowed, she must steadily raise the proportion of income saved till she begins to invest a higher proportion of income than do the advanced countries. This is how the Soviet Union and the People's Democracies, for instance, have sought to narrow the gap between the advanced countries and themselves. It has been estimated that the Soviet Union and Poland invested 27 &

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The Plan, Ch. 1, Para. 4

The Plan, Ch. 1, Para. 19.

*** UN, Methods of Financing Economic Development in Underdeveloped Countries, 1949, p. 79.
and 17% of their national incomes in 1948, and Hungary 17% of her income in 1946-49. But in a poor underdeveloped country it is impossible to save 10-15 per cent. of national income without a measure of compulsion. 'Since very small per capita savings have to be obtained from a large population', observes a UN study, 'it is difficult to mobilise them by purely voluntary methods'. In fact, even in advanced private enterprise countries where per capita income is very much higher, and hence the scope for a high rate of voluntary saving very much greater, a 10-15 per cent. rate of saving is achieved through an element of compulsion. This is provided by corporate savings which, as pointed out in Chapter IV, normally account for the bulk of gross capital formation in such countries. If corporate assets were amortised at their actual rate of depreciation and obsolescence, and if corporate profits were wholly distributed among the stockholders, the proportion of income saved in these countries would appreciably be lower than its present level. For a good portion of the amounts currently saved by way of undistributed corporate profits and of amortisation of assets at rates higher than their actual rate of depreciation and obsolescence, if distributed among the stockholders, would definitely go to finance personal consumption expenditure. Since the present rate of saving in advanced countries is obtained through a measure of compulsion of a sort, India cannot save anything like the same proportion except through suitable measures of compulsion. To attain the high rate of investment required by industrialisation, compulsory savings are indispensable. This, however, should not be construed to mean that we consider voluntary savings of no consequence in India. Our plea is not for an exclusive reliance on compulsory saving, but stresses the need to supplement commonly adopted methods of promoting voluntary

* Ibid., p. 74.
** UN, Mobilisation of Domestic Capital in Countries of Asia and the Far East, Bangkok, 1957, p. 68.
savings by measures of compulsory saving. The two sets of measures are discussed separately in this Chapter.

3. The Plan, unfortunately, does not give a capital budget for the whole economy covering the Plan period. It, however, gives such budget in respect of the industrial sector and also in respect of the economy as a whole for the year 1950-51. We reproduce them below for help in the analysis of the problem.

### Table 79: The Capital Budget for the Industrial Sector (1951-56)

<table>
<thead>
<tr>
<th>Cross Investment</th>
<th>Sources of Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Net investment in</td>
<td>(1) Foreign investment</td>
</tr>
<tr>
<td>fixed capital in the</td>
<td>(Investment in refineries)</td>
</tr>
<tr>
<td>public sector</td>
<td>(64)</td>
</tr>
<tr>
<td>(2) Net investment in</td>
<td>(2) Domestic Resources</td>
</tr>
<tr>
<td>fixed capital in the</td>
<td>(a) Resources of the public sector invested directly</td>
</tr>
<tr>
<td>private sector</td>
<td>(74)</td>
</tr>
<tr>
<td>(3) Net investment in</td>
<td>(b) Resources of domestic private industry.</td>
</tr>
<tr>
<td>working capital</td>
<td>(533)</td>
</tr>
<tr>
<td>Total net investment</td>
<td>(i) Corporate undistributed profits in the industrial</td>
</tr>
<tr>
<td></td>
<td>sector</td>
</tr>
<tr>
<td></td>
<td>(ii) New issues</td>
</tr>
<tr>
<td></td>
<td>(iii) Assistance</td>
</tr>
<tr>
<td></td>
<td>(iv) Industrial Finance Corporation</td>
</tr>
<tr>
<td>(4) Investment in the</td>
<td>(v) Refund of E.P.T. Deposits</td>
</tr>
<tr>
<td>private sector on</td>
<td>(vi) Banks and other sources of short-time finance</td>
</tr>
<tr>
<td>modernization and</td>
<td></td>
</tr>
<tr>
<td>replacement</td>
<td></td>
</tr>
<tr>
<td>(5) Current depreciation</td>
<td></td>
</tr>
<tr>
<td>expenditure not</td>
<td></td>
</tr>
<tr>
<td>covered by normal</td>
<td></td>
</tr>
<tr>
<td>income-tax allowances.</td>
<td></td>
</tr>
</tbody>
</table>

Source: The Plan, Ch. 29, Para. 35.

+ Excludes current depreciation expenditure covered by normal income-tax allowances.
### TABLE I: INVESTMENT AND SAVING IN 1950-51 (M. CRORES)

<table>
<thead>
<tr>
<th>Investment*</th>
<th>Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Domestic</td>
<td>(A) Public</td>
</tr>
<tr>
<td>(i) On Public Account</td>
<td>(B) Private</td>
</tr>
<tr>
<td>Irrigation, navigation, drainage etc. (incl. multi-purpose river valley schemes)</td>
<td>(a) Corporate enterprises</td>
</tr>
<tr>
<td>Agriculture</td>
<td>47</td>
</tr>
<tr>
<td>Electricity</td>
<td>23</td>
</tr>
<tr>
<td>Industries</td>
<td>12</td>
</tr>
<tr>
<td>Railways and Communications</td>
<td>38</td>
</tr>
<tr>
<td>Roads and Buildings</td>
<td>42</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>16</td>
</tr>
<tr>
<td>(ii) On Private Account</td>
<td>225</td>
</tr>
<tr>
<td>Large- and small-scale industries</td>
<td>80</td>
</tr>
<tr>
<td>Transport other than railways</td>
<td>25</td>
</tr>
<tr>
<td>Construction of buildings</td>
<td>100</td>
</tr>
<tr>
<td>Agriculture and cottage and small industries in rural areas</td>
<td>20</td>
</tr>
<tr>
<td>(B) Foreign**</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>65</td>
</tr>
</tbody>
</table>

| TOTAL | 475 | TOTAL | 475 |

Source: Appdx. to Part I of the Plan

* Excludes investment in inventories
** Increase in net external assets on account of the surplus in the balance of payments
The Plan also gives the development budget* for the public sector covering the Plan period. The details of development outlay and of estimated financial sources in respect of this budget have been given previously**.

I. METHODS OF COMPULSORY SAVINGS

Public Saving.

4. The choice of methods of compulsory saving must be related on the one hand to the conditions prevalent in India, and on the other to objectives in view. From this standpoint public saving, i.e. saving from current revenue (including surplus produced by the public sector) appears to provide the most effective and the most appropriate method of compulsory saving. A high rate of aggregate saving in India is unthinkable without a high rate of public saving. This follows from the following facts of the current situation. Annual income per capita is very low – just Rs. 255 (approximately £ 19). The aggregate income earned by those in the high income groups is quite modest. The proposed socio-economic reforms, viz. the abolition of landlordism without compensation, the nationalisation of foreign and of Indian cartel capital, and reduction in the salaries paid to high government officials, will further reduce this aggregate. On account of the low level of development of capitalism, corporate gross profits form a very small proportion of the gross national income. The bulk of the population are not wage-earners but small producers. The proposed transfer of land to the tiller and development of cottage and small-scale

* We have deliberately used the term 'development budget' instead of the 'capital budget', for the whole of the expenditure covered by this budget is not investment outlay. About Rs. 400 crores of this outlay consists of a recurring nature on agricultural extension services, health, education, community projects, etc. (The Plan, Ch. III, Para. 8)

** See Chapter IV, Paras. 6 and 59.
industries will further increase the number of small producers. Under these conditions other methods of compulsory saving employed in advanced countries, such as compulsory deposits, compulsory purchase of non-negotiable savings bonds, compulsory employer and worker contributions to social insurance and welfare funds, limitation of dividends, direct restriction of consumption and deficit financing (use of newly created money) can be of only limited efficacy. A high rate of public saving is indispensable for a high rate of aggregate saving. This view is accepted by the Plan. 'Enlargement of public savings through taxation and through the earnings of the public enterprises,' observes the Plan, 'is one of the major means open in ....... the present stage of our organization to raise significantly the level of net savings in the country.' 

Accordingly, under this Plan, 58.7% of the current domestic savings (Rs. 738 crores out of a total of Rs. 1,258 crores) required to finance the contemplated public development outlay will be provided by public savings. **If the Plan had provided for as high a rate of investment as we think necessary and feasible, the contribution of public saving to total saving would have been considerably higher.

5. Public saving is not only an indispensable but a very appropriate method of saving. A few of its advantages are mentioned below.

(a) It not only produces savings but also simultaneously mobilizes them; the creation of savings and their mobilization becomes a single process. It thus becomes possible even for an under-developed country with a very low per capita income to start creating

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* The Plan, Ch. III, Para. 8.
** However, since about 400 crores of this amount will be absorbed by development expenditure of a recurring type, public saving in the true, Keynesian sense comes to Rs. 338 crores.
a heavy industry, individual units of which normally require investment of tens of crores of rupees each. Such a country can thus launch upon a course of development which in our view provides the quickest way to industrialization. In such a country, in the absence of a high rate of public saving, not only will the rate of aggregate saving be lower than required, but also the savings will flow in numerous exceedingly thin trickles which may be impossible to bring together in sufficient number to form mighty streams which alone can create heavy industry. The thin trickles may at best coalesce into tiny flows that may feed trade, usury, agriculture, cottage and small-scale industries or large-scale light industries. An under-developed country can produce and mobilize the huge amounts required for heavy industry only through public saving.

(b) Planned development requires that savings be directed into the preferred fields. Public saving, since it transfers resources to public spending, greatly facilitates this task. The Government's capital budget becomes a powerful instrument for directing development along desired lines.

(c) Public saving is the only practicable way to finance development in the non-profit-making fields, such as general and technical education, health, soil conservation and flood control, various public and social services, etc.

(d) When funds are privately saved the income earned through lending or investing them accrues to private persons. Since normally a high proportion of larger incomes is saved, the rich save much larger amounts than the poor, with the result that in the next round income is even more unequally divided. Therefore, when economic development is financed by private saving, the tendency is for inequalities of income and wealth to grow. This explains the great inequalities of wealth and income
in advanced private enterprise countries. But to the extent investible funds are obtained through public saving, economic development involves growth in the collective wealth and income of the community. Accordingly if public savings forms a high and growing proportion of total saving, the country steadily moves in the direction of an egalitarian, socialistic society. Rapid progress, economic equality and social justice are all ensured when development is financed through public saving. The Plan attaches equal importance to equality of wealth, income and opportunity, and to abolition of poverty. But it is not sufficient merely to accept social equality as the major goal of policy; it is equally necessary to take the appropriate measures to that end. Technically advanced industries and agriculture necessarily involve a high degree of centralization of capital. The only way to ensure that such centralization of capital will not be associated with concentration of economic, and hence political, power in the hands of a small property-owning minority is to bring the bulk of such capital under collective ownership. Development financed through public saving is the only way to achieve this. We, therefore, do not agree with the Plan that the distinction between the public and the private sectors is one of relative emphasis. This may be partly true for purposes of control of the economy; but for the purpose of creating an egalitarian society (through collective ownership of capital) and for ensuring a rapid rate of development (through a high rate of public, and hence, total domestic saving), the distinction between public and private ownership of capital is of decisive significance.

(e) A given amount of public saving in a year means this much addition to government-owned capital during the year. Next year, therefore, the government's revenues improve because of larger income from its investments. Thus year to year

* Introduction, Para. 4.

** Chapter II, Para. 16.
the resources available to the government for investment increase at a compound rate. A high rate of public saving is a powerful instrument for rapid, and ever faster, development.

(f) When the bulk of the community's saving is made by means of a current budget surplus, it does not mean that private enterprise is starved of resources for development. For, it is open to the Government to put a suitable portion of its savings at the disposal of the private sector through grants, loans and participation in capital.

(g) Reliance on public saving to provide the bulk of required aggregate saving, by its tendency to reduce inequalities of wealth and income, reduces the demand for imported high-class goods purchased by the richer class. It thus not only removes the strain on the balance of payments but also creates additional market for domestic industries. This is one of the reasons which led a UN study to comment that 'taxation should be used to the highest practicable degree to finance economic development in under-developed countries'.

6. The rate of public saving proper may be stepped up in four ways: (a) by increasing tax revenue, (b) by increasing the surplus yielded by the public sector, (c) by slashing government non-development expenditure, and (d) by economising in development expenditure of a recurring type. (a) and (b) step up the rate of public saving by increasing current revenues, (c) and (d) by reducing the draft on it for current purposes. The scope and methods of achieving these objectives are discussed below.

7. Tax revenue may be increased in three ways: imposing fresh taxation, raising the rate of existing taxes, and improving tax recovery. There is scope in all these directions. The Plan points out that in 1950-51, total tax revenue (of both Central

and the State Governments) was 625 crores, i.e. 7% of the national income: the corresponding percentage for Canada, Ceylon, Australia, the USA, Japan, New Zealand and the UK was 19, 20, 22, 23, 27 and 35%. The coverage of tax revenue is also very narrow. 28% of the tax revenue comes from direct taxation (excluding land revenue) which directly affects only 4% per cent. of the working force of 133 million in 1948-49. 17% of such revenue comes from import duties and 8% from excise duties. The incidence of these taxes, according to the Plan, also mainly falls on the rich**. The Plan considers the burden of taxation on the rest of the population (i.e. low-income groups) relatively light***, and suggests that they may be reached through indirect taxation. It contemplates an increase in tax revenue of Rs. 70-80 crores by 1955-56. The ratio of such revenue to national income will, however, remain unchanged at 7% due to increase in national income. In order to fulfil their target of saving, viz. Rs. 408 crores, States are required by the Plan to raise Rs. 232 crores of additional revenue over the Plan period. The measures to be adopted in respect of about three-quarters of this amount have already been settled in consultation with the State governments. The details are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs. crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land revenue and agricultural income-tax</td>
<td>34.0</td>
</tr>
<tr>
<td>Irrigation rates and betterment fees</td>
<td>29.5</td>
</tr>
<tr>
<td>Forests, electricity and minerals</td>
<td>4.8</td>
</tr>
<tr>
<td>Estate Duties</td>
<td>21.3</td>
</tr>
<tr>
<td>Sales Tax</td>
<td>25.5</td>
</tr>
<tr>
<td>Economies in non-development expenditure</td>
<td>12.4</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>165</strong></td>
</tr>
</tbody>
</table>

Proposals for the balance of Rs. 67 crores still remain to be worked out.

* The Plan, Ch. III, Para. 10
** Ibid., Para. 11.
*** Ibid., Para. 8
O Ibid., Para. 17.

Strictly speaking, Rs. 12.4 crores are to be saved through economies in non-development expenditure and the balance through increase in the revenue.

*** The Plan, Ch. 3, Para. 25.
The Plan has pointed out the existence of substantial tax evasion, especially in the case of direct taxation*. Such evasion takes place, according to the Income Tax Investigation Commission both in the high and the middle ranges. The predominance of unincorporated enterprises facilitates tax evasion. Traders and the professional men especially evade taxation on a large scale. The Plan notes that even in the case of corporate enterprises, the close inter-locking of managerial and other controlling interests in industry, trade and finance offers opportunities for evasion**.

8. Undoubtedly, there is some scope for increase in the tax revenue. But we must not exaggerate it. It is true that in India tax revenue accounts for a very much lower percentage of national income than is the case in advanced countries. But it must be remembered that the smaller the income, the lower is the percentage of it that may be conveniently extracted through taxation. Moreover, where, as in this country, foreign trade forms a relatively small proportion of national income, enterprise is mostly unincorporated, and a substantial proportion of the output is not exchanged for money, taxation can appropriate only a relatively small percentage of income. Again, apart from the fact that it is not quite true that indirect taxation falls largely on richer classes, there is the consideration that the income of the mass of the people is too low to admit of taxation. That a large proportion of the population contribute very little to the tax revenue does not mean that the burden of taxation on them is light; it simply means that their income is too low to permit of a margin for taxation. Finally, a government would be justified in imposing fresh taxation only if it also takes all other measures outlined in this study to raise the rate of public saving. If it fails to do this, the public may quite legitimately resist additional tax burdens.

** Ibid.
9. The main taxes in a modern state may be broadly grouped as under:

1. Taxes on income, agricultural and non-agricultural.
2. Taxes on the ownership, succession to, purchase or sale of, and increment in the value of property.
3. Taxes on professions, trades, callings and employments.
4. Taxes on movement of goods out of or into the country or into a local area.
5. Taxes on the production, purchase and sale, and consumption of goods and services.

The scope for increased revenue from each of the above types of taxes is discussed below briefly.

10. A tax on agricultural incomes has no place in an economy where the land is transferred to the tiller and is held in small parcels of a few acres each. Some increase in the rate of the corporation tax and the income-tax on upper slabs also appears to be feasible. The greatest scope is, however, provided by improved recovery of income-tax and the corporation tax. There is at present a widespread evasion of income-tax and corporation tax. Managing agents have evolved highly ingenious methods of concealing and misappropriating the profits earned by enterprises under their management. Production and sales are, for instance, understated. The concealed output is then disposed of, usually in the black market, through either different shops run by the enterprises concerned or different agents connected with the managing agents, or different subsidiary companies. Sale proceeds of even the indicated output are understated through sales at low prices to fictitious dealers set up by the managing agents. Thus what should have been the concern's profit accrues to the managing agents. Expenses are overstated through fictitious purchases from firms or companies also run by the same managing agents. Building materials and equipment are purchased for extension purposes and then sold secretly, the proceeds being usurped by

* For some of these ways, see D. Burman, Mystery of Birla House, Calcutta, 1950.
the managing agent. And so forth. The managing agent thus fattens at the expense of the State (by cheating it of taxes), the shareholders (by cheating them of legitimate dividends), and the consumer (by not making available to them the whole output at controlled prices). Understatement of income and evasion of income-tax is no less common among unincorporated enterprises; if anything, it is even more widespread. The fact that, by November 1952, the Income Tax Investigation Commission had unearthed Rs. 38.50 crores of concealed income (the tax due on which is estimated at Rs. 22.7 crores)* and that by Feb. 1952, the concealed incomes voluntarily disclosed aggregated to Rs. 64.5 crores**, indicates the extent of the evil. The yield of income and corporation taxes will improve substantially if the various evasive practices on the part of business, big and small, are effectively checked. India urgently needs something like the Wu Fan movement*** in China, which during the first half of 1952 largely put an end to illegal acts on the part of private enterprise.

11. A tax on inherited property can be an important source of revenue. The proposal for an estate duty has been under discussion in India for some three decades now, but for various reasons could not be implemented. In the 1952 Winter Session of Parliament, the Government, at long last, introduced an Estate Duty Bill, which has been referred to an Elect Committee. The Act providing for an Estate Duty at suitable rate should be put on the statute-book at the earliest moment. Most advanced countries have this tax. Besides fetching considerable revenue to the government, it can help to reduce inequality of wealth and income. Imposition of house property tax throughout India at suitable rates could also bring in some additional revenue. So could also enhanced or new taxes and fees on the sale and purchase of real estate, on transactions in stock exchange, on execution and transfer.

*** The Wu Fan (anti-five) movement was launched to check five corrupt practices, viz., bribery, tax-evasion, theft of state property, cheating on government contracts and stealing economic information from government sources for private speculation, on the part of private enterprises.
of credit instruments, and on the keeping or use of selected articles (motor cars and motor bicycles, radio-sets, dogs, etc.).

12. A progressively raised licence fee on commercial establishments, together with the steady extension of the sphere of state and co-operative trade, would be an important instrument to reduce and keep down the earnings of private persons engaged in distribution to the level required to effect the designed shift of considerable numbers from distribution to production. At the same time, such a licence fee could make a substantial contribution to the national exchequer. A heavy licence fee may also be imposed on all professions, trades, callings and employments considered socially undesirable. But the professional tax imposed by local bodies on artisans, teachers, etc. are obnoxious and must be abolished forthwith.

13. Taxes on movement of goods include export and import duties and terminal taxes, while taxes on the production, purchase and sale, and consumption of goods and services refer mainly to excise duties and sales taxes. Currently, the commodities meant for domestic use are subjected to import or excise duties (according as they are imported or produced at home), sales taxes, and terminal taxes. This is irrational. A sales tax and a terminal tax on an imported or a home-produced commodity has basically the same effect on it as so much additional import duty or excise tax. It is, therefore, more rational to tax commodities at only two points: at the point of production or of import. The present taxes and duties at different stages should, therefore, be replaced by two taxes: custom duties on imported commodities and a turnover tax on home-produced consumer-goods. The turnover tax may be at different rates on different commodities; the rate of the tax on a particular commodity at any time would depend upon its cost and the desired price. No turnover tax

* Of course, such displacements must not proceed faster than the rate at which the persons released from distribution can be absorbed in production.
tax may be at different rates on different commodities; the rate of the tax on a particular commodity at any time would depend upon its cost and the desired price. No turn-over tax may be imposed on commodities the prices of which need to be kept low. The turn-over tax should be imposed only on consumer goods. The effect of a turn-over tax on producer goods (machinery, raw materials, power and fuel, etc.) is to raise the cost, and hence the price, of the consumer goods into the manufacture of which they are used. Should such a rise in the price of the consumer-goods concerned be countenanced, this may better be done by raising the rate of the turn-over tax on it than by imposing turn-over taxes on the producers' goods used in its manufacture. No turn-over tax may be levied on the output of cottage and very small industries. The adverse effect of the turn-over tax on the competitive capacity of the domestic industry in the domestic market can be removed by countervailing import duties equal to the rate of the turn-over tax. The loss to the States and the Local Bodies due to the abolition of sales taxes and the terminal taxes may be compensated by giving them a share in the proceeds of the turn-over tax, just as at present States are given a share in the income tax collected by the Centre.

14. The change suggested above commends itself on the following grounds:— (a) The cost of collection will be lower than at present, when taxes on commodities are imposed at several stages. (b) It will be easier to check tax evasion. At present evasion of the sales taxes and its misappropriation (i.e. failure of dealers to forward to the Treasury the full amount of the tax realised from the buyers) is widespread. (c) The tax will facilitate the fulfilment of the export programme. The country's exports will consist of consumer goods and surplus raw materials and capital goods. The latter are, by definition, available for export. But an export surplus of consumer goods (e.g. of mill-made cloth) will need to be created by keeping domestic consumption low. This may be achieved by keeping the turn-over tax on such commodities sufficiently high. (d) By exempting the output
of cottage and very small scale industries from the payment of
the turn-over tax and by keeping the turn-over tax on mill-
production sufficiently high, cottage and small scale indus­
tries can be ensured adequate demand throughout the period that
they are contemplated to go on paying an important role in India's
economy. (e) Contrary to common belief, a turn-over tax, through
an indirect tax, is not necessarily a regressive tax. The neces­
sities of life, e.g. common foods, can be altogether exempted while
the rest of the consumer goods (including services) can be taxed
on the principle "the less essential the commodity, the higher the
rate of tax on it." The turn-over tax can thus be made highly pro­
gressive. An important advantage of the turn-over tax when imposed
in this manner is that the surplus purchasing power may be mopped
up without provoking powerful demands for such wage increases as
may initiate a wage-price spiral. For the exemption of necessities
of life will keep the working class cost-of-living relatively low,
while the high prices of less essential articles will absorb the
surplus purchasing power. (f) The diversion of productive re­
sources from essential to less essential output can be prevented
by keeping the effective demand for the latter sufficiently low,
through subjecting them to a sufficiently high rate of turn-over
tax. (g) It permits the sphere of rationing to be restricted to
the indispensable minimum. Rationing will need to be instituted
only in the case of commodities, mostly goods necessary for the
life of the community, the demand for which at current prices
exceeds their supply, and in whose case it is undesirable to re­
strict demand by raising price. In the case of the remaining con­
sumer goods and services, the demand may be brought down to the
available supply through a sufficiently high rate of the turn­
over tax. Thus even during the first two Stages when there may
be a relative shortage of consumer goods, the cost, wastage and
the inconvenience of administering a comprehensive rationing
system in a vast country with a largely decentralised economy
and a predominantly rural population may be avoided. (h) Through
an appropriate increase in the turn-over tax, the Government
can prevent the private dealers or producers gaining from the rise
in prices necessitated, not by a rise in costs, but by a temporary
shortage of supply relatively to demand. (i) The adverse effect
of a high turn-over tax on the export of consumer goods can be
avoided by allowing a suitable rebate of the tax on the quantities exported. (j) If the turn-over tax is not indicated separately but concealed in the price, as is currently the case with the excise duty on sugar, the burden of the tax will be felt less than at present the case with the sales tax. This is only a psychological consideration but, none the less, an important one.

15. The Plan recognises the importance of the sales tax which is but a form of the turn-over tax. But it opines that 'turn-over taxes on the scale in evidence, for instance, in the Soviet Union involve a degree of organisational control over production and internal trade which cannot be realised in India'. Of course, administration of the turn-over tax does involve effective control over production and internal trade. But such control is also inherent in the comprehensively planned development of the type required for high speed industrialisation. Accordingly, to claim that such control is impracticable in India at present is really to argue that comprehensive planning, and hence rapid economic development, is unattainable.

16. Since we contemplate the import mainly of capital goods and industrial materials and not of finished consumer goods, the yield of import duties will be relatively less important. Export duties by their very nature can yield but modest amounts. It is only when terms of trade are highly favourable that the export duties offer some scope for raising revenue. Since India's exports will increasingly consist of finished consumer goods, far from collecting export duties on them, substantial rebates of the turn-over tax will have to be allowed to enable them to compete in the world market. Since the country's per capita income will remain low for many years to come, and since we contemplate socio-economic measures that will tend to reduce inequalities of wealth and incomes, the scope for increasing the yield of direct taxes will be quite limited. It follows that under the contemplated conditions the main reliance for increasing tax revenue must be placed on the turn-over tax. The turn-over tax is a powerful instrument of planning and of

*Chapter 3, Para.16*
increasing the tax revenue. By imposing the turn-over tax at rates higher than the present combined rate of the excise duty, the sales tax and the terminal tax payable by commodities, by extending the coverage of the tax, by improving its collection, and by abolition of prohibition*, the Government can collect much larger amounts even to begin with, than are at present collected through the excise, sales and terminal taxes. As the large scale industry's output of consumer goods increases, the yield of the turnover tax will rapidly multiply.

17. A substantial improvement in the revenue appears feasible through the above-mentioned measures, especially when they coincide with measures to raise national income discussed in chapter VI. As pointed out earlier, India is not at present a very heavily taxed country. Allowing for the fact that in a poor country with low per capita income, the ratio of tax revenue to national income cannot be brought to anything like that practicable in the richer countries, there is little doubt that there is at present an appreciable scope for increasing the tax revenue in this country.

18. Increase in tax revenue alone cannot, however, provide all the additional public revenue required for a rate of public saving high enough for rapid industrialisation. Without a marked rise in national and per capita income, the scope for increase in tax receipts is relatively limited. But such an increase in income can only be the result of a substantial measure of economic development. The sole reliance on tax revenue thus places the country in a vicious circle. Without a substantial measure of economic development, there cannot be a marked rise in tax revenue, and without a marked rise in tax revenue there cannot be a high rate of public saving required for rapid economic devele

* The abolition of prohibition will, according to one estimate, bring in an additional Rs.35 crores and at the same time save Rs.5 crores in administrative expenditure (Commerce, Vol.XXXV, No.2177,25 Oct.2052, p.757). Of course the abolition of prohibition involves moral issues which should receive at least as much weight as economic considerations.
ment. In the countries of People's Democracy, a way out of this vicious circle has been sought in the surplus yielded by a rapidly expanding public sector. A large public sector, comprising not only public utilities and other investments of the 'public' i.e. non-profit type, but also investments of the 'private' i.e. profit making type, was created through the nationalisation of existing, in the beginning only large, enterprises. Subsequently the public sector has been expanded mainly and sometimes entirely through revenue-financed investment. The large and growing surpluses yielded by the rapidly expanding public sector have played a major part in providing these countries with rapidly expanding public revenues required for a rapidly rising rate of public saving.

19. China has sought to solve the problem along the same lines. By nationalising ex-enemy (i.e. Japanese) and bureaucratic-capitalist enterprises, i.e. the enterprises owned by the big five families of Chiang, Soong, etc., a sizable public sector was initially created. Thereafter it has been rapidly expanded through mainly revenue-financed investment. By 1952 the public sector comprised 80% of heavy industry, 40% of light industry, the entire railway transport, 60% of steam navigation transport, 90% of foreign trade, 40-100% of the wholesale domestic trade in commodities essential to the people's daily life or to industrial development (e.g. foodgrains, coal, cotton, cotton yarn, cloth, salt, sugar, iron, steel, timber and cement), and 20% of the entire retail trade. The State bank controlled 90% of all loans and deposits. This figure rose to 98-99% if the operations of banks jointly owned by public and private interests were also included. The rapid expansion of the public sector has had two important consequences. First, the contribution of state enterprises to public revenue has greatly increased. In 1950 profits from state enterprises accounted for 17.1% of the Government revenue, against 41.4% contributed by land taxes and 38.9% by other taxes. In 1951, the order of importance of these sources of revenue was: other taxes, the profits from state enterprises, and the land tax. In 1952 the returns from state enterprises com-

** UN, Economic Survey of Asia and the Far East 1950, p. 159.
stituted the largest single item of revenue*. Secondly, the public revenue has rapidly multiplied. For instance, the 1952 budget provides for an increase of no less than 41.46% over the 1951 figure**. This has made possible rapid increase in the rate of public saving. In 1952, in spite of very large amounts spent on the war in Korea, more than half the total budget allocation was for economic and cultural construction. Thus high rate of public saving and rapid expansion of the public sector have fed each other, continuously stepping up the tempo of economic and cultural development.

20. India being at about the same level of development as China, the problem admits of the same solution, of course with suitable adaptation to conditions prevailing in this country. To expand public revenue rapidly India must create a substantial public sector through nationalization of some existing enterprises and then rapidly expand it through mainly revenue-financed and partly loan-financed public investment. Even to-day the public sector of the Indian economy is by no means unimportant outside the sphere of agriculture, small-scale industries, motor transport and residential housing. This is brought out by the following:


<table>
<thead>
<tr>
<th>Public Sector</th>
<th>Investment++ (Rs. crores)</th>
<th>Private Sector</th>
<th>Investment++ (Rs. crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Railways</td>
<td>837</td>
<td>Factory Establishments</td>
<td>1,110</td>
</tr>
<tr>
<td>Irrigation Works</td>
<td>230</td>
<td>Plantations</td>
<td>100</td>
</tr>
<tr>
<td>Communications and Broadcasting</td>
<td>83</td>
<td>Electricity undertakings</td>
<td>70</td>
</tr>
<tr>
<td>Electricity undertakings</td>
<td>49</td>
<td>Wines</td>
<td>30</td>
</tr>
<tr>
<td>Industries</td>
<td>44</td>
<td>Shipping and Aviation</td>
<td>32</td>
</tr>
<tr>
<td>Ports</td>
<td>8</td>
<td>Motor Transport</td>
<td>130</td>
</tr>
<tr>
<td>Civil Aviation</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central Tractor organisation</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>1,236</strong></td>
<td><strong>Total:</strong></td>
<td><strong>1,472</strong></td>
</tr>
</tbody>
</table>

Source: The Plan, Ch.3, Para 12, 13.
(Continued)

* The 1952 Budget*, People's China, Sept. 1, 1952, p. 2

** Ibid., p. 1.
Excludes investment in motor transport. Productive capital assets owned by port trusts, municipalities and other semi-public agencies estimated at Rs.1,000 crores are also excluded.

Includes investment in working capital. Estimates of investment in fixed capital, however, relate to historical and not replacement value.

The net surplus yielded by the public sector is, however, small because, firstly, it is mainly comprised of public utilities which are generally run on the cost of service principle and, secondly, the public investment having been mainly financed not from revenues but from loans, a large proportion of the surplus earned is absorbed by interest payments.

21. We are not, however, in favour of wholesale nationalisation of private enterprises. Such wholesale nationalisation is neither practicable nor necessary at the present stage of development of the country. In India capitalist development has not proceeded far. The bulk of industrial output and the trade turnover is accounted for by numerous relatively small industrial, handicraft, and commercial units. In agriculture very small-scale production accounts for all but a fraction of the total output. It is simply impossible for the State immediately to take over and efficiently run all, even the majority, of all these small units. For the present, the State must confine itself to large-scale units. Furthermore, the policy of wholesale nationalisation of public enterprises will antagonise the entire middle class. A common threat will force them to join the landlord class and the foreign monopoly capitalists to resist the creation of the new socio-economic set-up. The policy of wholesale nationalisation will thus jeopardize even the liquidation of feudalism and the nationalisation of foreign business investments in India; it should, therefore, be avoided. For a long time to come, nationalisation of existing enterprises should be kept down to the minimum required for the creation of an independent and dynamic economy. A socialist society, i.e. a society where there is no
private appropriation of any part of value produced by others' employment, cannot be created immediately. It took the Soviet Union nineteen years to complete the creation of such a society. The People's Democracies of Eastern Europe and New China as yet claim themselves to be engaged only in laying the foundations of such a society. It is utopian to talk of immediate socialism in this country. Nationalisation should, therefore, at present seek only three main objectives: (a) freeing of the economy from the influence and control of foreign capital, in order to facilitate its independent growth, (b) creation of a sizable public sector, the surpluses yielded by which could make a handsome contribution to public revenues, and (c) full and efficient utilisation of existing productive resources. To fulfil these objectives, only the following need to be nationalised: (i) foreign, to begin with British and American, business investments in India, and (ii) Indian cartel capital. The nationalisation of foreign business investments was discussed in Chap.IV. As then pointed out, this will not only free Indian economy from the influence and control of foreign capital, but also appreciably extend the size of the public sector and make a sizable addition to national income, foreign exchange resources and public revenues. The raison d'etre of the nationalisation of Indian cartel capital is considered below.

22. Since capitalist development in India has proceeded in the frame work of a semi-colonial, semi-feudal economy imposed by imperialism, there has come into being in this country, a handful of business houses which have close links with, and hence support, foreign monopoly capital and native feudalism. This support manifests itself in the following:

(a) They oppose the nationalisation of foreign capital; they rather welcome such capital and advocate an "open door" policy towards it. Their preference is for foreign equity capital as against creditor capital. They enter into agreements with foreign monopoly capital for setting up joint enterprises in India which, since they mostly undertake assembling as distinguished from manufacturing, are a means not so much of starting new manufacturing industries in India as of joint exploitation of the Indian
market. They thus collaborate with foreign monopoly capital in enabling the latter to extend its influence and control over Indian economy.

(b) They insist on payment of compensation to landlords. This, as explained in the previous chapter, rules out abolition of landlordism and the transfer of land to the tiller.

(c) They insist on India's foreign trade maintaining its present directional pattern, which makes India dependent on Britain and America. They are particularly opposed to India developing mutually beneficial trade relations with the Soviet Union, the People's Democracies and New China. In fact they advocate close integration of the Indian economy to that of Britain and/or America.

(d) In ch. III we saw that India's supplies of raw materials which she lacks could be ensured only if the neighbouring Asian countries could gain control over their resources. But those who do not favour their own country establishing control over her resources cannot possibly sympathise with other countries in their struggle for this. The struggle of the countries of the Middle East and of South-East Asia to free their resources from the grip of foreign monopoly capital evokes no sympathy from them. Their sympathy is more often with their ally, viz. foreign monopoly capital.

These business houses thus are opposed to all the policies and measures which appear an indispensable preliminary to the nation's rapid economic progress. Their anti-national role flows from the fact that they are capitalists of a peculiar type. The explanation of their anti-national attitude to foreign monopoly capital and native feudalism is provided by the fact that they have multiplied their wealth and influence, less by accumulating real capital and developing production capacity and more by extending their control over ever larger sections of the economy. The source of their enrichment is thus not so much capitalist development as cartelisation of the economy.

That explains why even though the level of economic development,
especially industrial development, remains very low, a handful of business houses commanding great wealth (relatively to the income and wealth of the mass of the people) have come into existence. The cartel-capitalist character of these business houses is of great significance. Had these business houses sought to increase their wealth and influence by accumulating real capital and multiplying production, the need for an expanding market would have brought them into conflict with native feudalism and foreign monopoly capital, because the former, by holding down agricultural production, limits the size of the market, and the latter tries to retain the largest possible share of that limited market. The position is very different at present. The more important source of enrichment of these business houses is their cheating of the State and the share-holders, and the exploitation of the workers and the consumers made possible by their control of large blocks of capital and an obliging state apparatus. Enrichment without proportionate multiplication of real capital and capitalist production greatly reduces the scope for conflict between these business houses on the one hand and foreign monopoly capital and native feudalism on the other. The liquidation of landlordism to open the way for rapid increase in agricultural production ceases to be an urgent necessity. And instead of bitter struggle to drive foreign monopoly-capital from the domestic market, collaboration with it for joint exploitation of this market becomes feasible. In fact collaboration with foreign monopoly capital and native landlord elements becomes obligatory. Cartel-capitalist exploitation requires the preservation of a state apparatus that cannot for long enjoy the support or even acquiescence of the people, for

(Continued from the last page)

houses in India which advocate all these policies, one has merely to go through the files of the *Eastern Economists*, a journal controlled by the foremost cartel-capitalist business house, viz. the Birlas.
cartel capitalism does not develop the country at a satisfactory pace. This makes the cartel capitalists seek the support of, and collaborate with, foreign monopoly capital and native feudal elements, who, too, need such a state apparatus to safeguard their 'interests'. Cartel capitalists thus, in their own interest, become collaborators with, and supporters of, foreign monopoly capital and native landlordism. Accordingly, to free the economy from the influence and control of foreign monopoly capital and to liquidate landlordism, it becomes necessary to deprive the cartel capitalists of their present economic power and political influence. Nationalisation of cartel capital, i.e. capital owned by the cartel-collaborationist capitalists, is an indispensable step in this direction. Of course, nationalisation of cartel capital means the nationalisation not of the entire capital controlled by the cartel capitalists but of only that owned by them. The rest of the capital in the enterprises controlled by the cartel capitalists will continue to be owned by present owners.

23. Not all even quite substantial capitalists are cartel-collaborationist capitalists. One has but to compare the policies and measures recommended in respect of foreign capital by the All-India Manufacturer's Organisation (AIMO)-an organisation of middle bourgeoisie— with those persistently advocated by "the Eastern Economist" to find that the interests of other capitalists, and hence their attitude, are very different from those of the cartel capitalists. Enrichment through cartel capitalist exploitation by its very nature is possible for only a handful of business houses. The rest of the bourgeoisie, in order to enrich themselves, must accumulate real capital and raise production. This makes an expanding domestic market an urgent necessity for them. This is what made them support the Congress in its fight against the British and their native feudal allies. These sections of the bourgeoisie can play a useful part in the industrialisation of the country. Capital owned by them must not be nationalised; rather they should be encouraged and assisted to set up new enterprises and expand existing ones in the desired fields.
24. The nationalisation of foreign capital and Indian cartel capital will make a large addition to the public sector. Furthermore, since it will now include a substantial proportion of investments of the profit-making type, there will be a large increase in the surplus yielded by the public sector. There is scope for further large immediate increases in this surplus through extension of the public sector to the sphere of foreign and domestic trade. The scope for state trading has been examined by a Committee appointed by the Ministry of Commerce*. The Committee’s approach to the problem is not quite the same as ours. The Committee’s bias was in favour of the normal channels of trade’ i.e. private trade. The Committee did not favour state trading in all those cases where it was found to be feasible. State trading was to be resorted to, only when private trading was demonstrated to be incompatible with the realisation of the various ends of foreign trade policy mentioned by the Committee** to add to the revenues of the state was just one of these objectives. The Plan recognises the importance of state trading but mainly for “controlling relative prices and profitability”, for “gaining control over the economy at strategic points***, and for “stabilising or reducing the cost of living”*. The diversion into the public sector of surpluses earned in the fields encompassed by State trading is looked upon more as the latter’s incidental result. We, however, are not only free from any bias for the ‘normal’ channels of trade, but also look up to profits earned in state trading to play an important part in augmenting public revenues. State trading is accordingly recommended wherever possible.

25. State trading should, however, be limited to those cases where the commercial risks are not unduly large. As regards imports, the Committee on State Trading considered commercial

* Committee on State Trading. Report, Delhi, 1950.

** Ibid., pp. 25-26.

***The Plan, Ch. 2, Para 22.

* Ibid., Ch. 11, Para 19.
risks in the following cases not unduly large.

(a) Where the demand for particular articles is large and stable, so that it can be easily estimated;

(b) where estimates of demand are facilitated by the existence of a centralised body of consuming interests which is in a position to pool orders or even to underwrite imports;

(c) where the internal demand is so great in relation to the supply likely to be available, and where the nature of the market is such, that it is possible to limit imports to a few varieties so as to facilitate bulk handling, without incurring the risk of having unsold stocks; and

(d) where the shortage is so great and the demand so inelastic that there is a virtual certainty of off-take for almost any type of variety.

The Committee considered state trading in imports feasible in all these cases. But on account of its bias in favour of the 'normal channels of trade', it recommended state trading only in the following cases: foodgrains, raw jute (but only if centralised raw jute imports of the Indian Jute Mills Association are found to operate to the detriment of the home growers of raw jute or to the national interest in general), selected classes of vehicles, fertilizers, steel, non-ferrous metals and East African Cotton. We contemplate state trading on a much larger scale. When development of the economy is planned, when public investment forms a large and rising percentage of total investment, when imports largely consist of capital goods and when consumers' co-operation makes rapid progress, a large proportion of the import demand may be expected to be stable and capable of easy estimation. State trading could then comprise the following items: foodgrains; raw cotton; raw jute; natural rubber; basic grades of raw wool, raw silk and rayon yarn - of course only up to the time these continue


** Accordingly the Committee felt that the progress of consumers' co-operation would extend the scope for state trading.
to be imported; mineral oils and oil products; ferrous and non-
ferrous metals (not metal products) and ores; main types of
vehicles; basic equipment for public and private enterprises;
government stores including defence equipment; fertilizers;
 basic chemicals, drugs and medicines, dyes and colours, and
agricultural machinery.

26. Regarding exports, the Committee on State Trading consi-
dered commercial risks in the following cases not too
large:

(a) where procurement difficulties are minimized as the result
of control over internal production and distribution, or
by reason of the fact that the bulk of domestic production
is for export;

(b) where India is in the position of a monopolistic or semi-
monopolistic supplier to the world market;

(c) where the commodity is in short supply in the world market;

(d) where the world demand is reasonably stable or inelastic, and

(e) where the tasks of forecasting the world demand and of
ensuring supplies according to the needs of the market
are not complicated by the existence of numerous qualities
or varieties or by the factor of the consumer's preference.

In the Committee's opinion, state trading would be
feasible in jute manufactures, coal, shellac, manganese ore,
short-staple cotton and, perhaps, sugar. It, however, did not
consider that state trading would necessarily be desirable
in the case of all of them. It opined that it might be
desirable only in the following cases: coal and short-staple
cotton, jute manufactures, manganese and shellac. It objected
to state trading in tea, mainly on the ground that it has a
wide variety of qualities and grades and that expert knowledge
of tea-growing is confined to a small section of the trade.
Fears of deterioration of quality were also expressed. State
trading in mica was also rejected, on the ground that mica
is very difficult to standardize.
We would favour state trading in all these cases where in the absence of unduly large commercial risks, it is feasible. The following appear to be suitable for state trading:—metals, minerals and ores; raw jute and jute manufactures; tea; vegetable oils; short-staple cotton and staple varieties of cotton, and possibly silk and rayon, cloth. We consider state trading in tea feasible. The nationalization of British investments in India will bring the tea-industry largely under government ownership. When the government owns the bulk of tea output, it will be but proper for it to undertake its marketing. The foreign demand for India's tea, and the prices to be charged for it, can be stabilized by entering into bulk sale agreements with other countries. The Committee on State Trading seems to have confused grades with state-marks. The various trade marks and brands do not represent so many different grades of tea; in the majority of cases, they represent nothing more than the attempt of the producer to earn an element of monopoly profit by giving a distinctive mark to his product. When a public agency proceeds to fix different grades solely on the basis of real, qualitative differences, the number of such grades will be very much smaller. The difficulties created by the present multiplicity of brands should not, therefore, be exaggerated. The lack of a sufficient number of experts for tea-testing and -grading is surely remediable. A scheme for practical training in tea-testing is already reported to be under consideration by the Government. Its implementation can be expected to meet the present shortage of experts in the field. The Committee's objections to state trading in tea seem to be ill-founded.

27. The expansion of trade with the Soviet Union, the People's Democracies and China, will extend the scope for state trading, for these countries themselves practise state trading and because their requirements can be known in advance and covered by annual trade agreements. Trading with these countries will involve no commercial risks (provided domestic prices in India are stabilized), and so will be eminently suitable for state trading.
28. There is also considerable scope for state trading in the sphere of domestic trade. Once again such trade should be limited to fields which do not involve unduly large commercial risks. The following seem to be suitable for state trading:—principal foodgrains (rice, wheat, millets, maize and gram), industrial raw materials (raw cotton and raw jute), and oil-seeds (groundnuts, rape and mustard); goods imported or exported by state trading organisations; output of the public sector of the economy; and those goods in short supply whose equitable distribution can be arranged only through public agency. State trading should begin with wholesale trade and with items involving least commercial risks. More risky items and retail trade should be taken up only when the public trading corporations have accumulated sufficient business experience and have set up adequate sales organisations. The growth of consumers' co-operatives in the towns and the multi-purpose co-operatives in the villages will extend the scope of state trading at the wholesale level.

29. The expansion of the public sector is undoubtedly a very important means for securing larger public revenues and thus stepping up the rate of public saving. But the surplus yielded by the public sector will depend not only on the size of the public sector, but also on the measure of efficiency attained in the conduct of public enterprises. Public enterprises in India are at present notorious for inefficiency, red tapeism, graft, waste and general mismanagement characterise their working. If these defects are not remedied, the public sector may become for public revenue a vast sink instead of a bountiful source. If public enterprises continue to be as mismanaged as at present, the proposed nationalization of existing enterprises and the expansion of the public sector lose much of their justification. Failure to ensure efficient conduct of public enterprises will wreck all hope of rapid industrialisation of the country. The conditions of efficient conduct of different types of public enterprises are: (a) an appropriate agency for the conduct of each type of enterprise, and (b) efficient and devoted personnel. Measures to meet these requirements are taken up below.
30. In India public enterprises take one of the following organizational forms:—(a) an organization run departmentally under a Union or State Ministry; (b) an organization run by a Board or Committee of various Ministries; (c) a public company; (d) a mixed company; (e) a statutory corporation; or (f) an industry run under a public trust. In India departmental management covers postal and telegraph service and ammunition factories. In this case, ordinary rules of public administration, finance, recruitment, status, rights and duties of civil servants and accounting and auditing procedures are used. Where in the case of an enterprise proposed to be planned and executed departmentally the assistance, concurrence and sanction of several Ministries are frequently required, Committees or Boards, comprised of the representatives of various Ministries concerned are sometimes set up. The planning construction of the Sindri Fertiliser Factory was, for instance, undertaken by an inter-ministerial committee. In recent years the Government of India has increasingly acted on the principle that where the work is substantially commercial in character, a limited company is more appropriate than departmental management. It has, therefore, sought to convert several departmentally managed industrial enterprises into public companies. The Sindri Fertiliser Factory is one of them. The Board of Directors of such a company are appointed by the appropriate Minister. Generally, the directors are drawn from the upper ranks of the bureaucracy, but sometimes (as in the case of Indian Telephone Industries, Ltd.) private businessmen are also appointed. There are also mixed companies where part of the capital is owned by the government and the rest by private interests. The Eastern Shipping Corporation, the Air India (International) and the Hindustan Shipyard, Ltd., for instance, belong to this category. Several State governments have also set up such mixed companies. On the Board of Directors of such a company both the Government and the private shareholders are represented. In recent years the Government have also set up several statutory corporations. The Damodar Valley Corporation, the Industrial Finance Corporation, the Rehabilitation Finance Corporation, and the
Employees State Insurance Corporation are the most important of these. Finally, enterprises of service and development type are in several cases run under public trusts. Port trusts and commissions, municipal trusts, improvement trusts, etc. fall in this category. The trust authority is generally an autonomous body, holding and operating assets of the State in trust.

31. Public companies, public corporations and public trusts are, in fact, not so many different alternatives in the organization of public enterprises but variants of the same basic form, vis. the public corporation. Public enterprise poses the problem of finding an organizational form that will combine efficiency, flexibility, freedom and responsibility. The public corporation is claimed to provide solution, maybe an imperfect one, of this problem. The consensus of opinion is that, while the non-profit-making fields — education, health, etc. — development may be undertaken by the Government departments directly, in industry, commerce, agriculture, etc. specialized institutions and corporations are more suitable. The more directly operational and commercial the task, the more appropriate the device of a specialized institution or corporation to undertake it is considered to be*. The advantages claimed for this organizational form are: it helps to undertake enterprises that are large in scope, to decentralize decisions, to avoid administrative disputes where, (as in the case of River Valley Projects in India), the task of development extends over several administrative units, to ensure rapid turn-over and repeated use of funds, to facilitate joint participation, may be considered necessary or desirable, to achieve efficiency and soundness in operations of the enterprises, and to take away economic development to some extent from the sphere of party politics and make its direction more technical and more continuous. Several shortcomings and drawbacks are also commonly pointed out. There is, first of all the scope for overlapping between public corporations and

government departments, and among public corporations themselves. This difficulty may, however, be overcome through a clear-cut demarcation of the sphere of action of each such corporation. Secondly, there is the possibility that the cost of administration might be excessive, as public corporations would require special staff, directors and managerial personnel. This danger would, however, be greatly lessened if such public corporations are organized on a sufficiently large scale, and handle not one enterprise but all the public enterprises in a given sector or sub-sector of the industry. For instance, there should not be a separate public corporation for each publicly owned fertilizer factory but one corporation for all such enterprises. If one private corporation such as the Associated Cement Company (ACC) can handle several enterprises widely separated from one another, it should surely be possible for a public corporation to do the same. Finally, there is the tendency for each specialized organization to consider its own tasks to be the most important and to try to carry them out regardless of the general conditions of the country and the overall development plan. But the same difficulty will arise if the conduct of public enterprises be entrusted to administrative departments. The solution of the problem lies not in discarding the device of public corporations, but in improving the planning and enforcement machinery, such institutions can be compelled to conform to the national Plan.

32. The view that public enterprise of a commercial character should be entrusted to specialized public corporations has been accepted by the Government. A number of public corporations have been set up in India. They include the Industrial Finance Corporation (IFC), the Damodar Valley Corporation (DVC), the Rehabilitation Finance Corporation (RFC), etc. The salient features of these are:- (a) The state subscribe the whole or a large part of the share capital. For instance, the entire share capital of the DVC is subscribed by the Central Government and the Governments of West Bengal and Bihar, while the share capital of the IFC is subscribed as follows: 20% by the Central Government, 20% by the Government-owned Reserve Bank, 10% by the co-operative banks, and the balance by private institutional
Innovators. Where a part of the capital is subscribed by private shareholders as, for instance, in the case of the IFC, the State guarantees the security of, and a minimum yield on, such capital. (b) The Corporations are subject to taxation like any other commercial concern. (c) If net earnings exceed a specified yield, the whole or a specified portion of the excess is payable to Government in addition to the dividend due to it in its capacity as a shareholder. (d) The corporations are allowed to borrow in the open market. Sometimes an upper limit is fixed to the amount thus raised. (e) The corporations may either deposit their funds with the Reserve Bank or with Agents of the Reserve Bank, or invest the funds in Government securities. (f) The corporations are autonomous in their day-to-day working. The general policy, however, laid by the Government. (g) The Government appoints the whole, or a majority, of the Board of Directors, depending upon whether or not private interests participate in the share-capital. The Managing Director is always appointed by the Government. (h) The corporations conduct their affairs on the lines, not of government departments but of commercial enterprises. (i) The corporations may utilize private as well co-operative agencies for the conduct of some of their operations. (j) The corporations, though autonomous, are not irresponsible. They are accountable for their doings to the Government, the Legislature and the general public. Their accountability is enforced by providing for the audit of their affairs and by requiring them to submit periodically (usually annually) true and faithful reports of their activities.

33. While expressing general agreement with the policy of entrusting commercial-type public enterprise to specialised public corporations, we suggest the following modifications in the constitution and working of these corporations:

(a) As a rule, the entire share-capital of public corporations should be owned by the State. Private participation in

* This view is Dr. Gyan Chand's also. He countenances private capitalists, if any, only as debenture holders. He wants them to have 'no say whatsoever in the decisions and working of public enterprises'. Public Corporations, ed. A.N. Aggarwal, pp. 25-26.
equity capital should be provided for, only when indispensable to ensure successful working of the enterprise concerned.

(b) The public corporations should have no independent borrowing powers. All public borrowing should, (for the reasons which follow) be centralised in the Union Government.

(c) The Government should not appoint private businessmen to the Board of Directors. Nor should such people be appointed who have close links with private business. It is as wrong to entrust the affairs of a public enterprise to a private businessman as to appoint a health officer who at the same time continues to be a private practitioner. Neither can be expected to devote himself entirely and unreservedly to the public work entrusted to him. Private businessmen cannot afford to allow public enterprise to become more successful than private enterprise, for this will demonstrate the falsity of the main argument commonly advanced in favour of the latter. The managerial and other leading posts should be filled by promoting such of the competent workers and employees and other specially trained personnel as neither have any private business interests of their own nor are intimately linked otherwise with private business. The Fiscal Commission suggested the creation of a specialised economic service for providing suitable personnel for the government departments dealing with economic matters and for the nationalised industries*. The proposal is reported to be under Government consideration. We endorse the proposal for the creation of a managerial service, add the proviso that recruitment to this service must not be 'from the ranks of business and trade'. We suggest that an indispensable condition of the successful working of the public sector is that recruitment to this service should be so made that only those get appointed who are not only competent but also unreservedly devoted

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* Report, 21. ** The Plan, Ch. 6, Para. 16.
to making a success of the new order represented by a rapidly expanding public sector. Is not recruitment to the superior services so conducted at present that only those get appointed who are unreservedly devoted to the present socio-economic order?

34. Every effort should be made to root out the prevalent red-tape, waste and corruption in the conduct of public affairs. Instead, there must be set up a tradition of efficiency, honesty and devotion to public interest. India badly needs the counterpart of a Tam-fan movement*. This will prepare the way for patriotic emulation movements among workers and employees for higher production, lower costs, and improved quality. Success in each of these directions will swell the surplus yielded by the public sector.

35. Next we turn to the scope and methods of augmenting public saving through reduction in non-development public expenditure. Our attention is at once drawn to the disproportionately large defence expenditure. India spends a larger proportion of Central Revenues on defence than do even the foremost military powers in the world**. And, what is worse, since Independence the defence expenditure has shown a steady upward tendency. The two facts are brought out by the following:

* The Tam-fan (anti-three) movement in the first half of 1952 in China was directed against corruption, waste and bureaucracy among government employees. 4.5 per cent. of them were found guilty of these in varying degrees. The movement purified government institutions and strengthened the People's Government and the working people. (Three years of Historic Achievements, op. cit., p. 10).

** With the exception of United States since 1950-51.
The defence expenditure charged to the capital account has also tended to grow. From ₹ 1.95 crores in 1949-50, through ₹ 4.19 crores in 1950-51 and ₹ 6.15 crores in 1951-52, it has risen to ₹ 17.0 crores in 1952-53 (Budget). Including defence capital outlay, the defence expenditure has risen to more than half of the total Central Revenues. Between 1949-50 and 1952-53, total defence outlay has increased from ₹ 150.91 crores to ₹ 214.95 crores, i.e. by ₹ 64.14 crores! The writer is not qualified to discuss national defence: nevertheless, he has a feeling that if organized on well-thought-out lines, it should not be impossible to bring defence expenditure down to about ₹ 150 crores at current prices.

36. In planning national defence, account must be taken of the following: (a) the concrete interpretation of national defence, (b) the contemplated dangers, and (c) the resources available to the nation. National defence has
some times been interpreted very widely. The USA, for instance, has given it a meaning that requires her to establish bases all over the world, especially in the countries bordering the Soviet Union, the People’s Democracies, and the Chinese Republic, and to intervene in the internal affairs of a growing number of countries. This is indefensible as it would be if the Soviet Union claimed that her national defence requires that she must have bases all over the world, especially in Canada, Mexico and the islands in the Pacific and the Caribbean. This is the path, not of peace but of war. India must give national defence the meaning that really belongs to it, viz. capacity to resist foreign invasion of national territory. The object of defence planning should be to raise this capacity to the maximum.

37. The threat to India’s security can come only from Pakistan or from one or more of the so-called Great Powers. Other countries do not have the resources or the facilities for attempting an invasion of this country. The resources at present available to India for defence require that defence against the potential threat from Pakistan should be organized along different lines from those of defence against possible aggression by a Great Power. Pakistan is not only smaller in population, territory and resources, but also industrially even more backward than India. Moreover, while Pakistan consists of two widely separated parts and has strained relations with her neighbour on the North-West, India is compact and has friendly relations with neighbours. It is, therefore, possible for India to maintain more powerful modern defence forces than Pakistan has. And that is what India should do. The size of the regular defence forces should be fixed at about twice the size of Pakistan’s regular defence forces. The regular defence forces should then be more than able to cope with any possible aggressive action by Pakistan. Since Pakistan’s expenditure on defence in the years since its inception has averaged Rs. 50-60 crores a year, India should feel safe
from that quarter with an annual expenditure of Rs. 100-120 crores a year. Expenditure on the regular forces could be cut down still further if the officers' salaries and allowances could be brought into line with the country's very low per capita income, if the graft and wastage associated with the Ordnance, Supply and Engineering Corps could be done away with, if a growing proportion of the required equipment and materials could be produced within the country, and if, consistent with efficiency and due mobility, defence forces could be made, as in China, to undertake production*

38. The defence against a possible invasion by a Great Power must be prepared for along very different lines. Till India becomes highly industrialized she cannot maintain regular defence forces, equipped with the latest weapons, of a size comparable with those of the United States, the Soviet Union, or Britain, because, first, she is too poor to bear the cost, and secondly, defence forces equipped with arms imported from one or the other of the Great Powers will be of little use in defence against an attack by those very powers. Egypt's experience must be an eye-opener to us. When in 1951, the Egyptians started their struggle to expel the British from the Canal Zone, their supplies of war material from Britain were at once cut off. The only way to meet an invasion by one of the Great Powers is to confront the 'great' invader with the invincible might of a multi-million, united, armed people. The regular defence forces should try to prevent a landing on the Indian soil. But should the invading forces succeed in effecting a landing, thereafter they will be confronted by an armed people determined as one man to fight a prolonged war of attrition. The regular forces also should then be suitably split up for the purpose. It should not be forgotten that the 23 million people of Viet-Nam, fighting such a war of attrition have during the last six years, brought down France, one of the Great Powers, to the point where she could not maintain her position in that country

* The writer learns that a beginning has already been made in the Indian Army in this last direction.
without extensive US military aid. It is doubtful if France would be able to do this even with such aid. If these 23 million people can wear down one of the Great Powers, the 360 million-strong Indian people, waging an equally determined war of attrition, should be able to make mincemeat of any other invading force. It was the prospect of such a war of attrition which in 1951 made even MacArthur oppose the idea of an American landing on the Chinese mainland.

39. Such an approach to the problem of national defence requires that the regular defence forces should be backed by a vast national militia fully trained to use and manufacture weapons suitable to a war of attrition. The proposed transfer of land to the tiller, the nationalization of foreign and Indian cartel capital, the reform of the state apparatus, and the initiation of a programme of high-speed industrialization with a view to raising India to the front rank of nations will arouse mass enthusiasm. Millions will then be ready to sacrifice their all to defend the new way of life, and will be only too glad to enrol in the national militia. The national militia must be equipped entirely with weapons domestically manufactured, so that it can continue the fight under all circumstances and against all invaders. An annual expenditure of Rs. 30 to 50 crores a year on the training and equipment of the national militia should be quite adequate for its expansion at a satisfactory rate.

40. If national defence is organized on these lines, it should be possible to cut down the defence expenditure to about Rs. 150 crores which means a saving of Rs. 50 to 60 crores compared to the present level of outlay. Since the basic approach of the present Government to the problem of national defence is the same as that of the regime from which they have taken over, namely reliance is almost entirely placed not on the armed people but on a professional army, the Plan contemplates no scaling down of defence expenditure*. 

41. There is also considerable scope for reduction in the expenditure on civil administration. It has been remarked

* The Plan, Ch. 3, Para. 21.
that "India has a Rolls-Royce administration in a bullock-cart country". That character of the administration is derived from the purpose for which it was originally set up by the British. The purpose was not to lead the people in a great constructive endeavour but to hold them down, and thus to make and keep India safe for imperialist exploitation. The costliness, corruption and inefficiency of this administrative system followed from its anti-people character.

(a) To ensure that as between the Indian people and the British Crown, the administration would be solidly loyal to the latter, it was necessary to entrust its commanding positions to Britons or to Indians of the more-loyalist-than-the-King brand. This entailed the creation of superior services — the Covenanted Service or the Indian Civil Service being the foremost among them — invested with tremendous authority and enjoying scales of pay among the highest in the world. This ensured that Britons would readily take up appointments in these services and that any Indian admitted to them would remain thoroughly loyal. The opulence of the salaries of superior officials was, therefore, an inevitable consequence of the anti-people character of the administration. The need to keep down the people also required disproportionately large expenditure on police.

(b) An anti-people administration could not, by its very nature, build up a tradition of service to, or sacrifice for, the people. The personnel, high and low, freely made use of their position for personal enrichment. Corruption, nepotism and wasteful use of public funds were the rule. This inflated public expenditure.

(c) Being anti-people, the system had to rely entirely on paid personnel even for carrying out very minor functions for which a popular system would normally draw upon the voluntary service of public-spirited citizens. This unduly inflated its size and increased its cost. So also did the fact that, in the face of severe unemployment
in the country, the officials, and later the Popular Ministries tried to provide their families and relatives with jobs through unnecessary multiplication of departments and staff.

42. Independent India retained this state apparatus intact, except that the superior services were now manned entirely by Indians. Since Independence involved no basic social change, the need for a new type of state apparatus was not felt. Accordingly, the character, traditions and conduct of the administrative apparatus remain basically unaltered. One consequence of this is the continued costliness of civil administration. Civil administration and security services absorb more or less as high a proportion of the central and the provincial expenditure, respectively, as they did in the days of British rule. This is brought out below:

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<th>Government of India</th>
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<td></td>
<td>Expenditure Total</td>
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<td>1952-53 (Budget)</td>
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The University Education (Radhakrishnan) Commission do not appear to be guilty of exaggeration when they remarked that 'comparing the operation of this cumbersome, wasteful system with modern, efficient administration, it seems possible that with radical improvement of administration the entire public work of India might be accomplished with less than half its present expenditure'.

* Security services include General Administration, Administration of Justice, Jails and Convict Settlements, Police
43. No basic reform of the administrative set-up was possible as long as the purpose for which it was designed remained unchanged. An anti-people apparatus could not but be what it was. But when the country decides to effect basic socio-economic reform, with a view to launching upon rapid economic development, there is a change in the essential role of the administrative set-up. Instead of holding down the people in the interest of the exploiting classes, it is required to offer devoted service to the masses and to lead them in a great constructive effort. This makes it both feasible and obligatory to carry through a basic reform of this set-up. The object of this reform will be to cut down the administrative apparatus to the minimum necessary for the due discharge of its functions, to reduce the size of the paid administrative staff through full use of the free service of public-spirited citizens to do functions that require no specialised administrative skill or training, to purge the administration of all anti-people elements and traditions, to reduce the salaries of high officials with a view to making them bear a reasonable relation to the country's per capita income, and to end corruption, waste and bureaucracy. An important consequence of this reform will be a substantial saving in the purely administrative expenditure.

44. The great constructive effort required for India's industrialisation calls for a radical improvement in public administration. But actually, as noted by the Plan, the recent years have been marked by a decline in the standards of administration*. Accordingly, the Plan underlines the need for integrity, efficiency and economy in the conduct of public affairs**, considers this an indispensable pre-requisite of enthusiastic public co-operation in the execution of the development programme*** and suggests measures to that end*. The suggestions offered in the Plan for raising the standards of integrity and honesty in public administration are as

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* The Plan, Ch. 5, Para. 7
** Ibid., Ch. 6, Para. 7.
*** Ibid., Chapters 5 and 6.
*+ Ibid.
follows. (a) The existing legislation relating to corruption should be extended to cases in which a public servant's near relations may have been found to have become suddenly rich. (b) The public servants should be obliged to furnish a return each year concerning not only immovable property but also movable assets acquired by them or their near relations. (c) Officials who do not have a reputation for honesty should not be appointed to posts where there is considerable scope for discretion. (d) The Central Government's special police establishment should be equipped to deal with cases not only at the Centre but also in the States. (e) When specific allegations of corruption are made against individual officers, either the Government should prosecute the party making the allegation, or the official concerned should be required to clear his name in a court of law. (f) Departmental enquiries should be carried out expeditiously. (g) Responsible officials should so arrange their social relations that the public should have absolute confidence in their disinterestedness and impartiality. (h) The recent growth of the practice among business firms of employing relations or friends of influential persons as 'contact men' needs to be discouraged. (i) The scope for corruption may be minimized through clear enunciation of policies, precise formulation of principles on which claims may be made, and expeditious disposal of applications. (j) Positive measures to reward honest and good work and to penalize inefficiency and dishonesty should be devised. (k) The co-operation of the public should be sought and obtained for eliminating corruption in public administration. The Plan has also made suggestions for improvement in recruitment, training, methods of transacting business, and arrangements for supervision and inspection with a view to minimizing red tape and inefficiency. The need for financial control and economy is also underlined especially in view of the large public expenditure envisaged. We welcome these suggestions. But only the future will tell how far they are implemented and how far they prove adequate. But one thing is quite clear even now, namely that the Plan does not envisage any modification of the Rolls-Royce character of the administration. It, therefore, does not promise any increase in the
rate of public saving through reduction in the purely administrative expenditure.

45. Expenditure on food subsidies has in recent years been a heavy charge on the public purse. Food subsidies bridged the gap between the import and the issue prices of foodgrains. In the current year (1952), the Government of India tried to abolish food subsidies just when it had provided an increase of Rs. 17.56 crores in the Defence Expenditure over the previous figure. This provoked a storm of protest, and the food subsidies had to be partially restored. The only satisfactory way to do away with food subsidies is to make the country self-sufficient in foodgrains. Self-sufficiency requires not only an increase in total output, but also in the marketable surplus. Measures to that end have been discussed in Chapter VI.

46. At the time of the 1951 Census the migrants from Pakistan numbered 7.5 million (including 4.9 million from West Pakistan). Since then a further substantial number has come over from East Bengal. Their evacuation, relief and rehabilitation has involved the Government in heavy expenditure. Up to March 31, 1952, the Government had spent Rs. 90.54 crores on rehabilitation* as distinct from relief of displaced persons. Rs. 27.81 crores are proposed to be spent in 1952-53 and Rs. 29.14 crores in 1953-54**. It is expected that the Rehabilitation of displaced persons from West Pakistan would be more or less completed by 1953-54. Accordingly, the expenditure on the Rehabilitation of these migrants will fall to Rs. 5.1 crores in 1954-55 and Rs. 1.1 crores in 1955-56. The likely expenditure on migrants from East Pakistan is uncertain. If the conditions remain normal, the present scale of expenditure (Rs. 11 crores a year) will suffice, but if conditions in East Pakistan worsen, larger expenditure may have to be incurred***.

* comprising rural resettlement, urban housing, loans by the Rehabilitation Finance Corporation, and Technical Training, Education, and other Schemes.
** The Plan, Ch. 38, Para. 22.
*** Ibid., Paras. 23-24.
The problem of refugee rehabilitation has a vital bearing on the country's economic development. The provision of gainful employment to the millions of displaced persons will add a substantial amount to national income and saving. At the same time, the Government could devote to economic development the resources at present expended on refugee relief and rehabilitation.

47. The problem of refugee rehabilitation is basically the problem of providing them with employment and shelter. That explains why it has been comparatively easy to settle the displaced landholders from West Pakistan. Once they were allotted evacuee lands and given some financial assistance, they were able again to stand on their feet. The problem of refugee tenants still remains unsolved. So also does the problem of non-agriculturist displaced persons. Herein the task was, of course, more difficult, because of the difference in the occupational pattern of the incoming and outgoing population. While the bulk of the emigrants were labourers or artisans, the immigrants mostly belonged to the trading or professional classes. A few were also small or medium industrialists. The problem of shelter was sought to be solved by allotting evacuee houses (1.5 million persons were thus accommodated) and by undertaking an extensive programme of housing construction. Up to March 1952, 150,000 houses and tenements were constructed at a total cost of Rs. 38 crores. Another 50,000 (cost: Rs. 21 crores) are proposed to be built during 1952-54. Private house building was also promoted by

- Of course, not all the expenditure on rehabilitation is of the current type. A good portion of it goes to finance investment in housing, business, agriculture, etc. To this extent the completion of Rehabilitation will not add to the aggregate of available investible resources but release them for other purposes.

- About half a million families have been settled on 4.7 million acres (2.4 million 'standard' acres) in the Punjab and Pepsu. 57,500 families have been settled on 7.4 lakh acres in other States, especially Rajasthan and Delhi. Some 4,000 families have been settled on reclaimed cultivable waste lands. Up to 1951-52, Rs. 8 crores were advanced to the agriculturists from West Pakistan for the maintenance of families and for financing agriculture and housing repair and construction. 3.5 lakh out of a total of 4.7 lakh
providing sites and loans. All displaced persons from West Pakistan are thus expected to be provided with shelter by 1953-54. In the Eastern States, by March, 1952, the Government had spent Rs.8.8 crores on housing. In addition, private persons were given developed plots and loans for housing construction. During 1952-54, it is proposed to build 95,000 units, 25% of these directly by the Governments and the remainder by private persons with Government assistance. But rehabilitation also covers provision of gainful employment. Properly to rehabilitate the non-agricultural displaced persons, large employment opportunities needed to be created. The Government tried to meet this requirement by absorbing displaced persons in Government employment, imparting technical and vocational training to those fit for it, allotment and construction of business premises and industrial undertakings, by grant of loans for small- as well as large-scale businesses (the first directly by the State Government and the latter by the Rehabilitation Finance Corporation) and by grant of financial assistance for schools and college education. It is, however, gross exaggeration to claim that the "gainful employment of displaced persons has been largely achieved". The employment problem confronting displaced persons is basically the same as that facing other unemployed and underemployed millions. The failure of the Five Year Plan to work out a correct employment policy leaves a bleak prospect of these people being provided with gainful employment. And so long as this is not done, the problem of refugee rehabilitation will be there. In this study we have, however, laid the greatest emphasis on immediate absorption of the entire available manpower in gainful employment; for that, in our opinion, provides the key to an immediate substantial rise in national income and savings. Given the various measures to create additional employment (see Chapter VI), it would be possible to provide the displaced persons like others with an opportunity to earn their living. And this will obviate the need of spending tens of crores of rupees every year on the relief and rehabilitation of refugees, which means that much

* For details of these measures see the Plan, Chapter 38, Para. 15.
** The Plan, Chapter 38, Para. 15.
addition to the rate of public saving.

48. The debt services form a major item of public expenditure in India. The 1952-53 Central Budget provides for Rs. 69.59 crores for interest on debt and other obligations. The interest liability transferred to Railways, Irrigation, Posts and Telegraphs, State Governments, etc., on account of the Central funds lent to them is put at Rs. 36.43 crores, leaving the amount charged to central revenues as Rs. 31.16. In addition, Rs. 5 crores are earmarked for the reduction or avoidance of debt. A reduction in the cost of debt services will raise the rate of public saving. Such reduction may be brought about in two ways: (a) by progressively converting to a lower rate of interest, and (b) by reducing the size of the public debt. The first method at present offers little scope. Most of the long-term debt has been incurred at quite low rates of interest. In the foreseeable future, a lower long-term rate of interest is hardly feasible. Rather, in the past two years or so, the interest rates in India as well as abroad, have tended to harden. It appears neither practicable nor desirable to lower the rate of interest to a level below that at which the long-term debt has been incurred. A marked reduction in the size of the debt appears equally impracticable. Such a reduction may possibly be brought about in one of the following ways:

(a) Cancellation of the debt through hyper-inflation. One consequence of the hyper-inflation in Germany in 1923, in Hungary in 1947, and in China in the last days of Kuomint Rule (1947-48), was the cancellation of the public debt. Since we do not contemplate such inflation, this method is not open to us.

(b) Repudiation. The Soviet Union, to take an example, got rid of the public debt by repudiating all Tsarist debts. But this method, too, is ruled out by the following facts**:

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** We are glancing away from the constitutional difficulty involved in this. For this study the problems are discussed mainly from the economic standpoint.
First, about one-third of Government of India’s interest-bearing obligations (Rs. 879 crores out of a total of Rs. 2675 crores) consists of Treasury Bills, Ways and Means Advances, Treasury Deposit Receipts, Small Savings, Depreciation and Reserve Funds, etc., which cannot possibly be repudiated.

Secondly, the bulk of rupee-loan outstandings are held by the State-owned Reserve Bank and the various institutional investors, such as the scheduled and the non-scheduled banks, the co-operative banks, the insurance companies, the various government or mixed companies and corporations, such as the Industrial Finance Corporation etc., and by the Central and State Governments on Treasury Account. Very little of the funded rupee debt is held by individuals. This is brought out below:

| TABLE 63: DISTRIBUTION OF THE CENTRAL GOVERNMENT RUPEE-LOAN OUTSTANDINGS (L. CRORES) |
|-----------------------------------------------|-------------------|-------------------|
| Total Rupee-loans (Excluding Treasury Bills, Treasury Deposit Receipts and Ways and Means Advances) | 1,447             | 1,447             |
| of which those held by:                       |                   |                   |
| (a) Reserve Bank of India                     | 464               | 533               |
| (b) Commercial and Co-operative Banks          | 758               | 299               |
| (c) Insurance Companies                        | 113               | 113               |
| (d) Part A and Part B States                   | 209               | 148               |
| (e) Non-Residents                              | 61                | 60                |
| (f) Others                                     | 242               | 284               |
| Source: The Plan, Ch. 3, Para. 28.            |                   |                   |

A part of the rupee loans indicated as held by 'others' are held by the Government in the Cash Balance Investment Accounts.

Clearly, the bulk of the Government rupee loans are held not by individuals, but by the Government and semi-government institutions and by other institutional investors, so that repudiation is simply impracticable and undesirable.

Thirdly, India’s public debt is now mostly internal debt.

so that its repudiation, in any case, cannot be as advantageous as that of an external debt might be.

(c) Repayment. Another possibility is that a sizeable portion of the debt may be repaid out of the proceeds of a capital levy, and the balance retired in due course through maintaining a revenue-fed sinking fund. We are doubtful if, in the concrete conditions of this country a capital levy is really feasible; it may do more harm than good. But even if such a levy be feasible, its proceeds should be used for economic development rather than for debt retirement. It would be self-contradictory first to use the proceeds of the levy to retire the public debt, and then to borrow again to finance public investment. The same objection applies to debt retirement through maintaining a revenue-fed sinking fund.

49. Reduction in the size of the public debt thus appears impracticable. Rather, to the extent development is financed through borrowing, public debt will grow. The proposed main reliance on public saving (instead of public borrowing) to finance development will, however, keep the rate of growth of public debt down to the minimum.

50. Finally, the rate of public saving may be stepped up through economizing development expenditure of a recurring type. Development is not just accumulation of real capital, i.e. it is wider in scope than investment. For it also encompasses measures for social and cultural development, and, what may be called, skill formation. It is on this account, that about Rs.400 crores of the total development outlay in the public sector under the Plan consists of non-investment (or recurring expenditure)*. Development necessarily involves expansion of social services. The need to raise investment to the maximum level practicable requires that the recurring type of development expenditure on social services should be kept down as low as possible. This may be done by mobilising free labour of patriotic citizens for work in connection with these services. For instance, an attempt to liquidate illiteracy wholly through a paid teaching service will entail annual expenditure of hundreds of crores of Rupees for many years to come. But if

* The Plan, Ch.3, Para.8.
deposits, rather than through still higher taxation, is that beyond a certain point higher taxation may have an adverse effect on incentive and enterprise. There is less chance of such adverse effect in the case of compulsory deposits, for in this case the compulsory deduction from income is not lost to the payers, but only accumulates to their credit to be unblocked in the future.

Compulsory Purchase of Saving Bonds

53. Non-income-tax-payers whose incomes provide some margin for saving may be obliged to undertake compulsory saving through compulsory purchase of non-transferable savings bonds. These latter should, however, be eligible for encashment by the Government after the expiry of a specified period. But to induce the holders not to cash these at the earliest moment the latter become eligible for this, their yield should be higher in proportion to the length of time that they are held. The amount to be thus subscribed by a person should be determined on a basis appropriate to the category to which he belongs. For instance, in the case of peasants whose holdings exceed a specified minimum of standard acres, the amount compulsorily invested should be a specified percentage of the land revenue, and should be collected along with it by one and the same agency. For the non-income-tax-paying employees earning in excess of a specified salary, the amount investible should be a suitable percentage of the excess. To the extent of this amount, the employer should pay his employees in the form of savings bonds which he would himself buy from the Government agency concerned. The shopkeepers may be required to invest a specified multiple of the proposed annual licence fee payable by them. And so forth. The cost of the administration of the scheme may thus be kept very low.

Limitation of Dividends

54. Corporate enterprises may be compelled to save their profits.

The Plan, too, favours the exploration of the possibilities of paying part of wages and salaries in the form of Savings certificates.
educated employed persons are mobilized for this work, the
annual outlay on this account may be relatively quite modest.
The resources thus economized may then be utilized in invest-
ment proper. To the extent the Government succeeds in pro-
viding for social and cultural progress through mobilizing
the free service of citizens, its capacity to achieve a higher
rate of public saving will increase.

OTHER METHODS OF COMPULSORY SAVING

Compulsory Deposits

51. We have discussed public saving at length, because qua-
titatively this is the most important method of compulsory
saving. Other methods may be discussed more briefly. One of
these is the method of compulsory deposits. This was adopted
in 1942, when an Ordinance was issued requiring all those
assessed of the Excess Profits Tax (E.P.T.) to make a deposit
with the Government equal to one-fifth of the E.P.T. payable
by them. In 1944, the rate of the compulsory deposit was raised
to 19/64 of the tax. The compulsory deposits were to be re-
funded after the end of the War. Compulsory deposits came to
an end when the E.P.T. was abolished in 1946. As from December,
1949, the Government has enforced a scheme of compulsory de-
posits in respect of Government employees drawing Rs.250 or
above.

52. We suggest that the scheme of compulsory deposits should
be extended to all the income-tax payers. The income-tax payer
should, in addition to the tax payable by him, be obliged to
make a refundable annual deposit equal to a specified percentage
of the tax payable. Since the tax on personal incomes is a
graded tax, this will ensure that those with larger incomes
will pay into the compulsory deposit a larger proportion of their
income. Such deposits should carry a reasonable rate of in-
terest and may be unblocked when the supply position of con-
sumer goods has, in consequence of the completion of projected
enterprises improved sufficiently. The justification for
mopping up surplus purchasing power through compulsory de-
in excess of a certain percentage through statutory limitation of dividends. In October, 1948, the Government limited dividends to 6% of the paid-up capital of the company concerned of the average annual dividend distributed by it during the two-year period April 1, 1946 to March 31, 1948, whichever was higher. The Act so limiting dividends was allowed to expire in March 1950, on the alleged ground that it discouraged private investment. The opposition of business interests perhaps would have been a more correct explanation of the Government's failure to renew the Act. There was little improvement in the flow of private investment in India following the abolition of that limit on dividends, proving that the existence of the limit was not the real cause of lack of vigorous investment activity. A limit on dividends does not take away surplus profits; it merely requires these to be ploughed back into business. Its alleged depressive effect on the flow of private investment should not, therefore, be exaggerated. Dividend-limitation can serve as an important instrument to ensure a high rate of corporate saving.

Compulsory Contributions & Social Insurance and Welfare Funds.

55. In Chapter VI we briefly mentioned the provision for social security made in India through the incorporation of the Employees' State Insurance Corporation and the initiation of the Employees Provident Fund Scheme. The revenues of the Corporation will be drawn mainly from compulsory contributions from employers and employees. Any excess of the revenues of the Corporation over the combined total of benefit payments and the administrative expenses, represents so much saving by the Corporation. The corporation could be made an instrument of compulsory saving by fixing employee and employer contributions at higher rates than necessary to meet its administrative expenses and benefit payments. We, however, do not recommend this method of compulsory saving. We favour fuller social security for workers, entirely at the expense of the employers (including the State in cases where it is the employer) as in New China, i.e. the scope of social insurance should be extended and no contribution should be demanded from the employees. This will necessarily
require an increase in the employer's contribution. Since
the scope for this is necessarily limited, the Employee's State
Insurance Corporation cannot be made an important instrument of
compulsory saving.

56. The Employees Provident Fund Scheme is, however, expected
to serve as an important instrument of compulsory saving. Every
week each worker covered by the scheme pays 6% of his basic
wage and dearness allowance into the Provident Fund Account
and his employer pays in an equal amount. The amount in this
will steadily grow because of the certain excess of payments
over the withdrawals, and of the increase in the number of
workers covered by the Scheme. The Plan has estimated that
during the 5-year period, the Fund would be able to invest
Rs. 56 crores in government securities. The Employees Provident
Fund Scheme will thus serve to promote savings. In a rapidly
industrializing country, the importance of such a scheme as a
device for compulsory saving will rapidly grow, both on account
of increase in the number of workers and employees, and of a
rise in wages.

**Direct Restriction of Consumption**

57. A rise in consumption *par ipasse* with the increase in income
can be prevented, and thus the rate of saving stepped up, through
rationing of some goods and non-production and non-importation
of others. This method has serious drawbacks. Firstly, it
limits the consumer's freedom of choice. Secondly, if a wide
range of goods are rationed, the administration of the system
makes an unduly large draft on the productive resources, and
either inflates administrative expenditure or raises the cost
of rationed articles, according as the cost of administering the
rationing system is met by the Government or realised from the
consumers. Thirdly, it leaves surplus purchasing power in the
hands of the public. This need provide no cause for worry, if
the public could be counted upon to use it either to subscribe
to approved public or private issues or to undertake approved
direct investment. It would not be disconcerting even if the
public just hoarded the surplus cash with it. To hoard cash is to hold a non-interest-bearing bond; it thus amounts to the grant of an interest-free loan. If the public could be relied upon just to go on adding to their hoards of cash, to that extent investment could be financed with newly created money without generating inflationary pressures. But it is highly improbable that the public will follow only the above two courses. The danger of the surplus purchasing power being used for undesirable purposes, such as developing a black market, dealing in second-hand goods, undertaking undesirable investment, or just enjoying more leisure, is very real. Fourthly, comprehensive price control and rationing may lead to the adoption of ingenious methods of circumventing the law, such as barter transactions, hoarding, black-marketing, production of goods of worse than the prescribed quality, non-production of less expensive goods, and so forth. The method of restricting consumption through reducing disposable personal income has the great merit of simultaneously limiting consumption and mopping up surplus purchasing power. We would, therefore, suggest that rationing should be confined to essential goods in short supply; over the rest of the field, the desired restriction of consumption should be achieved, either by reducing disposable income through direct taxation and compulsory and voluntary saving, or through keeping the turn-over tax at the appropriate level. We do not favour rationing for its own sake. The alleged inevitability of standardisation of consumption in a planned economy is sheer balderdash. The progressive abolition of rationing in the Soviet Union, first in the mid-thirties and, after the War, again in 1947, proves that rationing is in no way indispensable for a planned economy. So also does the progressive abolition of rationing in the People's Democracies since 1950.

Deficit Financing

58. When total Government disbursements on current as well as capital account exceed current revenue (including the surplus produced by the public sector), the gap between the two (which may be described as the budget deficit) may be met in one or more
of the following ways:

(a) By borrowing genuine current private savings.
(b) By using the domestic currency proceeds of foreign loans and grants.
(c) By drawing on existing cash balances.
(d) By expansion of net outstanding bank credit, i.e. by using newly created money.

To the extent the Government meets the gap in the last two ways, i.e. by the activation of idle government balances or the expansion of monetary supply, it is said to practise deficit financing. Deficit financing thus refers to the finance of expenditure through expansion of effective monetary supply. We consider deficit financing to be a form of compulsory saving, for it restricts consumption* by keeping prices higher than they would be if the same investment were financed out of current revenues, or by (a) and (b) above. This, of course, does not mean that the prices necessarily rise because of deficit financing; it may as well mean that they do not fall in response to an increase in production made possible by the expansion of capacity.

59. Deficit financing in the economy as a whole signifies that money investment exceeds the desired rate of money saving out of the current level of money income. For money investment at a rate equal to the rate of money saving out of the current level of money income does not entail any expansion of monetary supply. But whenever actual money investment exceeds the desired rate of money saving out of the current level of money income, the

* We consider consumption as restricted when the gap between income and consumption widens, whether due to decline in consumption or due to the failure of consumption to expand pari passu with increase in income, In either case the flow of saving increases.
multiplier relating increment of money investment to increment of money income (let us call it $k_m$) comes into play, with the result that money income or aggregate money expenditure tends to increase by $k_m$ times the amount of deficit financing practised. We illustrate the point by a concrete example. The condition of equilibrium is that actual money investment should be equal to desired money saving out of current level of money income. We start from such a position. Case I below depicts such a position.

**Case I:**

<table>
<thead>
<tr>
<th></th>
<th>Rs. crores</th>
<th></th>
<th>Rs. crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate money investment $(I_m)$</td>
<td>5</td>
<td>Aggregate money income $(Y_m)$</td>
<td>100</td>
</tr>
<tr>
<td>Aggregate money consumption $(C_m)$</td>
<td>95</td>
<td>Aggregate money consumption $(C_m)$</td>
<td>95</td>
</tr>
<tr>
<td>Aggregate money expenditure $(E_m$ or $Y_m)$</td>
<td>100</td>
<td>Aggregate money saving $(S_m)$</td>
<td>5</td>
</tr>
</tbody>
</table>

Let us now suppose that the rate of aggregate money investment is stepped up to Rs. 10 crores, the extra Rs. 5 crores needed for the purpose being obtained through deficit financing, i.e. by either running down cash balances or by expansion of net outstanding bank credit. On the assumption that the marginal propensity to save is the same as envisaged by the Plan during the first quinquennium of planned development, viz. 20 per cent., the various magnitudes will expand as follows:

<table>
<thead>
<tr>
<th></th>
<th>Rs. crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in money income $(ΔY_m)$</td>
<td></td>
</tr>
<tr>
<td>+ 5</td>
<td></td>
</tr>
<tr>
<td>+ 4</td>
<td></td>
</tr>
<tr>
<td>+ 3.2</td>
<td></td>
</tr>
<tr>
<td>...</td>
<td></td>
</tr>
<tr>
<td>+ 1</td>
<td></td>
</tr>
<tr>
<td>Increase in money-consumption $(ΔC_m)$</td>
<td></td>
</tr>
<tr>
<td>+ 4</td>
<td></td>
</tr>
<tr>
<td>+ 3.2</td>
<td></td>
</tr>
<tr>
<td>+ 2.56</td>
<td></td>
</tr>
<tr>
<td>...</td>
<td></td>
</tr>
<tr>
<td>+ 0.8</td>
<td></td>
</tr>
<tr>
<td>Increase in money-saving $(ΔS_m)$</td>
<td></td>
</tr>
<tr>
<td>+ 0.64</td>
<td></td>
</tr>
<tr>
<td>...</td>
<td></td>
</tr>
</tbody>
</table>

* Keynes denotes the investment multiplier by $k$. But since Keynes measures various aggregates in wage-units, this signifies that all his functions are cast in real terms. Accordingly, $k$ relates not the increment of money investment to the increment of money income but the increment of real investment.
\[ \Delta Y_m = \frac{5}{1 - \frac{4}{5}} = \text{Rs. 25 crores.} \]
\[ \Delta C_m = \frac{4}{1 - \frac{4}{5}} = \text{Rs. 20 crores.} \]
\[ \Delta S_m = \frac{1}{1 - \frac{4}{5}} = \text{Rs. 5 crores.} \]
\[ k_m = \frac{25}{5} = 5 \quad (k = \frac{1}{1 - \frac{\Delta C}{\Delta Y}} = \frac{1}{1 - \frac{4}{10}} = 5) \]

Accordingly when the multiplier effect has worked itself out, the position is as follows:

<table>
<thead>
<tr>
<th>Case II</th>
<th>Rs. crores.</th>
<th>Rs. crores.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate money investment ((Y'_m))</td>
<td>10</td>
<td>Aggregate money income ((Y'_m))</td>
</tr>
<tr>
<td>Aggregate money consumption ((C'_m))</td>
<td>115</td>
<td>Aggregate money consumption ((C'_m))</td>
</tr>
<tr>
<td>Aggregate money expenditure or money income ((Y'_m \text{ or } C'_m))</td>
<td>125</td>
<td>Aggregate money saving ((S'_m))</td>
</tr>
</tbody>
</table>

If we abstract from the possible acceleration effect*, equilibrium is restored through an increase in money income (or expenditure) and money saving to Rs. 125 crores and Rs. 10 crores respectively. The increase in money investment from

(Contd) to the increment of real income. But for analysis of the effects of deficit financing we stand in need also of the multiplier relating increment of money investment to increment of money income. We denote it by \(k_m\).

* Where the magnitude and direction of investment are determined by the Plan, and not by the magnitude and composition of consumption demand, it is not very unrealistic to abstract from the acceleration effect.
5 crores to Rs. 10 crores will mean an increase in real investment only if the output* of investment goods increases. Otherwise, the only effect would be to raise the prices of investment goods. Similarly, the increase of money consumption from Rs. 95 crores to Rs. 115 crores will mean an increase in real consumption only if the output of consumption goods increases. Otherwise, increased money consumption will simply raise prices of consumption goods. It follows that to the extent increased money demand in consequence of deficit financing evokes an increase in output, there is no net inflationary pressure. Clearly in an economy where there are lots of productive resources currently idle due to insufficient demand, i.e. in an economy which has less than full employment (Keynesian sense), deficit financing should be welcome for its main effect would be not to raise prices but to push up production. It is only in an economy which has no employable idle resources, or where resources are idle due to reasons other than insufficient demand, that deficit financing generates inflationary pressures. The larger the rate of deficit financing, the higher the marginal propensity to consume and the larger the time-dimension of investment currently being undertaken, the stronger will be the inflationary pressure. For if the marginal propensity to consume is high, \( k_b \), and hence the total increase in aggregate demand corresponding to a given rate of deficit financing, will be larger. Again, longer time-dimension of investment means that the required increase in output to neutralise the expansion of money demand will be achieved later.

60. In India, there is lot of idle man-power, but it is idle, not mainly due to insufficient demand but due to lack of complementary resources. More expansion of demand will not, therefore, induce appreciably larger output. The War-time and post-War experience should leave no doubt on the point. The

* To simplify the argument we assume a closed economy. The same was done by Keynes in the General Theory.
fact is that India already has very near the Keynesian full employment. The main effect of deficit financing will, therefore, be not to induce rapid increase in output but to generate inflationary pressures. To increase output what is needed is not multiplication of demand through deficit financing but socio-economic measures to draw idle man-power into production through a more intensive use of the available complementary resources. The crucial importance of the proposed land tenure reform is mainly derived from this consideration.

61. Deficit financing by the Government, however, need not always generate inflationary pressures. The circumstances when it may not do this are discussed below—

(a) A portion of Government disbursements consists of payments other than those in respect of purchase of goods and services. These include: government transfer payments, subsidies, grants and loans to the private sector; and interest on the public debt. All these payments directly add nothing to aggregate demand. Additional demand is created only to the extent that the receipt of these payments increases private consumption and investment. But to the extent the receipt of such payments either merely swells idle cash held in the private sector or causes contraction of outstanding bank credit, on account of the private sector using the surplus cash to reduce its indebtedness to the banking system, the effect of deficit financing by the Government is offset by what may be called surplus financing by the private sector. The magnitude of deficit financing practised by the Government is thus not by itself sufficient to indicate whether or not, or to what extent, the economy will be subject to inflationary pressures. To determine this we need to know the extent of deficit financing in the entire economy, i.e. in the public as well as the private sector**.

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*** The private sector practises deficit financing to the extent that it meets its purchases of goods and services through
In other words, we have to find how much of the aggregate national expenditure is financed by either the expansion of bank credit (including Central Bank credit), or by the activization of idle balances. To the extent that deficit financing in the public sector is offset by negative deficit financing, i.e. surplus financing in the private sector, the inflationary potential of the former is lost.

Hoarding of cash by the public enlarges the scope for the practice of deficit financing by the Government. As such, it should be welcome, for it amounts to an interest-free loan to the Government. But constantly expanding private hoards of cash contain the danger that like a volcano which may be quiescent for the time being, they may become active at any odd moment. At any time the Government may be faced with buying sprees which may cause sudden and highly inconvenient spurs in prices. It is, therefore, considered better to channel these savings into public loans, for the interest that has to be paid on them is deemed not too high a price for the advantages derived from bringing the savings into the open, namely, the possibility of an accurate measurement of current savings, and the freedom from the danger of sudden buying sprees. The scope for deficit financing is no doubt thus reduced, but so is also the need for it. For the more of genuine current savings of the public the Government is able to borrow, the less becomes the need for deficit financing.

(b) When Government deficit financing is not fully offset by surplus-financing in the private sector, i.e. when there is net deficit financing in the economy as a whole, the flow of effective demand is swelled. The extent of the increase in aggregate demand depends upon the size of the multiplier and the intensity of the acceleration effect*. There will still be no increase in prices if the inflationary effect of such increase in demand is fully offset.

* The multiplier refers to the effect of changes in investment on consumption while the accelerator refers to the reciprocal effect of changes in consumption on investment.
by the deflationary effect of negative net foreign investment (or import surplus), over and above that already accounted for through inclusion of foreign loans and grants received by the Government among the non-inflationary finance available to the Government. The use of sterling balances to finance an import surplus will, for instance, impart deflationary impulse to the economy which will to this extent offset the inflationary effect of net deficit financing practised by it. It is on this account that the Plan would prefer to keep deficit financing down to Rs. 290 crores, i.e. equal to the anticipated utilization of sterling balances during this period under the Indo-British Sterling Balances Agreement of 1951. The remaining gap between the proposed outlay in the public sector and the financial resources in sight, the Plan would like to fill through further external aid, or, in the absence thereof, by additional taxation and borrowing.

(o) Even if the inflationary effect of net deficit financing in the economy is not fully offset by the deflationary effect of negative net foreign investment, there may still be no rise in prices if expanding effective demand is matched by expanding output. For instance, in an advanced private-enterprise country, at the trough of the depression, when there is plenty of idle labour and production capacity, deficit financing does not bring about an inflationary situation. Expansion of demand activizes idle labour and capital, and so is largely offset by increase in output. At this stage the rise in prices is very limited and welcome. If production thus responds immediately and vigorously to expansion of demand, deficit financing may not generate inflationary pressures.

62. We do not favour deficit financing of an order which will create an inflationary situation. Inflation must be avoided at all costs. Inflation encourages speculation*, promotes inessential transactions, discourages voluntary saving, disrupts foreign currencies, and so on. A currency crisis, holding of gold, foreign exchange, real estates, etc.
wages, distorts the relationship between sectional price levels, causes an unplanned and inequitable redistribution of money incomes, and, since it implies inconstancy in the value of the monetary unit, deprives production costs of that definiteness which is necessary if planned programme is not to be upset. For an economy where the bulk of the population consists not of wage-workers but of small producers, it may soon prove self-frustrating. The raison d'etre of inflation as a method of compulsory saving is that it restricts consumption through a rise in prices. But in a community where the bulk of the population sell not labour-power but produced goods, a rise in prices means a more or less proportionate rise in the incomes of the greater part of the population. Inflation fails to restrict the consumption of this part of the population. Some decline in the consumption of the wage-earning population is likely, because wages normally lag behind prices. But a high rate of saving achieved through reducing real wages is not only highly objectionable, but politically impossible, in a society where the working class is expected to be the leading social force. Moreover, if the workers are granted a dearness allowance based on the cost of living, the capacity of inflation to restrict consumption of even the wage-earning classes will be severely limited. Finally, inflation will wreck the plan put forth in Chapter VII to convert the nation's hoards of precious metals and stones into productive capital. Deficit financing should not, therefore, be undertaken on a scale which will generate such strong inflationary pressures as will neither be relieved soon enough by increase in production nor be held in check through a system of price control and rationing which is no more elaborate than can be administered economically, conveniently and efficiently.

69. It follows that in India the scope for deficit financing depends upon the potential strength of the above-mentioned offsets to its inflationary effect. The first offset is surplus financing by the private sector. In an economy where the private (Contd) contains the possibility of large speculative gains which cannot be matched by productive investment in economic development.
sector engages by far the greater proportion of population, where the persons so engaged are not wage-earners but independent producers, where the banking system meets only a small proportion of the need for credit, and where idle cash held is by no means insignificant, the possibility is that when a programme of rapid economic development provides extensive opportunities for investment, there will an increase in the bank credit made available to the private sector, and that the present hoards of cash will be drawn upon and activated; in other words, deficit financing by the public sector is likely to be reinforced, rather than offset, by deficit financing by the private sector. The first offset is thus unlikely to be inoperative. The second offset is likely to work less effectively under the scheme for the utilization of sterling balances suggested in this study than under the scheme of utilization provided by the Plan. Under this scheme, Rs. 400 crores out of these balances will be used for buying out British and American business investments in India. Rs. 200 crores will be held as a currency reserve, and Rs. 100 crores will be drawn upon at the rate of Rs. 20 crores a year. The Plan proposes to draw upon this source of finance to the extent of Rs. 290 crores. Though our scheme for the utilization of sterling balances will reduce the scope for deficit financing during the first five years, it will, by increasing Government revenues by a minimum of 25 crores a year, permanently reduce the need for it to that extent. Finally, we consider the offset provided by increase in production. There is plenty of idle labour in an under-developed country but very little unused real capital. The scope for increase in output, therefore, depends upon the extent to which appropriate socio-economic measures are taken to draw idle man-power into production through a more intensive use of the available complementary resources. A consideration of the potential strength of the three offsets thus seems to suggest that the scope for deficit financing in India, as in other under-developed countries, is pretty narrow. It is this consideration which led Maurice Dobb,

* cf. Chapter IV, Para. 75.
(in lectures delivered at the Delhi School of Economics in 1951), to advance the view that it is hardly possible for an under-developed country engaged in industrialization to avoid—at least for a time, some measure of inflationary pressure*. This he attributed to the country's failure to produce sufficient money savings out of current money incomes to match the increased investment expenditure. Deficit financing—and this is what the gap between investment expenditure and savings out of current money income involves—increases the level of money income, and consequently the money demand for consumer goods. But since for the time being, i.e. till 'industrial investment bears fruit in enhanced production', the supply of consumer goods is relatively inelastic, their prices tend to rise. This temporary inflationary pressure would not indicate a fall in average consumption but the failure for the time being of the supply of consumer goods to match the increase in the demand for such goods, resulting from the increase in aggregate money income.

64. The plan of economic development presented by us has the merit of reducing to the minimum the possibility of inflationary pressures. The danger of inflationary pressures is the greatest when investment forms a relatively high proportion, say 20%, of national income, and when the bulk of this investment is in the heavy industry, i.e. is in fields where it has a relatively long time-dimension. Rapid expansion of heavy industry is, therefore, to be taken up in the Second Stage. In the First Stage, the percentage of income devoted to investment will be lower, for it will have to be progressively raised** from the current level of 5 per cent., and, as explained in Ch. VI, a large proportion of investment will be of types yielding quick results. At this stage, the emphasis will be on land reclamation schemes, minor irrigation works, agricultural implements worked by human or animal power, fuller utilization of organic manures, relatively simple equipment for lumbering and for fishing in inland, esturian and

** Though not as slowly as envisaged by the Plan.
coastal fisheries, extension and modernization of existing mines, thermal stations as against vast hydro-technical projects, tools and equipment for cottage and small-scale industry, elimination of arrears of depreciation as against new expansion in large-scale industry, village roads as against national highways, and so forth. Even in the field of heavy industry, to achieve quick results, the investment will be largely confined to the extension, modernization and completion of existing works rather than extended to the creation of new ones. Appropriate socio-economic measures, the land tenure reform being the most important among them, will also be taken to draw idle labour into production in the only way practicable at this stage, viz. through the widest possible extension of self-employment. This stage will, therefore, be marked by rapid increase in both the components of aggregate output, namely consumption goods and investment goods. This will permit a substantial measure of deficit financing without generating/inflationary pressures.

The measures to promote savings discussed in this study, together with the increase in the output of consumer goods, will ensure that (even in the face of increasing money incomes) the aggregate consumption expenditure is no higher than that required to buy the available supply of such goods at the current prices. The level of income attained by the end of the First Stage, together with the perfection of measures to promote savings, are expected to raise the rate of saving out of current income to very much higher than the present rate. Investment at the rate necessary to rapid expansion of heavy industry will not then require heavy deficit financing. Inflationary pressures could then be avoided by keeping deficit financing at the level at which the increase in consumption demand, due to rising money income, will not rise faster than the output of consumer goods. The experience of China during the last three years conclusively proves that, given appropriate socio-economic measures, inflation is not an inevitable concomitant of a high rate of economic development. Far from being confronted with stronger inflationary pressures, New China has actually brought under control a hyper-inflation.
as in other under-developed countries, is necessarily associated with the lack of adequate banking and saving facilities, which deficiency, in turn, is but an aspect of the state of general economic under-development. To induce a larger flow of savings, it would be necessary to extend and improve banking and saving facilities, for insufficient savings may at once be a cause and a consequence of the inadequacy of such facilities. It is no less necessary to make a positive effort to inculcate saving habits. Measures to achieve these objectives are briefly mentioned below.

(a) Wide-spread, easily accessible and varied deposit facilities should be provided, so as to meet the requirements of all types of savings and savers. Such facilities may be provided through government, co-operative or private agency. In the type of rural economy contemplated in this study, the best way to extend deposit facilities to the vast rural areas would be to create a network of efficiently functioning co-operative multi-purpose societies and postal saving banks. In the urban areas, the necessary deposit facilities may be provided through an increase in the number of commercial banking offices, postal saving banks and co-operative credit or multi-purpose societies. The proposed nationalization of foreign and Indian cartel capital will bring several commercial banks under Government management. These should be amalgamated to a form a single giant Government bank, which would have sufficient resources to spearhead the extension of banking facilities to those urban areas where there are non-existent or grossly inadequate. At the same time, the Government could aid and encourage private commercial banks to extend their activities by enacting appropriate measures.

- The Plan considers co-operative societies the best means of attracting rural savings into credit institutions (The Plan, Ch.10, Para.8)

**It has been decided to introduce, on an experimental basis, certain improvements in the facilities provided by the Post Office Savings Bank in the Bombay State. These include (a) introduction of the cheque system for withdrawals and deposits, (b) providing greater facilities to the depositors.
banking legislation — (in which direction the Banking Companies Act of 1949 is a very welcome measure)—, helping the smaller among them to strengthen themselves through amalgamation*, enacting laws and promoting practices encouraging the use of cheques and other credit instruments, providing premises for strong rooms, allowing initial expenses of opening new banks to be set off (for purposes of taxation), against profits, helping to train bank personnel, and so forth.

(b) Measures should be taken to ensure the safety of deposits. In India, as in other under-developed countries, confidence in the banking and saving institutions is as yet but a plant of tender growth. It needs to be sustained and built up through measures to safeguard deposits. The deposits with the postal savings banks being an unfunded debt of the Government of India, this problem does not arise in their case. But the depositors with Commercial banks, co-operative credit societies, etc., also need to be provided with an equal measure of assurance against loss of their money. This requires that the depositaries of public savings in their investment policies, and the Government in their policies towards them, should be governed by the paramount need to ensure the security of deposits. The type of planned economy contemplated in this study necessarily involves that the Government will control bank investments, either directly or through the agency of the Reserve Bank. But in the exercise of this control, the Government must take care not to allow, induce or compel banks to undertake risky or less liquid investments without taking appropriate measures to safeguard the depositors. And, should any bank failure occur, it should be the Government’s duty to ensure that the depositors suffer no loss. It has been very aptly remarked that when the banking system is supervised by a central bank, ministry of finance or other Government institution, a bank failure really indicates a failure of supervision; for this reason there is an implicit responsibility on the

*We favour branch banking as against unit banking, because it better fulfills the requirements of a planned economy.
part of the Government to compensate depositors for losses suffered in depositing their savings with recognised institutions'.

(e) Usury should be suppressed, since banks and other institutions offering deposit facilities cannot offer anything like the rates of interest earned on usurious loans. The prevalence of usury is, therefore, an important obstacle to the growth of modern banking and savings institutions. The suppression of usury will contribute to the growth of savings and banking facilities and habits by inducing a good portion of the funds now employed in this business to flow into the various savings and banking institutions. For the same reason, the suppression of the black market will also help to promote banking and saving institutions. The funds employed, and the incomes earned, in the blackmarket cannot be deposited in such institutions for fear of detection. The suppression of the black market will cause these funds to come into the open with benefit to the banking system.

(d) A persistent and effective propaganda campaign should be conducted to educate the public in the importance of saving through banking and other saving institutions. In particular, the people need to be informed that to hoard cash amounts to granting an interest-free loan, and that even pure self-interest is better served if such cash is deposited with, say, a postal savings bank, where it will not only be more safe but also earn interest.

Rate of Interest

69. Higher interest rates are sometimes advocated as a means to raise the savings function, i.e. to induce the people to save a larger amount at each of the different levels of income. This,

however, appears to be an incorrect view. As pointed out by Keynes, as a rule savings are mainly a function of income. The effect of an increase in the rate of interest will be complex and uncertain. It may strengthen some of the inducements to save but will weaken others. The final outcome of these conflicting tendencies cannot be determined with any degree of definiteness. Few are likely to respond to a rise in the rate of interest by saving more out of a given income. The available empirical evidence seems to confirm the Keynesian contention that 'the short-period influence of the rate of interest on individual spending out a given income is secondary and relatively unimportant, except, perhaps, where normally large charges are in question'. An increase in the rate of interest as a means of raising the savings function is of dubious value.

69. There, however, appears to be a strong case for offering greater inducements to the small savers. In the largely egalitarian society visualised in this study, small savings will occupy a highly important place among voluntary savings. This underlines the need of offering sufficiently attractive terms, especially adequate rates of interest, to the small savers. Currently the terms offered to small savers in India are no better than those common in the highly developed countries, where, average per capita income in middle and lower income groups being several times higher than in India, small saving requires much less sacrifice. Small savings may at present (Dec. 1952) be either deposited in savings accounts provided by commercial and co-operative banks, postal savings banks, and co-operative credit or multi-purpose societies, or invested in Post Office National Savings Certificates and Ten-Year Treasury Savings Deposit Certificates. The rate of interest allowed by larger scheduled banks as on Dec. 31, 1951, varied from 1 to 2½ per cent. per annum**. The rate of interest allowed on postal savings bank accounts was revised on April 1, 1952. Still it is no higher than 2% per annum on any balance not exceeding

* General Theory, p. 94.
** Reserve Bank of India, Trend and Progress of Banking in India in 1951, p. 52.
A simple interest of 50% is thus earned in 12 years.

Rs.10,000, and 1½% on the remainder of the balance. The maximum amount of a single deposit is fixed at Rs.15,000 for an individual holder, and Rs.30,000 for joint holders. The Ten-Year Treasury Savings Deposit Certificates carry annually payable, tax-free interest at 3½ per cent., and are repayable at par on the expiry of 10 calendar years. They are not transferable but may be redeemed at the option of the depositors, at any time after the expiry of one year, subject to varying rates of discount (depending on the number of years they are held before being presented for redemption). The rates of discount are so fixed as to make the yield per cent. higher, the longer the certificates are held. The 3½ per cent. per annum (tax-free) rate is earned when the certificates are held the full term of 10 years. The Postal National Savings Certificates differ from the Treasury Savings Deposit Certificates in being transferable, but are otherwise similar to the latter. The 12-year Certificates are the most popular. They are available in denominations of Rs.5, 10, 50, 100, 500, 1000, and 5000. The minimum period for the encashment of the certificate with face value of Rs.5 is one year; for all others it is 1½ years. The amount payable after each complete year of retention is so fixed as to make the per annum yield higher, the longer the certificates are held. For instance, the amount payable on the Rs.10 certificate is Rs.10-2 after 1½ years, Rs.10-4 after 2 years, and Rs.10-6 after 3 years. Thereafter the amount payable increases by Rs.8 for every additional year of retention. The amount payable if a Certificate is held for 12 years—which gives an annual yield of about 3½%. Subscription to Treasury Savings Deposit Certificates and to Postal National Savings Certificates is subject to a maximum limit varying with different categories of subscribers. Clearly the terms offered at present in India to the small savers are about the same as are commonly offered in the highly developed countries. If hoarded cash is to be brought out into the open, to remove the potential threat of inflation held by it, and if the relative attraction of several undesirable or less urgent competing channels of investment, e.g. investment in precious stones and metals, real estate, etc., is to be reduced to direct Savings into the hands of the Government or into banking and savings institutions, so that they may
finance the more desirable economic development, small savings must be offered more attractive terms. Thus even though a higher rate of interest on small savings is unlikely to raise the savings function, there seems to be ample justification for it as a measure to unearth and discourage hoards of cash, to divert current savings from less to more desirable channels, and to promote the conversion of hoards of precious metals into productive capital. The suggestion for an increase in the rate of interest stems, not from a belief that it will make the community more thrifty, but from that it will help in a more desirable canalisation of savings.

70. As elsewhere, the long-term rate of interest has shown an upward tendency in India since 1950. There has been a steady fall in the prices of Government longer-dated bonds. The Price Index of Government and Semi-Government Securities (Base: 1938=100) fell from 100.8 in June 1950 to 91.4 in March 1952. The fall, of course, has been the heaviest in the case of the longer-dated loan, the 3% conversion loan of 1946 payable 1986 or later. The fall in the price of Government bonds means a rise in their yields. The average flat yield on the 3% Conversion Loan of 1946 has risen from 3.23% in June 1951 to 3.75% in Dec. 1952. This means that the true long-term rate of interest now stands at about 52%. This is lower than the current long-term rate in UK, where the price of 2½% Consols being about £ 60, it stands higher than 4%. The higher rate of interest on small savings suggested above, may necessitate a further slight rise in the long-term rate of interest in India (to bring it into reasonable alignment with the former**), but we suggest that for increasing the popularity of Government bonds chief reliance must be placed, not on higher rates of interest but on greater liquidity of these bonds through stabilisation of the long-term rate of interest. Stable long-term rate of interest means stable security.

** Ibid., p.192. *** We would favour the stabilisation of the long-term rate at 4%.
prices. And when securities can be counted upon to keep their value (in terms of money) unchanged, they become near-money and hence more attractive. Bonds will be more popular with investors when the rate of interest is stable though lower, than when it is higher but rising. Stable and not higher rate of interest is the way to stimulate the flow of savings into government bonds.

71. The contemplated increase in the rate of interest on small savings and on longer-dated Government loans may necessitate some upward revision of the rates allowed on time deposits. At present, these are among the lowest in the world.

The upward revision of rates allowed by banks on deposits will not necessarily adversely affect production by making credit dearer. The interest paid on deposits forms less than 1/5 of the total expenses of banks. In 1951, the total expenses of 16 larger Indian scheduled banks were Rs.20.7 crores, of which the interest paid on deposits was only Rs.6.1 crores. The increase in the rates allowed on savings and time deposits will, therefore, make relatively small additions to total expenses. As on Dec.31, 1951, the aggregate of savings and time deposits stood at Rs.364.64 crores. An average increase of one percent in the interest allowed would add only Rs.3.6 crores to the aggregate expenses of all the scheduled banks. This increase need not, for the following reasons, oblige the banks to charge a higher rate on advances to industry. (a) The earnings of the banks will improve due to higher yield of Government securities. The fact that banks' investments in Government securities (Rs.305.83 crores on Dec.31, 1951) now aggregate over 80% of the total savings and time deposits with the banks, indicates that the improved return on the former will substantially offset the increased payment on the latter. (b) There is considerable scope for economy in establishment expenses, mainly through amalgamation of smaller banks to form

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* Reserve Bank of India, Trend and Progress of Banking in India in 1951, p.52.
** Ibid., p.16
*** Ibid., p.48.
bigger banks. In banking, as in other public utilities, the wastes of competition are unduly large, and should be avoided through reduction in the number of banks and judicious control over the opening of new branches by each of them. The Banking Companies Act of 1949, gives the Reserve Bank ample powers in this direction. (c) The increase in the volume of business available to banks due to expansion of industry and trade will also help to economise expenses through wider distribution, over-head costs. (d) Should it still be necessary to improve bank earnings through raising the rate of interest on advances, such rise may be confined to advances for the finance of commerce. Different rates of interest on advances for the finance of production and distribution are surely feasible. Dear credit for the finance of commerce may not be undesirable. To the extent it discourages the maintenance of unnecessarily large stocks and brings down investment in distribution to no more than necessary to ensure free flow of goods, it will afford a positive advantage. In India, as in other under-developed countries, the funds tend to seek investment in trade rather than production. The distribution of bank credit also shows the same tendency. For instance 53.1% of the outstanding scheduled bank advances on Dec. 31, 1951, were for commerce, against 35.6% for industry*. Dearer credit for trading purposes will tend to correct this tendency. (e) Currently, a large proportion of the credit-requirements of industry and trade, particularly of the small and medium-scale producers and traders, are met by indigenous bankers and money-lenders, who charge much higher rates of interest. For instance the Bazar Bill Rate (i.e. the rates at which bills of small traders are reported to have been discounted by Shroffs) at Calcutta in 1951 was 10-12% ** while the bulk of advances of major scheduled banks are at rates of 3-5% ***. If, partly through the planned expansion of commercial banking, and partly through creating appropriate specialised financial institutions, the credit requirements of smaller producers and traders could be met at about the rates now available to larger businesses, credit requirements of industry and trade as a whole will be met cheaper than at present, even if the rate on all types of bank advances go up a little. At any rate the depressive effect on

* Ibid., p. 60-61. ** Ibid., p. 34. *** Ibid., p. 57.
private investment of a small rise in the rates charged on advances is likely to be insignificant, in view of the relatively low capital-intensity of the methods of production contemplated to be employed in the private sector.

72. We favour stabilisation of interest rates, but at somewhat higher levels than at present. We expect this to be beneficial, not by making the community more thrifty, but, first, by helping to bring out into the open any hoards of cash, and secondly, by making larger resources available for investment in production, through discouraging investment in gold and silver, real estate, inventories, etc. Higher rate of interest thus appears to us a useful weapon, not for augmenting the flow of savings but for their appropriate canalisation. And we recommend it as such.

Ploughing Back of Profits.

73. The direct reinvestment of profits, or their retention as business deposits in banks, forms an important part of total private saving in India. The Plan has estimated the corporate undistributed profits at Rs.40 crores in 1950-51, i.e. at 8% of the aggregate national saving in that year. During the Plan period, the expected corporate undistributed profits in the industrial sector alone have been put at Rs.200 crores. The Tata Iron and Steel Company is an outstanding example of steady expansion of business through ploughed-back profits. Against the total paid-up capital of Rs.10.47 crores as on March 31, 1952, reserves and gross block were Rs.13.45 crores and 44.14 crores, respectively. However, not all firms exhibit the same measure of 'financial prudence'. Many do not make even adequate provision for depreciation. It has been reported that many companies 'make no, or very inadequate, provision for depreciation in years of material loss. Even during good business years, those allowed by the Income-tax Act. Frequently the provision for depreciation is not made on merits, i.e. on an accurate

* The Plan, Appendix to Part I.
** The Plan, Ch.29, para.33
*** The balance sheet of TISCO as on March 31, 1952.
estimate of the amount by which the assets actually depreciate, but on 'extraneous considerations, such as the amount of profits secured during a year, the remuneration of the managing agents, and the dividends expected by the share-holders'. Few concerns provide for obsolescence (i.e. functional depreciation) in addition to physical depreciation. The Managing Agency System is an important factor responsible for the failure of firms to make adequate provision for depreciation and obsolescence. As pointed out earlier in this Chapter, the Managing Agents have devised ingenious methods for appropriating to themselves what should properly be the earnings of firms managed by them. This reduces the gross profits earned by these firms. Consequently the share-holders' expectations in respect of dividends are quite often met at the cost of inadequate provision for depreciation. Again, since the managing agents generally receive a percentage of net profits as their remuneration, it is in their interest to inflate profits. This is often done by making insufficient provision for depreciation. Since the managing agents hold their position by contract, the temptation to do the above is especially very great, if there is any chance of the contract not being renewed.

74. Adequate provision for depreciation and obsolescence is the first problem; ploughing back of a higher proportion of net profits comes only next. At present industry is faced with the problem not only of making adequate provision for current depreciation and obsolescence, but also of wiping out the arrears inherited from the past. According to the Plan, these stood at Rs.150 crores at the end of 1949-50. The possible resources of finance for meeting current as well as past depreciation and for industrial expansion in the private sector are: (a) past accumulations in the depreciation funds, (b) current provision for depreciation, (c) profits that may be ploughed back in business, (d) funds raised on the investment market, (e) funds released through reduced requirements of working capital, and (f) state financial assistance, provided either directly or through the agency of the IFC and the State Finance

- Ch.29, Para.33. -

Industrial Finance Corporation
Corporations\(^*\). The financial resources represented by (a) and (e) can be used but once. The requirements of working capital will be reduced if either higher levels of operational efficiency are attained, so that uninterrupted production is ensured with fewer goods-in-process, or the prices of raw material fall. Clearly, the scope for the release in this way of financial resources for investment in fixed capital is rather limited. Sources (b), (c), (d) and (f) are of continuing as well as greater importance.

75. It is very necessary to induce or compel the private sector to make adequate provision for depreciation, physical as well as functional. The following are some of the measures that may be taken to this end: First, the management of private enterprises should be reformed. The holes through which at present management s line their own pockets at the expense of the enterprises under their control must be plugged. This, together with greater efficiency in management, would increase the gross profits earned by enterprises. It would then be possible for them to make more adequate provision for depreciation. The suggested substitution of true private enterprise for cartel capitalism will also help in this. When management is in the hands of capitalists who seek to enrich themselves, not through lining their own pockets at the expense of enterprises under their control and then using these funds to bring more enterprises under their control, but by developing the enterprises already under their charge, profits will not be unduly inflated at the expense of provision for depreciation. Secondly, every effort should be made to develop among the managements a higher sense of responsibility, and a better appreciation of their true interest. Thirdly, a small cess per unit of production may be levied on all corporate enterprises. The proceeds of this may be handed back to the individual units from which they are

\* For details regarding how the Plan proposes to finance current as well as past depreciation and the contemplated new expansion in the industrial sector, see Para. 3 above.
collected to be spent only on the renovation and replacement of plant. Fourthly, grant of financial or other assistance by the Government should be made conditional on the enterprise concerned making adequate provision for depreciation. Fifthly, if provision for depreciation still continues to be inadequate, provision may be made in the Indian Companies Act to compel managements to provide for depreciation according to minimum rates prescribed for different assets in different industries, similar to those laid in the Income-Tax Act.

76. Private enterprises should be encouraged, not only to make adequate provision for depreciation and obsolescence, but also to plough back into business a reasonable proportion of profits. For this, the first necessity is a reasonable marginal efficiency of investment*. The prospect of an adequate rate of return on investment provides a powerful incentive to plough back profits into business. In the rapidly-developing economy contemplated by us, where on account of a high rate of public investment the problem may be excess rather than deficiency of demand, private investment will be assured of a reasonable rate of return. Private enterprise will thus have an adequate incentive to plough back profits. Another incentive may be provided through tax discrimination in favour of non-distributed (or, as in Chile, reinvested) profits. A limitation of this method, however, is that, since the Government loses revenue by taking undistributed profits at lower rates, the increase in private saving is partly offset by decline in public saving. Still another method to encourage ploughing back of profits may be to make, as in Mexico, the grant of government assistance, or bank loans, conditional on the enterprises concerned reinvesting a part of their profits. Finally, the substitution of the private enterprise for cartel capitalism will mean managements which will be as anxious to plough back a reasonable proportion of profits as to make adequate provision for depreciation.

* The marginal efficiency of investment is the highest rate of return that investment in any line of business may be expected to fetch.
77. Two dangers are commonly claimed to be inherent in ploughing back of profits. First, since profits usually tend to be primarily invested in the same or closely associated line of activity, there is the danger that the distribution of investment may tend to be different from that required by the Plan. The Industries (Development and Regulation) Act of 1951 (which came into force on May 8, 1952), provides against that danger by requiring that in scheduled industries any new undertaking, or any expansion of an existing undertaking virtually amounting to a new undertaking, will need a licence. Reinvestment of profits may, thus, be prevented in fields not preferred. This may somewhat weaken the incentive to plough back profits, but since in a planned economy all private investment is subject to direction by the Government in accordance with the programme of development laid in the Plan, the discouragement to reinvestment of profits may be no more than it would be to private investment financed from other sources. Secondly, it is pointed out that where the financing of development depends largely on reinvestment of earned profits, the foundation is laid for a strengthening of monopolistic conditions. There is little ground for fear on that score in the type of economy contemplated in this study. The nationalization of cartel capital will end existing private monopolies and semi-monopolies, and the fact that public investment will form the bulk of total investment in industry will prevent the emergence of new monopolies. In such an economy, reinvestment of profits could never be on such a scale as will create giant monopolies such as have come into existence in Western countries.

Opportunities for Direct Investment by Savers

78. Opportunities for direct investment by savers act as a powerful spur to savings. The prospect of extending or improving one's farm or cultivation, of setting up or extending one's own business, and of building one's house, provides a strong inducement to save. In 1950-51, private savings directly invested in agriculture, cottage and small-scale industries, transport and construction of buildings, are
estimated at ₹ 150 crores against the total private saving of ₹ 357 crores*. An economy which affords opportunities for direct investment of savings in ample measure provides a strong incentive for saving. And the economy contemplated in this study will be such a one. In a country where the agricultural population is seriously under-employed and where capital is in short supply, a high rate of investment in agriculture should best be achieved through investing idle labour in the improvement of land and cultivation. Nothing provides a more powerful incentive for that than the transfer of land to the tiller. For the tiller who is to provide the labour can be expected to work the hardest when he thereby extends and improves his own farm. He can be expected, not only to spend his spare time in extending and improving his farm, but also to devote to this purpose a fair portion of his income and even any accumulated savings (cash, ornaments etc.) that he might possess. That portion of his income which is now paid to the landlords and the usurers by way of rent and interest and so goes to support propertied classes could then be invested in land and cultivation. Thus, throughout the period capital is expected to be in serious short supply, the bulk of the investment in agriculture could be financed through expenditure of the currently idle labour-power of the agricultural population in the improvement of land and cultivation, and through direct investment by the peasantry of both accumulated savings and savings out of current income. Land reform is indeed a powerful device to create savings for the finance of investment in agriculture.

The importance attached to cottage- and small-scale industries in the early stages of development is also justified on that score. Such industries imply numerous independent or co-operative business units and thus provide vast opportunities for direct investment by savers. An economy which deliberately promotes such industries naturally provides numerous people with a strong incentive for larger saving out of current income and for the productive employment of accumulated savings.

* The Plan, Appdx. to Part I.
79. Housing is another field which admirably lends itself to direct investment by savers. In India at present the position in respect of residential accommodation is very unsatisfactory. On account of the low level of construction activity since 1939, particularly in the field of low-income housing, the absence of proper maintenance and repairs, the destruction of houses during the Partition riots and the very large increase in the urban population due to natural increase, migration from the rural areas, and migration from areas in Pakistan, extreme conditions of overcrowding prevail in towns. Vast 'labour-camps' have come into existence. Conditions in rural areas are no better except that the villager has access to open space, fresh air and sunshine, denied to the town-dwellers. Clearly, the situation calls for urgent attention. A substantial proportion of aggregate national investment must be devoted to housing construction. Hitherto, residential housing has been left almost entirely to private enterprise. And we suggest that in the future, too, the position in this respect should remain unchanged, except that many more people should be provided the opportunity to build houses for themselves than is the case at present. This policy is justified on the following grounds:— (a) Everywhere people like to possess a house of their own. Even in the socialist Soviet Union, houses owned by workers and collective farmers account for the bulk of the residential accommodation, and the Government aids private persons in different ways to build houses for themselves. A house built for one's own residence is really durable consumer goods and not capital goods. Its private ownership is not, therefore, incompatible with a socialist society. (b) Then the workers own houses in the locality where they are employed, 'flitting' of labour will be discouraged. (c) Opportunity to build a house for oneself will provide a powerful incentive to save out of current income, and to the conversion of hoards of cash and precious metals, into productive investment. Even if a part of the cost of the house is met by taking out a mortgage loan against it, the need to meet the interest and amortization payments requires the house-holder to save, not only the full annual income

yielded by the house, but also something besides.

The Government should carry out a complete housing survey in urban areas, and, taking into consideration the present requirements and the impact on these of the development programme, should determine how much additional accommodation, and of what type, will be necessary in each locality. Private individuals and co-operative housing societies should then be encouraged to build houses of the approved types and standards to meet the estimated shortage. In view of the prevailing high land values in the towns, the most important form in which the Government can encourage private house building is by providing cheap sites. To this end, it should plan for a development regionally more balanced, so that the bulk of new industrial enterprises are set up, and the new demand for residential accommodation created, in areas where land values are low, amend the Land Acquisition Act with a view to facilitating the acquisition of land for housing purposes at prices payable for land on the basis of use to which it was put on the date on which it was notified for acquisition, and so modify the tax structure as to discourage land hoarding. The above will facilitate Government acquisition of land for developing housing colonies. Building sites in such colonies could be sold to private persons at cost price. The Government could promote house-building by removing difficulties in the way of getting controlled materials at control prices, providing amenities and services in advance, exempting the newly-built houses from Municipal Tax and the Urban Immoveable Property Tax for a specified number of years, offering technical advice free of charge, or at concession rates, taking steps to acquaint the people with the latest developments in house construction and building materials, sponsoring research into methods of cutting down costs**, arranging for the training of building personnel, and supplying credit on easy terms to cover a part of the cost.

* Ibid., p. 213.
** A committee of experts appointed by the Government is reported to have estimated that even without a radical alteration in the method of construction, it is possible to effect, by adopting the measures suggested by it, economy of the order of 15% in building construction.
80. Opportunities for direct investment provide a very powerful incentive for saving. Furthermore, to the extent investment is financed out of the savings of the investor, the draft on mobilized savings is reduced. Accordingly, to achieve a high rate of saving, and to reduce the strain on mobilized savings, such opportunities should be provided to the maximum practicable extent. The Plan of development suggested by us meets this requirement. It is thus consistent with the need for attaining a high rate of saving.

Subscription to Public Issues

81. In an under-developed country like India the flow of savings may, for the following reasons, be materially influenced by promoting private subscription to public issues:—
(a) In India, in the absence of a level of capitalist development as high as that attained in the West, most people are not used to investing in private securities. They may, however, be persuaded to invest in Government securities and savings bonds, for normally they carry far less risk than private securities. In particular, the government saving bonds appear to be the only effective instrument to tap the long-term savings of the vast rural population. (b) The Government can also appeal to the patriotism of the savers, while private institutions can appeal only to their self-interest. A UN study, however, has expressed its misgivings regarding the advisability of the Governments of under-developed countries actively campaigning to attract savings on the ground that, in the face of distrustful attitude of the public towards the Government, the effect of such campaigning may be just the opposite of that desired*. We may, however, point out that the responsibility for this distrustful attitude lies not with the people, but with the Governments. Most under-developed countries have colonial-feudal, anti-people, dependent regimes. They cannot, therefore, win the people's co-operation. Once an under-developed country gets a regime which the people feel works in their interest, they enthusiastically respond to all
national economy. The enthusiastic response of the Chinese people to the Victory Bonds floated by the People's Government in 1950 bears testimony to this. All the policies recommended in this study assume that the country will have a regime enjoying the confidence and co-operation of the people. In the absence of such a regime, economic development on the scale visualised in this study is simply ruled out. (c) Government bonds, because of varied denominations, dates of maturity, rates of interest, ease of cashing, use as collateral for credit, capital appreciation, lottery features, etc., may appeal to savers with different requirements. For instance, institutional and other large investors may be offered government securities in large denominations, bearing a relatively low rate of interest but having a short maturing period. Such securities meet the institutional investors' requirements as regards liquidity, though the cost of lower return. The Government of India Three-Month Bills* and the Treasury Deposit Receipts (issued since Oct. 15, 1948) belong to this type of securities**. To meet the institutional investors' demand for securities with higher yields, longer-dated but negotiable bonds are issued. On the other hand, to tap small savings, i.e., of the general public, savings bonds of relatively small denominations may be issued. Security and good return are the main inducements which these offer. In India, the Post Office National Savings Certificates and the Ten-Year Treasury Savings Deposit Certificates (mentioned in Para. 69 above) belong to this category.

82. The foregoing discussion underlines the importance of promoting subscription to public issues. For this purpose, it may be advisable, (mentioned out earlier in this Chapter), to raise the long-term rate of interest to about 4%, but in any case it is absolutely necessary to stabilise it at some rate. A rising rate of interest means falling security prices.

* Since 1950-51, the State Governments have issued no Treasury Bills.

** Treasury Deposit Receipts (TDRs) are issued in denominations of Rs. 25,000 and multiples thereof, at par, for periods of six, nine and twelve months, bearing interest.
It, therefore, reduces the demand for securities, for few would buy a depreciating asset. On the other hand, a stable rate of interest means stable security prices. A security with a stable price is attractive because it is as good as cash in liquidity and superior to cash in that it fetches interest. A stable rate of interest thus makes securities more attractive by monetising them to a greater degree. Below, we briefly discuss how to stabilise the rate of interest.

83. Let $L_t$ be the transactions demand, $L_1$ the asset-demand, and $L$ the total demand, for money. And let $M_t$ be the quantity of money absorbed in the satisfaction of the transactions demand for money, $M_1$ the quantity available for satisfying the asset demand for money, and $M$ the total quantity of money. We thus have:

$$
L = L_t + L_1 \\
W = M_t + M_1
$$

The rate of interest equates $L_1$ and $M_1$. It can, therefore, be stabilised at a given level through appropriate changes in $M_1$. Assume that it has been decided to stabilise the rate of interest at the current level. Assume further that the security prices tend to sag, indicating an upward tendency of the rate of interest. This would mean that, at the current rate of interest, $L_1$ exceeds $M_1$. To hold the rate of interest at the current level, $M_1$ must be suitably increased. This may be done in two ways: either $M$ should be expanded till $M_1$ (one of its constituents) increases by the required amount, or $M_t$ (the other constituent of $M$) should be so reduced through reducing the transactions demand for money that the required increase in $M_1$ is achieved. The point may be illustrated with reference to the actual position under the Final Plan.
84. The Plan is confronted with a gap of Rs. 655 crores between the planned total development outlay in the public sector and the non-inflationary resources available for this purpose. One way to find additional finance for the public sector would be to try to improve the response to public borrowing by raising the rate of interest. But apart from the extreme unlikelihood of the Government being able to raise the required finance through any practicable increase in the rate of interest, this step is ruled out by the assumed determination to stabilise the rate of interest at the current level. A course consistent with stable interest rates would be to fill each year the gap between planned investment on the one hand and public savings (including surplus yielded by the public sector), rupee proceeds of foreign aid realised during the year and the net proceeds of public issues (including small savings) on the other, to some extent, by drawing upon existing balances and funds (including the rupee proceeds of foreign aid accumulated in the past), but mainly through short-term borrowing from the Reserve Bank, either by issuing Treasury Bills in favour of the Issue Department of the Reserve Bank, or by securing Ways and Means Advances from the Banking Department. This, of course, means deficit financing. Accordingly, whether, or how far, this method may be adopted, depends upon whether, or how far, deficit financing may be practised without inflation. This, in turn, depends upon the strength of the factors mentioned in Para. 61 above. Should it be found that the scale of deficit financing on the part of the public sector necessary to cover in full the planned development outlay, without raising the rate of interest, will generate uncontrollable inflationary pressures, to avoid both inflation and a rise in interest rates it will be necessary adequately to reduce the scale of deficit financing in the public sector or to strengthen the offsets against it. The scale of deficit financing in the public sector may be reduced by cutting down development outlay, slashing government non-development expenditure, and increasing the tax-revenue and surplus produced by the public sector, while the inflationary effect of such deficit financing may be more fully offset by increasing production, curtailing less essential private investment through control of capital
issues and licensing of new construction, restricting personal consumption expenditure through rationing and restricted (as against dearer) consumer credit, and by increasing net foreign disinvestment (i.e. maintaining a larger import surplus, through either borrowing abroad more heavily, or drawing on foreign exchange reserves faster).

85. In essence, the process is the same as above, when the rate of interest is sought to be kept stable in the face of a gap between the planned development outlay and the available financial resources in the public sector through the Reserve Bank undertaking open market operations. The undertaking by the Reserve Bank to keep the rate of interest stable means that it will hold security prices stable. Once the Reserve Bank undertakes to keep security prices stable, the additional securities issued by the Government need no longer be bought out of genuine long-term savings. For it is now always possible for the buyers, without loss to themselves, to recover the cash paid by them for these securities by tendering these to the Reserve Bank at fixed prices. To the extent this happens, the purchase of additional securities will have been financed by created money. The Government will now find no difficulty in raising as heavy long-term loans as it needs to cover its development outlay. The securities placed by it on the market will be readily taken up. For the buyers, whenever they need cash, can obtain it by selling securities to the Reserve Bank at the fixed prices. But in this case, too, part of the development outlay in the public sector will be financed by expansion of monetary supply, i.e. through deficit financing. Only now the Reserve Bank will be creating additional cash against long-term Government securities, whereas in the former case it created it against short-term obligations of the Government. Once again, whether, or how far, this method may be adopted, will depend upon whether, or how far, deficit financing may be practised without inflation.

86. It is surely possible to stabilise the rate of interest at the desired level. But if inflation is to be avoided, the
planned public investment outlay must not exceed the level 
beyond which the flow of genuine current savings into the hands 
of the Government, including the proceeds of public loans at 
the prevailing interest rates, leaves a gap which requires 
deficit financing on such a scale as will generate inflationary 
pressures that cannot be offset or controlled.

87. A well-organized savings campaign can play an important 
part in promoting savings and channeling them into public 
loans. Measures to inform the citizens of plans and progress 
of economic development and to bring home to them its importance, 
organization of savings groups in the urban areas and at 
construction sites to make monthly contributions; celebration 
of National Savings Weeks; linking of savings with specific 
development projects*; appeals by mass leaders; appeals and 
parades by foremost workers, peasants and intellectuals; 
f ixation of specific targets for different cities, districts 
and states; naming of big enterprises after the towns, district 
and states which played the most conspicuous part in raising 
finance for their construction, special appeals to banks, 
insurance companies and various other institutional investors - 
all these instruments of propaganda may be adopted to promote 
the savings drive. The importance of small savings in the 
type of society contemplated requires that saving bonds issued 
should be such as both promote and attract savings. This requi-
rement is met if the savings bonds are available in relatively 
small denominations and at convenient places, are always on tap, 
bear a reasonable rate of interest, are non-transferable but can 
be cashed after the expiry of a specified period, yield higher

* It is reported that in Mexico the responses in savings and 
subscriptions were better when definite projects were 
presented (UN, Domestic Financing of Economic Development, 
1950, pp. 20-21). In India, the Plan seeks to provide a 
similar incentive to small savings. It has been decided 
that proceeds from small savings collected by the States 
in excess of the current level of Rs. 44.5 crores will be 
retained by the States responsible for raising them, the 
amount thus retained being treated as a loan from the 
Centre. This arrangement is designed to promote small 
savings campaigns more effectively by helping the State 
Governments to link up small savings with schemes of 
local development in which the people are directly 
interested' (The Plan, Ch. 3, Para. 3.)
return the longer they are held, and are subject to a maximum limit on investment in them. In India, the Post Office National Savings Certificates meet all these requirements except that they are transferable and carry an inadequate rate of interest. These features should be rectified. Lottery features may also be employed both by Government and by savings banks to promote and attract small savings. For instance, in Palestine, under British mandate, loans were floated at a low rate of interest, and the remainder of the amount that normally would have been paid as interest was divided as prizes to be drawn in a lottery. The system is reported to have been successful in attracting savings at lower total effective interest rates. In Thailand, the most popular issues of savings bonds are reported to be the lottery bonds which pay one per cent. interest. The system of prize bonds has also been used in the past in India and in the Soviet Union. The merit of lottery bonds lies in their appeal to man's gambling instinct. By issuing such bonds, the Government can exploit the gambling instinct for a noble cause, that of national construction. We suggest, however, that the element of chance involved in the use of the lottery method should not be extended to include the safety of the capital and that the prizes should be relatively small and confined to the interest component.

Subscriptions to Private Issues

Savings may also be promoted and institutionalised by inducing better public response to private issues of shares and debentures. For this purpose, such issues must assure the following: security, good yield, and liquidity. To assure the subscribers as regards the security of their investment, the Government should announce a clear-cut policy in respect of nationalisation and convince the public that, unless overriding national interest dictated a change, it will be adhered to. At present, as pointed out by the Fiscal Commission (1949-50) the Government of India's Industrial Policy Statement of 1948,

* ECAFE, Mobilization of Domestic Capital, Bangkok, 1951, p.86.
together with the Article 31 of the Constitution (defining the right to property) is sufficiently reassuring to the investor. In actual working, the Government's industrial policy during the last five years has been even more conservative than the Industrial Policy Statement. It has been repeatedly stated by top Government leaders that nationalization of existing enterprises is not contemplated, both because the Government does not have sufficient resources to pay compensation, and because it is considered better to invest the available resources in new development than to use them for the purchase of old investment. Those who still attribute the present barrenness of the capital market to any alleged threat of nationalization held out by the Government are grossly misinformed. No such threat exists as long as the Congress is in the saddle. The situation will, however, change if the Government proceeds to carry through the two basic socio-economic measures proposed in this study, namely, the transfer of land to the tiller, and the nationalization of British and American capital and Indian cartel capital. To make possible the first, and to facilitate the second, Article 31 will have to be abolished. This, together with the fact that public enterprise will be expected to play an important part in industrial development, may somewhat disturb the investor's confidence, but if the Government demonstrates in practice that it will not nationalize Indian capital other than cartel capital, precisely demarcates the sphere where private capital will be welcome, and, (in ways mentioned in the next Paragraph) aids and encourages private enterprise in the sphere allotted to it, it should not be difficult to restore confidence to private investors. The case of New China is illustrative. The People's Government there, in spite of its abolition of landlordism without compensation and the confiscation of Japanese and comprador capital has, by its policy of non-enroachment on and positive aid and encouragement to non-comprador capital, succeeded in inducing private Chinese investment at very much higher rate than under the Kuomintang. In the three years following the establishment of the People's Republic, the output of private industries is reported to have
increased by 70 per cent.*. And all this has happened in spite of a socialist society being the declared ultimate aim of the Chinese Communist Party. The prospect of ultimate demise has deterred the Chinese investor no more than does the prospect of ultimate death discourage people from devoting themselves to worldly pursuits.

89. To make private issues attractive, the yield on them, net of risks, should be brought at par with the yield on Government bonds. Honest and efficient conduct of corporate enterprises provides the key to a reasonable return on private issues. Honest management implies that the present malpractices by which the managing agents enrich themselves at the expense of the enterprises under their control should be done away with. And efficient conduct signifies that the enterprises are able to improve their profits without adversely affecting the consumer or the employees. The Government can play a valuable part in enabling private enterprises, corporated as well as unincorporated, to attain higher standards of operational efficiency. This it can do by rendering financial and other aid to such enterprises in the ways mentioned below.

90. Taking into account the conclusions of an NW expert study**, as well as the present study's approach to the problem of development, we suggest that Government financial aid to private enterprises may be legitimately extended under the following circumstances:

(a) When such enterprises are faced with difficult situations of a temporary nature;
(b) when they are of basic importance to the economy of the country or to the needs of the development programme;
(c) when they fail to meet their financial requirements on account of circumstances beyond their control;
(d) when in their case a subsidy is considered preferable to a protective duty as a means of assistance; or

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* Hsueh Wu-Chiao 'New China's Great Economic Victories'; op. cit.
** NW, 1950, pp. 44-45
(e) when they are unable to raise enough funds for planned expansion because high rates of public saving (maintained with a view to promote a high rate of aggregate saving) and public borrowing leave insufficient resources for private enterprise.

91. Government financial aid to private enterprise may take the form of grants or subsidies, loans or participation in capital. We agree with Mr. Achariah that loan finance should predominate in the financial aid given by the State. A subsidy, in view of the drain on public funds and the administrative difficulties involved, should be treated as an exceptional device. It may legitimately be granted only when protection is indispensable to stimulate the industry, and when a subsidy appears to be preferable to other methods of protection. This would be so when either the product of the aided industry is a basic raw material of industry, or the local production is small in relation to the local market and the cost of the subsidy small, or the subsidy is very much more convenient to administer than other forms and methods of protection. The burden on the exchequer may be reduced by combining subsidy with a low productive duty. Subsidies would also be justified when development in certain fields may best be undertaken by private enterprise, but when, to induce such activity on the desired scale, Government must share part of the cost. Subsidies to persons in low-income groups to build houses for themselves, or to peasants to effect agricultural improvements, are justified on this ground. The aid may take the form of participation in capital, when efficient conduct of the enterprise or any other vital consideration requires in the management the association of both private enterprise and the State. In other cases, State aid should, as a rule, take the form of loans.

92. Except in agriculture, where State aid, either direct in the form of concessive loans, or through co-operative agency (where it is available) appears preferable, Government financial aid to
private enterprise may best be provided through the agency of specialized financial institutions. Ordinary administrative agency is not suitable for this purpose, as grant of loans or subsidies needs careful specialist investigation or scrutiny. The above policy has already been accepted and progressively put into practice by the Government. Subsidies are now granted on the recommendation of the Tariff Commission, a quasi-judicial specialized agency. And to provide medium-and long-term finance to industry, the Industrial Finance Corporation has been set up. Only public limited companies and co-operative societies are eligible for aid from this corporation. This means that the corporation is essentially meant to assist large-scale industry*. The Corporation is empowered to provide financial assistance in the following ways:

(1) By granting loans or subscribing to debentures of industrial concerns, repayable within a period of 25 years and secured by sufficient pledge, hypothecation or mortgage of tangible assets;

(2) By underwriting the issue of stocks, shares and debentures;

(3) By guaranteeing loans floated in the market and repayable within a period not exceeding 25 years.

It is prohibited from subscribing directly to the shares of stocks of companies; any shares or debentures that it may have to take up in fulfilment of its underwriting liabilities, it must dispose of within seven years of their acquisition. The object is to make the Corporation primarily a lender, and not a partner in industry. Originally the policy of the Corporation was to finance only the acquisition and extension of fixed assets; it thus sought to supplement, not to supplant, the commercial banks which mainly provide working capital. But since 1950, the Corporation has, in some cases, extended accommodation to industrial concerns, even to meet their requirements of working capital**. Since February, 1952, the rate

* Individuals, partnership firms and private limited companies which predominate in cottage and small-scale industries are ineligible for financial assistance by the Corporation.

** of Chairman's address to the Fourth Annual (1952) General Meeting of the Industrial Finance Corporation.
of interest on loans advanced by the Corporation has been raised from 5½ to 6 %*. It still compares favourably with prevailing market rates. The maximum limit on accommodation to a single firm was originally fixed at Rs. 50 lakhs, but was in December, 1952, raised to one crore. As on June 30, 1952, the loans sanctioned and loans outstanding stood at Rs. 14.05 and 7.25 crores**, respectively. The Corporation has not hitherto undertaken any underwriting business.

The Corporation is authorised to borrow up to five times the amount of its paid-up capital and reserve fund. The Corporation may also accept deposits for periods of not less than five years, but the total deposits outstanding at any time must not exceed Rs. 10 crores. The Corporation can, with the previous consent of the Government, raise loans in foreign currency from the IBRD and elsewhere. The loans granted by the Corporation in a foreign currency may be repaid by the borrowing concerns, either in the same foreign currency or in rupees.

In the debate (Dec. 1952) on the Bill to amend the Indian Finance Corporation Act, serious charges of nepotism and favour- itism were levelled against the Chairman of the Board of Directors who himself belongs to the ranks of big business. If the suggestions made by us earlier, namely that the public corporations should be entirely government-owned and should not include in their management men who belong to or have links with private business, are accepted, this defect will be largely remedied. Another criticism against the Corporation is that it has played little part in promoting new, basic industries. But the fault for this really lies with the Development Plan. When the Development Plan does not provide for the creation and expansion of such industries on any significant scale, the question of the Corporation providing finance for such expansion simply does not arise. Finally, the gap between the loans sanctioned and the loans outstanding appears to be rather excessive. This unnecessarily ties up the Corporation's resources. Should the borrowing concerns continue to be as tardy as hitherto in using the loans sanctioned, the Corporation would be justified in

*A rebate of ½ % is allowed for prompt repayment of loans.
imposing a commitment charge, as suggested by the Chairman of Board of Directors in his Speech to the 1952 Annual Conference of the Corporation.

Since the medium- and small-scale industries did not fall within the scope of the Industrial Finance Corporation (I.F.C.), several provinces and States thought of setting up such corporation of their own to finance these industries. In Madras the Industrial Investment Corporation was set up in March, 1949. Another such Corporation was set up in Surashtra in Jan. 1950. Several other Provinces, e.g. Bombay, Bihar and the U.P., were planning to do the same. To ensure the setting up of Corporation on a uniform basis, the State Financial Corporations Bill was enacted in September, 1951. It provides for the formation of Finance Corporations in the States, generally on the lines of the I.F.C. However, unlike the I.F.C., the subscription to the share capital of the State Corporations is open to the public to the extent of 25 per cent. Before the institution of the State Corporations, Government loans to industries were provided under the "State Aid to Industries" Acts. We welcome the change, but should like the constitution and working of these Corporations to be modified on the lines suggested earlier in the case of all Public Corporations.

93. Measures to ensure adequate demand are another important method of state aid to private industry. Demand may be considered adequate when the industry is able to dispose of its capacity output at prices that bring in reasonable profits. Inadequacy of demand for the output of a particular industry can be due to one or more of the following: (a) insufficient aggregate demand*, (b) excess capacity, and (c) excessive imports. The possibility of insufficient aggregate demand is ruled out by the contemplated high rate of investment. Indeed, throughout this Chapter the problem before us has been how to prevent aggregate demand becoming excessive in consequence of a high rate of investment. Excess capacity signifies that the industry is unable to dispose of its capacity output at remunerative prices, even when there are no imports and aggregate demand is adequate. Excess capacity may be rectified as

* i.e. demand for national output as a whole.
follows: The Government may, through financial or other aid, help the industry to lower costs by improving its efficiency. Prices can then be reduced without lowering profits. And at lower prices, larger output will be sold, even if the amount spent remains unchanged. But to the extent this method is not feasible, the industry may be aided to convert to some other practicable line of production where expansion of capacity is urgently required. In China, for instance, when the electric fans industry was found to have excess capacity, some of the plants were encouraged and aided to convert to the production of electric motors, of which, in view of the high rate of economic development, there was a great shortage.

94. The prevention of excessive imports raises the question of what is commonly described as "protection to Industry". In an economy where there is comprehensive planning, the economics of protection are in many significant respects different from those in a largely free market economy. The Fiscal Commission recognised this fact when they remarked that "the protection of industries should be related to an over-all plan of economic development" and that the principles recommended by them should serve as a guide to the grant of protection to industries "until such a plan has been approved". Protection in a planned economy differs from that under a largely free market economy in an important respect. The question whether or not an industry deserved protection is settled when the plan proceeds to fix the targets of output for different industries. For once the targets are fixed, the industry must be enabled to fulfil them. Imports are permissible only to the extent that there is a gap between anticipated demand for the commodity and its targeted domestic output, and it is considered desirable

* Report, p.154.*
to fill this gap*. A planned economy designed to carry through rapid economic development of India must practise quantitative control of imports, to ensure that imports of particular commodities do not prejudice the fulfilment of production targets by the respective industries, and that less essential goods are kept out to release foreign exchange resources for the import of capital goods and technical skill required for the development programme. In such an economy import quotas are, therefore, the indispensable device to limit imports of particular commodities to the permissible level, as defined above. Hence, to the extent domestic industries are to be protected through restriction of imports, a planned economy must rely on quotas. Tariff still plays an essential but a different role. The raison d'être of quota restrictions is that landed cost is lower than domestic prices. If permitted imports are allowed free of duty, the importer will appropriate the difference between the two. This could be diverted into the national exchequer by imposing an import duty equal to this difference.

95. The role of protection in a planned economy is thus different from that in a largely free market economy, in the following respects. (a) The proper time to decide, on the basis of the criteria suggested by the Planning Commission or any other accepted criteria, whether or not an industry deserves protection is when fixing the production targets in respect of it. But once the target is fixed, the industry must be enabled to fulfil its targets, if necessary through protection. (b) To the extent industries are to be protected through restricted imports (as distinguished from measures to lower costs, including

* The mere existence of the gap is not sufficient to justify imports. For instance, a gap between the domestic demand and the targeted output of motor cars may be anticipated, but still their import may not be provided for, with a view to conserving foreign exchange resources for the import of essential goods for the life or health of the community or for the development programme.** Report, pp.155-57
subsidies), reliance on quotas is indispensable. The Fiscal Commission no doubt expressed its preference for protective tariffs as against quotas. But the Commission's recommendations are, as pointed out above, for the period until a plan is put into effect. A planned economy designed to ensure a rapid rate of development has really no choice in the matter. To restrict less essential imports, it has to have quotas. When imports of particular commodities have to be restricted on this account, whether or not it is necessary to grant protection to the respective industries, protection ceases to be necessarily associated with tariffs. An industry may enjoy the highest practicable degree of protection even if imports of goods concerned are not subject to any tariffs, for the simple reason that imports are prohibited. This, for instance, is the case with the Sugar industry since 1950. In that year protection was withdrawn from this industry, but since the Government has prohibited imports of sugar, actual protection enjoyed by the industry is the maximum practicable for any protective tariffs to achieve. If quotas have to be there to keep out imports that are undesirable, because of the need to conserve foreign exchange resources for the import of goods essential for development or the life or health of the community, there is a very strong case for using them also to keep out imports that will prevent the fulfilment of production targets by domestic industries. And once quotas become the main device also to protect domestic industries, the proper role of tariffs is merely to divert into the exchequer the difference between the landed cost and the domestic prices of restricted commodities. (c) If a particular industry is found not to fulfil the expectations entertained of it in respect of quality, costs of production, increase in output, research and technological improvement, marketing practices, training facilities, use of indigenous materials, conformity to Government controls, etc., the proper method to deal with it is not to withdraw protection from it and thus bring about its extinction— for this will upset the whole development Plan— but to bring it under State management, in extreme cases, under State ownership. We welcome the power assumed by the Government under the Industries (Development and Regulation) Act of 1951, to take over the management
of scheduled private industries under certain circumstances.

96. Other measures that the Government may take to aid private industry include the following:

   (a) Creation of external economies, e.g. the development of electric power and communications;
   (b) Provision of training facilities;
   (c) Provision of State services and supplies at preferential rates;
   (d) Aid in securing technical skill, or essential materials and equipment from within the country or outside;
   (e) Industrial research by Government in matters that may help private industry and
   (f) Assistance to private industry in technical and marketing research.

It has been observed that private business men are often prevented from setting up new enterprises, not so much by lack of finance as by deficiencies in business experience and practical knowledge of technical details. The Fiscal Commission suggested that the Government can help private promoters to overcome this difficulty by organizing a bureau which will obtain such information as intending industrialists may need and bring them in touch with expert consultants, and by making available to them the good offices of Trade Commissioners and Consulates. This is another way in which the Government can help private enterprise.

97. To the extent that Government policy succeeds (in the above mentioned ways) in ensuring to the subscribers to private issues yields on their investment that, net of risk, are at par with the yields on Government bonds, it will make private issues adequately attractive to private investors. However, in devising measures to promote subscription to private issues, care should be taken that the private sector gains, not at the expense of the public sector but either at the expense of less desirable

investment, or by inducing additional savings.

**Stock Exchanges**

98. The significance of stock exchanges is that investment which is illiquid for the community remains liquid for the individual investor. For instance, for the community, the Tata Iron and Steel Works at Jamshedpur are an illiquid investment, but for the share-holders of the TISCO, their individual investment remains liquid, for they can convert it into cash by selling it on the stock exchanges. Similarly, while the proceeds of a Government loan may have been converted into a power dam—an illiquid investment for the community— to an individual subscriber the Government securities issued represent a liquid investment, as he can convert it into cash on the Stock exchange. Efficiently functioning stock exchanges, therefore, not only promote private saving, but also canalise these into very desirable channels, viz., into investment in private and public issues.

99. There are two stock exchanges in Bombay, two in Calcutta, and one each in Madras, Delhi, Ahmedabad, Cawnpore, and a few other places. In some cities, there are also unrecognised individual stock brokers. Securities dealt in on the stock exchanges include (a) listed securities of private companies, (b) Union and State Government securities, and securities of Port Trusts and Municipalities. In order that wide sections of the people be induced to subscribe to such securities, their prices should be stabilized. For most of such potential investors are necessarily inexperienced, and not experts; they will therefore, hesitate to invest if security prices are subject to sudden and wide fluctuations. The more stable the prices of securities, the greater the extent to which they are monetized (i.e. become liquid). Stability of security prices promotes investment in them, by imparting them greater liquidity. Unfortunately, since about the middle of World War II, security prices, particularly prices of industrial securities, have been subject to wide fluctuations. In recent years, there have been not only very considerable fluctuations but also a falling
general trend in the prices of industrial securities. It is commonly recognised that such wide fluctuations in security prices deter genuine investors. Stability of security prices is particularly the exceptionally wide fluctuations in the prices of industrial securities in recent years have been largely due to the domination of markets by speculators as distinguished from bona fide investors. We believe that in the conditions contemplated by us, the Stock exchange speculator, or for that matter any other type of speculator, can play no useful role. When interest rates and profits are stabilised, prices of Government bonds and industrial securities will tend to become stable. Speculators will then be able to make any profits only by manoeuvring and destabilising the market. The commonly claimed advantages of legitimate speculation, (namely, that continuity, liquidity and smoothness are thereby imparted to the market), have validity, if at all, only in an economy where interest rates and profits actually are subject to wide fluctuations. Where they are expected to be more or less stable, the main function of the Stock exchange will be merely to bring the bona fide investors together, so that the one who needs cash can conveniently sell his investment to one who has cash to spare and wants to put it in public or private securities. To prevent destabilisation of security prices by speculators, the latter should be excluded from Stock exchanges. This can be done by

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* Refer to the Indices of, and actual, Security prices given by the Annual Reports of the Reserve Bank of India on Currency and Finance.


*** A bona fide investor is one who buys shares to invest or sells shares for ready cash. A speculator, on the other hand, is one who buys in the hope of selling back at a profit, or sells in the hope of buying back at a profit.

© When the economy is freed from fluctuations in economic activity, when development in the private sector proceeds in accordance with a plan, when private enterprises are assured of honest management, when industrial relations have been put on a satisfactory level, when wide fluctuations in prices and wages have been eliminated, and when interest rates and taxes have been largely stabilised, profits earned and dividends paid by private companies can be expected to be stable.
forbidding forward trading in stocks and shares, and by converting the Stock exchanges into "spot markets" where scrips and cash are exchanged across the counter.

100. The Committee on Stock Exchange Legislation, presumably because it contemplated an economy where interest rates and profits would tend to be fairly unstable, has expressed the opinion that Stock exchange speculation is necessary to impart continuity, liquidity and smoothness to the stock market.* But since the Committee feels that these results will flow only if speculation is legitimate, i.e., 'informed and within bounds', they have made the following recommendations to check illegitimate speculation: effective regulation of Stock exchanges on an All India basis, such regulation to be both internal (i.e. by means of Stock-exchange bye-laws) and external (i.e. by the Government); extension of control to all contracts other than 'spot contracts'; recognition of one Stock exchange for a particular area and the prohibition of all controlled business except through such Exchanges; lowering of Stamp Duties to a uniform level; abolition of the distinction between listed and non-listed securities, and assumption by the Government of power to compel any company to list its securities on the Exchanges; restrictions on 'taravani' business**; ban on brokers acting as principals without the knowledge and consent of their clients; the establishment of a clearing-house for every Exchange; and the

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** Should the exclusion of 'spot contracts' be found to provide a loop-hole to evade control over speculation proper, these contracts may also be brought within the purview of control. (p.5 of the Report).
*** Taravani operator (taravaniwala) is one who never buys and sells with the object of taking or giving delivery, but does seek so invariably with the sole object of profiting by differences. His operations are always settled within the period of settlement, often on the same day or in a few days. He generally buys or sells when there is heavy buying or selling, in order to profit from the rise or fall in prices that such buying and selling may bring about. He thus accentuates rather than reverses market trend. On this account, such business needs to be restricted.
establishment of a Stock Exchange Commission. There was
difference of opinion on the subject of blank transfers*. Some
members were in favour of their continuance as at present, while
others wanted to restrict their life to six-months. We have no
comment to offer on the recommendations except to reiterate that,
in the economy of our conception, there is no room for specula-
tion, legitimate or illegitimate, expert or immature. The pro-
hibition of this 'business' will release substantial financial
resources for investment in more socially productive fields.

Insurance and Provident Funds.

101. The system of comprehensive social insurance advocated in
Chapter VI will cover only the wage-earning population. But
since, for a long time to come, the wage-earners will form the
smaller part of the population, there is ample scope for life
insurance business to cover the needs of the rest of the popu-
lation. The expansion of life insurance business will serve to
induce and mobilise the savings of the vast non-wage-earning
population, especially the middle-income groups. The role of
life insurance in inducing and mobilizing savings has been de-
scribed by an ECAFE study as follows: After a person has taken
out a life policy and has paid the insurance premia for some
time, the urge not to allow the policy to lapse is so strong that
the payment of the renewal premia in practice becomes more or
less compulsory. Thus insurance companies encourage thrift and
mobilise funds, a large part of which might not otherwise have
been saved**. In India, insurance business, though as yet only
moderately developed, accounted (together with co-operative in-
stitutions) for Rs.45 crores out of a total of Rs.377 crores of
estimated aggregate private saving in 1950-51.9 Resources

* A blank transfer means a transfer form, wherein only the
transferer's name is specified, the transferee's name
being not mentioned. The date on which the transferer
has signed the form is also almost invariably missing.

** Mobilization of Domestic Capital, op.cit.,p.56. Indeed,
premium payments are quite like time deposits with banks.
Insurance activities thus strongly resemble savings activi-
ties through banks.

9 The Plan, appdx. to Part I.
mobilized by the insurance companies can be partly canalized into the public sector by obliging such companies to hold not less than a prescribed proportion of their assets in Government securities. In India, insurance companies are under statutory obligation to invest at least 55% of their assets with the Government. They have also provided sizeable amounts to joint-stock companies, co-operative societies, etc.

TABLE 84: DISTRIBUTION OF ASSETS OF INDIAN INSURERS AS ON 31ST DEC. 1950 (Rs. Crores)

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Govt. and Semi-Govt. Securities</td>
<td>128.39</td>
</tr>
<tr>
<td>Indian Govt. Securities</td>
<td>112.74</td>
</tr>
<tr>
<td>Securities of Part B States</td>
<td>4.68</td>
</tr>
<tr>
<td>Indian Municipal, Port and Improvement Trust Securities, etc.</td>
<td>10.97</td>
</tr>
<tr>
<td>Holdings in Indian Companies, Co-operative Societies, etc.</td>
<td>55.20</td>
</tr>
<tr>
<td>Other Assets</td>
<td>65.88</td>
</tr>
<tr>
<td>Total</td>
<td>227.47</td>
</tr>
</tbody>
</table>

Source: The Indian Insurance Year Book 1951, p.205.

102. At present life insurance is confined mainly to urban areas and to a relatively small number of persons. At the end of 1950, the number of policies affected in India by the Indian insurers was 30.49 lakhs, the sums insured (including bonuses) being Rs.655.81 crores. The premium income for the year was Rs.31.59 crores. The corresponding figures for non-Indian insurers were 2.31 lakhs, Rs.106.84 crores and Rs.6.11 crores, respectively. For the purpose of promoting savings, it is necessary to extend life insurance business to cover wide sections of the people, especially the vast rural population. A very undesirable feature of life insurance business in India is the excessive number of Indian insurers. As on 7th Oct., 1951, the number of Indian insurers registered for life insurance was 127, and for life and other classes -49. The corresponding figures for non-Indian insurers were 4 and 14 respectively. Thus

* The Indian Insurance Year Book 1951, p.3.
the total number of life insurers operating in \textit{India} was 194*. This number is much too large in relation to the available business. This unduly raises the expense ratio** of the insurers in respect of life insurance business.

\begin{table}
\centering
\begin{tabular}{|l|c|c|c|c|c|}
\hline
\hline
Indian insurers & 31.2 & 30.4 & 29.0 & 29.2 & 28.9 \\
Indian insurers excluding a few of the largest among them & 37.8 & 35.1 & 32.4 & 33.3 & 32.5 \\
Non-Indian insurers & 20.2 & 20.2 & 21.1 & 22.0 & 21.8 \\
\hline
\end{tabular}
\caption{Expense Ratio of Indian Insurers 1946-50}
\end{table}

Source: \textit{The Indian Insurance Year Book 1951}, pp.7-8.

The data on expense ratio given above indicate that a smaller proportion of the savings collected through life insurance premia will be swallowed by way of expenses of management than at present, if the number of insurers is reduced through amalgamation of the smaller companies so that each company on the average handles much large business. The non-Indian insurers which on the average handle larger business per unit have very much lower expense ratio. Side by side with the reduction in the number of insurers, other measures should be taken to improve their working. Co-operative insurance societies, by issuing small policies, may prove of greater help in extending life insurance to the rural population***.

103. Provident fund schemes are another method of promoting and mobilising savings. Recently (Nov. 1, 1952) the Govt. of \textit{India} has enforced its Employees Provident Funds Scheme, finalised in Sept., 1952. The Scheme in the first instance

* Ibid., pp. 1-2. ** i.e. the ratio of total expenses of management of the insurers in respect of life insurance business to the premium income. *** \textit{ECAPE}, Mobilization of Domestic Capital, op. cit., p. 132.
covers about 16 lakh employees, working in some 1600 factories in textile, cement, iron and steel, paper, engineering and cigarette industries. In these industries all employees drawing less than Rs. 300 p.m. basic wage become eligible for the benefits of the Scheme on completion of one year's service. The employee and the employer contribute to the Provident Fund at the rate of one anna in the rupee of the basic wage plus dearness allowance. The period of service required to qualify an employee for half the employer's contribution is 5 years, and for full contribution 20 years. All the money belonging to the Provident Funds has to be deposited in the Reserve Bank or invested in the Government securities. The Final Plan has estimated that the savings mobilised by these Provident Funds will provide the Government with Rs. 36 crores for the finance of development outlay. The amount of savings annually mobilised by these provident funds will increase with an extension of the coverage of the Scheme, the increase in the number of industrial labour on account of the progress of industrialisation, and the rise in wages. The ultimate objective should be old-age pensions at the expense of the employers, whether the latter are private or public agencies. In the mean time the Provident Fund Scheme could, if large-scale evasion by the employers were avoided, provide an essential element of social security as well as help to promote and mobilize private savings.

Instalment Plan for Future Deliveries.

104. W. Zacharias** has suggested the employment (with necessary adaptations) of Mr. Kovees instalment plan for future deliveries as a means of promoting savings in the present. The Plan suggests the formation of a National Commercial Corporation to sell to the public on an instalment payment basis durable consumers' goods at fixed prices to be delivered after the expiry of a specified period. The buyer places the order now

* These periods are much too long, especially when many employ-
"ee's service discontinuous through dismissal and re-
employment after a brief period.

** Finance of Indian Planning (Vera and Co), Bombay, 1948, p.85
and pay the price in instalments spread over this period. The plan deserves consideration. It may meet with considerable success if it covers the supply of goods that may remain in short supply till economic development has made considerable success, e.g. Government-built houses, building materials, motor cars, motor and pedal cycles, sewing machines, radio sets and other electrical appliances, furniture, etc., and if in fixing the total amount payable by the buyer in instalments he is allowed at least the current rate of interest on the amount prepaid.

Consumption Financed out of Accumulated Savings

105. When a section of the community live beyond their means, i.e. spend more than their income, the savings of the rest of the community are, to the extent of dis-saving of this section, neutralized. If such dis-saving is discouraged, the country will be able to achieve a higher rate of net saving. Dis-saving is financed by either running down cash balances or taking out loans or by selling off existing assets. To discourage dis-saving each of these sources of finance should be made more difficult. It has been suggested that consumption financed by running down cash balances may be checked by blocking bank balances except for new investment or severely restricting withdrawals*. But we are sceptical of the possibility of devising a satisfactory scheme for such control. There, however, seems to be greater scope for restricting dis-saving financed in the other two ways. This may be done by restricting credit for consumption purposes and by subjecting the sale of assets, especially land and housing property, to heavy stamp duties. Various types of restrictions on the sale and mortgage of land imposed in different States were primarily designed to prevent the agriculturists from living beyond their income and thus running into debt.

Community Spare-Time Work on Capital Formation.

106. There are many items of public investment to which the citizens can contribute directly by rendering free voluntary

* C.W. Zacharias, op.cit., p.89.
labour in their spare time. These include construction of roads, schools, recreation centres, irrigation works, etc., afforestation and soil conservation, and so forth. The saving in public outlay made in consequence of the citizens rendering such free labour means this much addition to aggregate saving, for the same amount can now be spent on financing other public investment. It is on this account that the Plan repeatedly emphasises the importance of community spare-time work on capital formation. It allocates Rs. 15 crores to assist local works to which the people themselves contribute in labour and otherwise. The avowed main object of the Community Projects for which the Plan provides Rs. 90 crores is 'to mobilise local man-power for a concerted and co-ordinated effort to raise the whole level of rural life'**. In a country with an adult population approaching 200 million, an impressive amount of saving can no doubt be made if most citizens devote a portion of their leisure. But the two essential requirements for this are a very popular political regime and a plan of national development which catches the imagination of the people. Given these two conditions, it should not be difficult to mobilise millions of people for such labour. The poor response of the people to the Bharat Sewak Samaj - the organisation formed by the Government to promote free, voluntary labour on national construction work - is mainly due to the fact that at present none of the above-mentioned conditions are satisfied in adequate measure.

III. CANALIZATION OF SAVINGS

107. Planned development requires that the flow of investment into different channels and the availability of credit for different purposes must conform to the requirements of the development programme. The distribution of investible financial resources among the different sectors of the economy

* The Plan, Introduction, Para. 9 ** Ibid., Ch. IV, Para.15
should be in strict accordance with the production plan, and 'should reflect in accurate financial terms the diversion of physical resources to them'. The succeeding paragraphs consider the measures required to ensure due accord between the production plan and the financial plan.

The Capital Budget

108. The capital budget determines the allocation of investible funds available to the Government. In an economy, where public saving forms a high proportion of total saving and where a substantial proportion of private savings are loaned to the Government, the capital budget is a powerful instrument for the canalization of savings. As brought out below, even in the year immediately preceding the launching of the First Five-Year Plan, i.e. 1950-51, not only was a substantial proportion of total national saving accounted for by public saving, but also an important proportion of aggregate private saving was loaned to the public sector and hence directed into investment through the capital budget of the Government.

<table>
<thead>
<tr>
<th>TABLE 66: DOMESTIC INVESTMENT IN THE PRIVATE AND THE PUBLIC SECTOR IN 1950-51</th>
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<tbody>
<tr>
<td>Source of Investible Resources</td>
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<tr>
<td>-------------------------------</td>
</tr>
<tr>
<td>(a) Savings within the Sector</td>
</tr>
<tr>
<td>(b) Net Inter-Sector Transfers</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: Data provided in Appdx. to Part I of the Plan.

Under the Plan of development suggested in this study, public saving will form a growing proportion of aggregate national saving and a high proportion of private saving will be loaned to the public sector. There will accordingly be a steady growth in the importance of the capital budget of the
Government as an instrument for the canalization of the nation's savings.

Control of Credit and Investment Policies of Institutional Investors

109. To canalize savings it is also necessary to influence and control the credit and investment policies of institutional investors. The following are some of the measures that may be taken to this end:

(a) Measures adopted by the Government to encourage private equity investments in the preferred fields will, by making the investors better risks for potential lenders, induce increased flow of credit to such fields.

(b) The Government may induce banks and other credit and financial institutions to grant loans to, or make investments in, particular lines of business by guaranteeing such investments.

(c) Selected re-discounting may also be adopted for the purpose. Under this method, preferred investments by banks and other financial institutions are granted a more favourable re-discount rate by central banks or their equivalents, while paper arising out of lending by such institutions for purpose inconsistent with the development plan may either altogether be refused re-discounting facilities, or may be provided these facilities only at a penal rate. In Mexico, for instance, in 1945, the re-discount rate for loans made for agricultural purposes was reduced to 3% while the rate on commercial loans was maintained at 8%. More recently, the Reserve Bank of India has started providing accommodation to the State Co-operative Banks for financing seasonal agricultural operations and marketing of crops at 1½%, while the Bank Rate i.e., at which, as a rule, re-discounts first-class eligible paper is 3½%. This method of qualitative control

* UN, Domestic Financing of Economic Development, 1950, p.54
of credit has, however, certain limitations. (1) It may be effectively applied only when the banks and other financial institutions are short of funds and, being unable to replenish from any other source on reasonable terms, are compelled to re-discount with the Central Bank. It is unlikely to meet with much success under liquid conditions. (2) It is not always possible for the banks to ensure that the funds will in fact be used for the purpose for which they were loaned. (3) The method may be more effective in its negative aspect, that is, for restricting supply of credit for undesirable purposes, than in its positive aspect, "that is, for promoting the supply of credit for desirable purposes".

(d) Credit rationing may be instituted, i.e. a ceiling may be placed on the supply of credit to particular enterprises and to particular sectors and sub-sectors of the economy. Credit allotments may be made on the basis of the production plan by a specialised body under the Planning Commission. The further distribution of this quota among firms may be left to Boards, one for each major industry, comprised of the representatives of Industry, the Reserve Bank, other Banks and financial institutions, and the Planning Commission. This method, too, is subject to limitations similar to those mentioned above in the case of selective re-discounting. (1) It may not always be easy in a mixed economy to control the ultimate use of credit. (2) A ceiling on credit may ensure that a particular industry or firm shall not borrow more than a given amount of short-term funds, but it cannot ensure that it will in fact borrow this much amount.

(e) The Government may directly or through the agency of the Central Bank regulate the composition of the assets of banking companies and other financial institutions, determine what securities will be eligible for investment by them, lay down the purpose for which advances may or may not be made, and so on.\* (Ibid., pp. 5-6.)
not be made, and fix different rates of interest for funds supplied to various types of economic activities - the differentials to be based on the priorities for development accepted by the Plan. In India, Section 21 of the Banking Companies Act of 1949 authorises the Reserve Bank of India to give directions to the banking companies as to the purposes for which advances may or may not be made. There is also statutory regulation of the investments of the Insurance Companies and the newly constituted Provident Funds for the industrial workers. Of course, the scope for the statutory regulation of credit and investment policies of institutional investors is limited by the need to ensure the latter's liquidity and solvency. To enlarge the scope for such control, the number of banks should be reduced through amalgamation and extension of branch banking, and the non-scheduled banks should be amalgamated to form scheduled banks. The disappearance of the private, non-institutional moneylender will also have the same effect.

Control of Capital Issues

110. Control of capital issues is another device for the desired canalization of savings. In India such control was first instituted in May, 1943 to help in the checking of inflation and to prevent investible funds and scarce materials and services, from being utilized for purposes which did not contribute to War effort or to any other purpose considered beneficial to the public. In the post-War period, it was retained with a view to securing a balanced investment of the country's resources in industry, agriculture and social services*. The Fiscal Commission recommended that control of capital issues in its existing form should be abolished. The Commission pointed out three main defects in it. (1) There was 'no clear-cut enunciation, in a positive way, of the principles that should be followed in consenting to, or withholding, sanction to capital issues, except in the case of food production

and house-building, where consent is readily given'. (2) There was 'no machinery for following up the sanctions, and no obligation on the part of the applicants to keep the control authorities informed of actual investments'. (3) The control 'operated only in a negative way, preventing direction of funds to certain undesirable purposes but it cannot ensure that they are diverted to more useful channels of investment'. We may, however, point out that the control of capital issues is indispensable for a planned mixed economy. The first two defects noted by the Fiscal Commission are remediable and should be removed. The Plan hopes that now that it has provided a scheme of priorities and a set of programmes, it should be possible to operate this control with a clearer perspective. The third defect is inherent in the very nature of this device. But that does not mean that it is of no use. Appropriate canalization of savings requires that steps should be taken both to prevent direction of funds to undesirable fields, and to encourage their flow into preferred channels. The control of capital issues is an indispensable weapon to achieve the first object. So it should form an essential component of an integrated group of measures designed to ensure the desired direction of investment.

Industrial Licensing

111. The flow of funds into undesirable investment in fixed capital may also be prevented through a system of licensing of new construction. The Industrial (Development and Regulation) Act of 1951 empowers the Government to license the establishment of new industrial units as well as substantial additions to existing ones. The Government should also acquire similar powers in respect of major construction in other fields.

Control on Disposal of Corporate Undistributed Profits

112. Since corporate undistributed profits form a significant proportion of the total flow of savings in this country**, it

* The Plan, Ch. 29, Para. 32. ** Vide Para. 73 supra.
is necessary to control their disposal, in order to ensure the appropriate canalization of savings. In India, the Government does not have this power at present. The Plan, however, hopes that licensing of industrial construction will make it possible to control the investment of corporate savings. It is sometimes objected that the assumption by the Government of this power will discourage corporate saving. But, as pointed out in Para. 73 supra this fear need not be exaggerated. Control of disposal of corporate savings need deter saving no more than does the control of capital issues. Control of the disposal of corporate savings is essential for the appropriate canalization of aggregate saving.

Government Encouragement of Private Investment in the Preferred Fields.

113. The methods of influencing the direction of private investment discussed hitherto are likely to be more effective for preventing the flow of funds into desirable channels than for stimulating the flow of funds into the proposed fields. To achieve the latter objective, it may be necessary to supplement them by positive Government measures to encourage private investment in the desired fields. Some of these measures are suggested below:

(a) To dispel uncertainty, the Government should clearly and definitely indicate to private enterprise the fields where it will be welcome, and should guarantee that there will be no sudden and arbitrary changes in policy on this point. Of course, there should be proper co-ordination between the private and the public sector.

(b) Private enterprise in the preferred fields should be provided with financial, fiscal and technical aid. The financial aid may be provided, as discussed earlier in this Chapter, in the form of grants, loans and participation in capital. The preferential fiscal treatment may take the form of exemption from taxation or lower

The Plan, Ch. 29, Para. 32.
taxation of new industrial undertakings in the preferred fields for a specified period, exemption from duty or lower import duties on plant, machinery and raw materials needed by the preferred industries, advance assurance of protection - the appropriate methods and forms of protection and the degree of protection to be determined by the Tariff Commission -, and liberal depreciation and obsolescence allowances in the computation of the income assessable to income-tax. The two chief limitations of fiscal method of promoting private investment in the preferred fields are that it is likely to make the fiscal system more complicated, and that it is detrimental to revenues. Provision of state services and supplies at preferential rates, aid in securing technical skill or essential materials and equipment from within the country or outside, industrial research by Government in matters concerning the industry or assistance in technical and marketing research, free supply of services of expert consultants, priority in the allocation of scarce supplies and services, Government of purchase of output at remunerative prices, and facilities to dispose of output abroad are some of the other possible measures to encourage preferred industries and thus to stimulate investment in them.

Creation of Appropriate Financial Institutions

114. In order to make savings available for desired investments, appropriate financial institutions should be created. For instance, to provide financial assistance to small producers whose credit needs are not likely to be met by ordinary commercial banks, specialised institutions or cooperative credit organizations of these producers may be created. Again, since commercial banks normally confine themselves to short-term loans, mostly to Trade and Industry, the medium-term and long-term financial requirements of even large-scale industry have to be met through creating specialised financial institutions. It is this consideration
that justifies the establishment of the Industrial Finance Corporation and the various State Finance Corporations. The creation of such specialized financial institutions can serve as an important instrument for the positive direction of savings into the preferred fields.

** ** **

115. The present Chapter is concerned with measures for the promotion and canalisation of savings. These measures seek to ensure that the bifurcation of the flow of money income into money consumption and money saving shall correspond to the division of physical resources between the output of consumption goods and services and of investment goods, and that the direction of money savings shall accord with the disposal under the production plan of real investible resources. This Chapter thus shows how a production plan designed to promote rapid economic development of India may be matched by a financial plan that will serve the same purpose.

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