CHAPTER XI.

An appraisal of the Indian Monetary Policy.

The Reserve Bank of India claims that, as a result of the revision of the monetary policy in November, 1951, there has been a distinct improvement in the general economic condition of our country. It claims also that, at present, the banking situation recorded an improvement as compared to the post-korean phase as the seasonal variations in the bank credit and the money supply generally conform to the traditional pattern. According to the Reserve Bank of India, "the lower volume of bank credit - the result of a relatively moderate expansion of credit in the busy season of 1951-52, a greater contraction in the slack season of 1952 and a moderate increase in the busy season of 1952-53 - has eased the strain on the system". "A normal relationship between the level of bank credit and that of economic activity appeared to have been reached in 1953 showing the continued success of the economic and financial policies pursued during recent years". Its claim gathered greater strength due to the fact that by exerting anti-inflationary measures, the Reserve Bank was able to contract the money supply and the volume of bank credit which helped it to prevent further threat of inflation. In the opinion of the Bank, it seems, an overall economic stability was attained.

1. Trend and Progress of Banking in India, 1952 P. 22
2. Trend and Progress of Banking in India, 1953 P. 6
In order to assess whether India achieved an overall economic stability after the adoption of anti-inflationary monetary policy in the middle of November 1951, it should be desirable to consider the problem in the context of economic situations of other countries of the world.

Series of fresh difficulties and problems, such as, higher prices accompanied by the expansion of money-supply and of credit, the disequilibrium in the balance of payments causing instability in exchange-rates and the reduction of civilian goods and services due to increased rearmament expenditure following the outbreak of the Korean War were brought into control in many countries of the continent and the United States. From the second quarter of 1951 onwards, a high degree of overall stability was achieved which will be noticed from the following facts.

Stability in World-prices.

The rising trend in World-market prices was reversed and in almost every country it proved possible to arrest the previous inflationary rise in wholesale prices and the cost of living. The progress towards moderate fluctuations in world prices, noticed since the second quarter of 1951 continued in 1952 and 1953 in several countries.

From the following table which shows the changes in the wholesale prices and the cost of living in number of countries, it will be clear that a greater degree of price-stability was attained in 1952 and 1953.
Percentage changes in wholesale-prices and the cost of living.¹

(* = increase, - = decrease)

<table>
<thead>
<tr>
<th>Countries</th>
<th>Wholesale prices</th>
<th>Cost of living</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>+38 -6 -1</td>
<td>+30 -1 -5</td>
</tr>
<tr>
<td>Belgium</td>
<td>+9 -10 -4</td>
<td>+10 -1 +0</td>
</tr>
<tr>
<td>Denmark</td>
<td>+17 -8 -5</td>
<td>+7 +2 -1</td>
</tr>
<tr>
<td>France</td>
<td>+26 -7 -2</td>
<td>+22 +2 -2</td>
</tr>
<tr>
<td>Western Germany</td>
<td>+14 -2 -4</td>
<td>+11 -2 -2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>+13 -4 -4</td>
<td>+5 +1 0</td>
</tr>
<tr>
<td>Norway</td>
<td>+17 +4 -2</td>
<td>+14 +6 +2</td>
</tr>
<tr>
<td>Spain</td>
<td>+11 +2 +5</td>
<td>+3 +2 +1</td>
</tr>
<tr>
<td>Sweden</td>
<td>+26 -4 -3</td>
<td>+6 0 -1</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>+13 -1 -1</td>
<td>+12 +7 +1</td>
</tr>
<tr>
<td>Australia</td>
<td>+24 +9 -1</td>
<td>+24 +10 +4</td>
</tr>
<tr>
<td>Canada</td>
<td>+6 -7 -1</td>
<td>+11 -2 0</td>
</tr>
<tr>
<td>Japan</td>
<td>+25 -4 +5</td>
<td>+18 +4 +18</td>
</tr>
<tr>
<td>South Africa</td>
<td>+20 +6 -1</td>
<td>+9 +6 +1</td>
</tr>
<tr>
<td>United States</td>
<td>+1 -3 +0</td>
<td>+6 +1 +1</td>
</tr>
</tbody>
</table>

¹. The 24th Annual Report, 1953-54, B.I.S. P.4
In regard to the price situations in individual countries, the declines in the general price level ranged up to 5 p.c. in the U.K., Germany, Greece, Italy, Netherlands, Sweden and Switzerland and they were limited to between 5 and 10 per cent in Belgium, Denmark, France and Canada. In contrast to these, the rise in prices persisted in Australia, South Africa, New Zealand, Norway, Portugal and Spain in 1952; but the extent of the rise was generally less marked relative to 1951.

The extent of the decline in a majority of countries was less noticeable in 1953 as compared with the previous year. In the U.S.A. and the U.K., the wholesale-price-index recorded hardly any net change during the year. In other countries, such as, Belgium, Denmark, France, Western Germany, Netherlands, Norway, Switzerland Australia, Canada and South Africa, the declines in prices were mostly limited to about 5 per cent. In contrast to their general declining tendency, in some countries, such as, Spain, Turkey and Japan, the moderate rising trend in the general price-level noticed in 1952 continued also in 1953.

The cost of living showed a moderate upward trend during 1952 as compared with a sharp rise in 1951 in most countries and in the closing months of the year, a remarkable degree of stability was attained in the U.S.A. and the U.K. In some countries, namely, Canada, Spain, Austria, Belgium and Western Germany, there was a moderate decline in cost of living indices. Besides these countries, in 1953, living costs showed a further decline in many other countries, such as Denmark, France, Sweden and Switzerland.
The progress towards a gradual downward trend in world prices in recent years was due to the following reasons: (1) the improvement in supply position which greatly facilitated the removal or relaxation of domestic and international controls in a number of commodities; (ii) slackening of demand which resulted in the relaxation in stock piling activity; (iii) "Flexible credit policies after the maintenance, for many years, of an artificially rigid interest rate structure and the application of import restrictions by countries whose balance of payments deficits had become so large as to impose a great strain on their monetary reserves"; (iv) new trends in commodity policy in 1952-53 which resulted in the abolition of controls over a wide range of consumer and other goods in a number of countries. The abolition of controls was not followed by any substantial rise in prices. As far as price movements are concerned, they reflected a high degree of stability which created a sense of security and a greater peace of mind among the public.

Notwithstanding some similarity in the downward trends in prices in India and abroad after the post-Korean boom, the decline was more in India than in many foreign countries. The Economic Adviser's general index moved down from 437.5 (base 1929-1930) to 430.3 in January 1952 after which it declined sharply to 364.9 by the middle of March 1952. The decline in prices between April 1951 and March 1952 was 18 per cent in India as against a moderate fall of up to 5 per cent in the United Kingdom, the U.S.A., Germany, Greece, Sweden and Netherlands, and between 5 and 10 per cent in other countries, such as Denmark, Belgium, France and Canada etc.

Statement - 12, P.118
The operations of the international factors such as modifications in the U.S.A. stock-piling-programme and korean truce proposal on the one hand, and the disinflationary measures, both fiscal and monetary, which included adjustments in government trade policy, the continuance of the enhancement of export duties on certain commodities creating a surplus on revenue account, the raising of the bankrate and the suspension of purchase of securities in the open market by the Reserve Bank of India from the middle of November 1951, on the other hand led to a sharp decline in prices. In the circumstances the Government had to adopt in May 1952, several anti-disinflationary measures to arrest further fall. These measures included lifting of quota and destination restrictions on a variety of exports, and abolition or reduction in export duties (which in the past had been raised steeply as an anti-inflationary measures), on certain commodities, such as raw cotton, raw wool, groundnut oil and other kinds of oilseeds. These measures, together with advances by the Reserve Bank against Government securities and Usance bills checked the price-fall in India. From July 1952 there was rise in prices and this will be evident from the table given below.
From the above figures, it becomes distinctly clear that the general index of wholesale prices showed a rise of 8.5 per cent between March 1952 and March 1953. By August, it rose to 410.4, i.e., by 25 per cent in five months. Since December, 1952, a feature to be noted was the sharp rise in the prices of industrial raw materials and of food articles. In the period January to June, 1953, the index of raw material prices rose by over 12 per cent and the index of food articles by nearly 17 per cent.

Notwithstanding the fact that prices began to decline from September 1953, as evident from the figures given above, the general index of wholesale prices rose by 8.8 per cent between March 1953 and March 1954. The declining trend of prices witnessed during the period between September, 1953 and December, 1954, was influenced by factors of a non-monetary character like the improved supply position, particularly of essential commodities, decision to import sugar, restrictions on export of groundnut oil, liberalisation of import duties of coconut oil and copra, reduction in import duties on palm oil, copra, sugar, fees-sale of food grains and reduction in the price of imported wheat by one rupee per mouzd in July, 1953 and by another rupee in November, 1953. Again, within four months from January to April in 1954, the general index of wholesale prices rose by 4.1 per cent from 398.5 to 402.6.

Despite the fact that prices declined immediately after the revision of the monetary policy of the Reserve Bank of India in November, 1953, upward trend in prices from middle of 1952 clearly indicated that the revised monetary policy had little influence in determining the price trends. Because, prices moved up from June 1952 to August, 1953 in spite of the contraction of money supply with the public to the extent of Rs.167 crores during the period from 1951-52 to 1953-54.

The all-India average working class cost of living moved up by 9 per cent from 135 to 144 between March, 1952 and March, 1953. In Bombay city it rose from 298 to 341, i.e. by 44 per cent. In August the all-India average working class cost of living rose to 153 while

1. Report on currency and Finance, 1953-54
Reserve Bank of India, p.28.
in Bombay, it went up to 356%.

Improvement in the balance of payments position.

In contrast to the period after the outbreak of hostilities in Korea, from 1952 onwards, steady prices were associated with the improvement in the world payments position as also a much greater freedom from inflationary pressures than in earlier years.

The balance of payments position which greatly deteriorated as a result of the series of events, following the Korean War, showed an improvement in the course of 1952 and a still greater improvement in 1953. This improvement was in a large measure the result of the return to a restrictive monetary policy combined with adequate fiscal measures. Because, the main purpose of monetary policy is to keep domestic demand within proper limits and, in particular, in countries with balance of payments deficits, to limit in such way as to contributed to an improvement in the balance of payments. In many countries where mere monetary measures proved inadequate, both monetary and fiscal measures were used simultaneously for the improvement of the balance of payments position.

The most significant improvement in the world-payments-position in 1952 was the balance of payments of the rest of the world with the United States, excluding military aid, the U.S. surplus with all countries on account of goods and services, private donations and capital movements in 1952, was about half of what it had been in 1951. As a result of this, one of the most encouraging developments in 1952 was the increase of about 1.5 million dollars in the gold and dollar holdings of other countries outside the United States.

The following figures will show the increase in the gold and dollar reserves of countries outside the United States in 1952.

<table>
<thead>
<tr>
<th></th>
<th>1951</th>
<th>1952</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>1953</th>
</tr>
</thead>
<tbody>
<tr>
<td>western Europe excluding U.K.</td>
<td>291</td>
<td>1255</td>
<td>133</td>
<td>403</td>
<td>557</td>
<td>161</td>
<td>205</td>
</tr>
<tr>
<td>sterling area</td>
<td>-685</td>
<td>-494</td>
<td>-577</td>
<td>-62</td>
<td>39</td>
<td>102</td>
<td>342</td>
</tr>
<tr>
<td>Canada</td>
<td>169</td>
<td>305</td>
<td>57</td>
<td>182</td>
<td>41</td>
<td>0</td>
<td>-53</td>
</tr>
<tr>
<td>Latin America</td>
<td>-95</td>
<td>4</td>
<td>5</td>
<td>65</td>
<td>37</td>
<td>11</td>
<td>163</td>
</tr>
<tr>
<td>All other total</td>
<td>398</td>
<td>140</td>
<td>137</td>
<td>42</td>
<td>-3</td>
<td>-32</td>
<td>129</td>
</tr>
</tbody>
</table>

It becomes clear from the above figures that the holdings of the Western European Countries (excluding the United Kingdom) and the sterling area were the maximum, the amount being about $3.6 billion and $3.6 billion respectively by the end of March, 1953. The increases were particularly large in the Netherlands and Germany. Gold reserves of the United States, on the other hand, began to decline slowly and fell from $23.5 billion in June 1952 to $22.6 billions by April 1953.

The declining trend both in the volume and value of world trade noticed in 1952 was reversed in 1953 and in the last three quarters of that year their rate exceeded that of 1952. There was further improvement in the last quarter.

1. Ibid P.6
2. Ibid P.6
ment in the balance of payments position in 1953. If economic aid of the United States is left out of account, the dollar receipts of countries outside the United States exceeded their payments. The sterling area and several countries in Western Europe achieved an overall surplus as well as a surplus with the dollar area. But in several countries in Latin America and in Asia, balance of payments difficulties persisted. Many raw material-producing countries experienced payments difficulties in 1953 due to the decline of their export prices, which had started in 1952 on account of the onset of recession in the United States. Again, in some primary producing countries payments difficulties were occasioned and intensified by the continuance of inflationary pressures, which in some countries led to a curtailment of development programmes.

The general record of improvement in the international payments situation was marked by an increase of gold and dollar reserves outside the United States and by a stronger free market quotations for certain convertible currencies. Rise of gold and dollars in almost every country outside the United States in 1953 and up to March 1954 will be evident from the following figures.
Continental O.E.E.C. countries

<table>
<thead>
<tr>
<th></th>
<th>1953</th>
<th>1954</th>
</tr>
</thead>
<tbody>
<tr>
<td>June</td>
<td>Dec.</td>
<td>March</td>
</tr>
<tr>
<td>5.5</td>
<td>6.1</td>
<td>6.6</td>
</tr>
<tr>
<td>6.6</td>
<td>7.7</td>
<td>7.9</td>
</tr>
</tbody>
</table>

United Kingdom

| 1.7       | 1.8  | 2.4  | 2.5  | 2.7  |

Other Sterling Area excluding colonies

| 0.7       | 0.8  | 0.8  | 0.8  |

Canada

| 1.8       | 1.9  | 1.8  | 1.8  | 1.8  |

Latin America

| 2.6       | 2.7  | 3.0  | 2.9  | 3.0  |

All others

| 2.3       | 2.1  | 2.1  | 2.2  | 1.9  |

Total:

| 14.6      | 15.4 | 16.7 | 17.9 | 18.1 |

Of the total increase, more than nine tenths accrued to Continental Europe and to the Sterling area.

In continental European countries, reserves rose steadily throughout 1953 and in other regions the rate of increase was considerably slow.

The balance of payments position of continental European countries improved not only with the United States but also with the rest of the non-European World. Except France and Italy, other countries in Continental Western Europe, such as, Western Germany, the Netherlands, Austria, achieved a large surplus due to their improving competitive position which made possible a substantial expansion of exports, lower export prices, import restrictions and disinflationary policy.

The sterling-area which had a deficit amounting to £200 million with the rest of the world in the first half of 1952, achieved substantial surpluses in the next two and half years. The improvement is to be accounted for by "the delayed effect on imports of the heavy slump in export earnings in the second half of 1951, reinforced by intensified import restrictions and disinflationary domestic financial policies." 1

Despite the fact that the Current Account deficit in the balance of payments position in 1952 was less than that of the previous year by 20 per cent due to favourable invisible trades and donations, balance of trade, in India, showed a further deficit of Rs.133.9 crores as against Rs.133 crores in 1951. 2 Again, despite the lowering of export duties and relaxing of export controls, the volume of exports declined by some 10 per cent as compared to the previous year. The terms of trade deteriorated by about 24 per cent in 1952. Although India's balance of payments during 1953 recorded a surplus of Rs.59 crores on current account, trade balance showed a deficit of Rs.33 crores: 3 There was also a further deterioration in the terms of trade. Some interesting facts were revealed by the Reserve Bank of India Bulletin of July, 1953.

In the first quarter of 1953 total imports of all groups of commodities registered a fall of about 62 per cent in quantity, while the fall in prices was only about 16 per cent when compared to imports in the first quarter of the previous year. At the same time, India's exports indicated a reversal trend. The quantity of exports of raw materials rose by 23 points (from 56 to 79), while prices fell by 28 points (from 143 to 115). As for manufactures, their exports registered

1. Ibid. P.37
a rise of one point only while prices recorded a fall of 77 points.
This means that India had to export much more in value for receiving
goods, much less in volume compared to the previous period. This also
meant that India made more payments to foreign countries than it receiv-
ed.

In the beginning of the First Five-Year-Plan, it was anticipated
that there would be a large deficit in India's balance of payments.
But it did not materialise to the extent it had been originally
anticipated. In 1955, the balance of payments on current account showed
a surplus of about 35 crores as compared with a deficit of Rs.4 crores
in the previous year.
Agricultural and industrial production in India.

Although industrial production in general for 1952 rose by 10 per cent to a post-war record level of 128.9, some industries, such as Sulphur, steel, sulphuric acid, machine tools etc. showed decline in output. In the agricultural sector, although increases in production were mainly noticed in respect of jute, cotton and sugar, production of food grains and oilseeds showed decline. Owing to the fall in demand, tea gardens, cotton and jute mills in 1952 were reported to have accumulated large stocks. Excessive stock accumulation was also reported in the automobile, aluminium, diesel engines and machine-tools industries. The hand-loom and cottage industries also passed through a difficult period. The general trade outlook was not at all encouraging.

During 1953-54, which was the third year of the Five-Year Plan, there was an improvement in the food situation as food production in the country increased by 11.4 million tons. But the Progress Report of the five-year Plan itself ascribed at least half of the increase to "good weather of 1953" which was a most uncertain factor. Further it was admitted that part of the increase in figures was due to better "statistical Coverage" - the production of 29 million acres being left out of calculation in the earlier estimates.

The production of jute and sugar (raw) recorded a decline in 1952-53 and 1953-54. The production of sugar declined from 6.1 million tons in 1951-52 to 5.3 million tons in 1952-53 and it showed further decline in 1953-54.

2. Ibid
In the industrial sector, the index of production rose in 1953-54 to 136.3 as against 118.2 in 1951 and 123.9 in 1952. Nevertheless production declined in some important major industries like sugar, jute manufactures, coal and iron and steel. The decline in production of coal and iron and steel industries was most serious from a point of national development. Again in some industries, such as machine tools and paper, production remained at almost the same level as in 1952.2 The production of textiles which reached 4906 million yards in 1953-54 exceeded the target laid down in the plan and was much higher than the years immediately preceding the plan. Here the fact must be remembered that 1946 which was taken as the base-year was marked by low production. But even in 1944, production had already reached 4862 million yards.3

According to the Progress Report of the five-year-Plan, despite the general rise, production in most industries was still much below capacity, due in most cases, to lack of demand at current prices in the domestic and external markets. Fall in export demand was in certain instances checked by appropriate revision of export duties.4

The Report remained silent about what had been done to overcome the lack of demand in the internal market and about why "current-prices" were allowed to remain high. Increase in industrial and agricultural production which should improve the economic condition of the common people and increase their purchasing power, did not lead to the expansion of the market. Therefore, the remedy for the disease of poverty

1. Ibid, P.151
3. Ibid, P.22
in the midst of plenty was sought by the Government by "appropriate revision of export duties."

Paradoxically enough, increase in production was not accompanied by increase in employment. Contrary to the hope expressed in the Five-Year Plan that 52,54000 persons would be provided with jobs during the plan period, there has been an alarming and continuous increase in the figures for unemployment. The number of the unemployed on the registers in employment exchanges increased from 228,971 in 1950, a pre-plan year to 589,000 in July, 1954; the number of persons on the registers at the various employment exchanges rose from 6.1 lakhs at the beginning of the year 1955 to 6.92 lakhs at the end of the year. As a large majority of the people did not at all register at these exchanges, the actual figures of unemployment would be much more. The worst of it is that many who had been working for a long time, were retrenched recently from their jobs. The Progress Report of the five-year-plan admits that "new jobs are not being created at a rate fast enough to absorb the additions to the labour force of about 1.5 million per year."2

The paradox of the situation till September, 1953, was that, while industrial production in general had been increasing and while the volume of currency issued by the Reserve Bank of India had not increased unemployment was increasing and prices did not come down but, actually increased. Dr. John Mathai pointed out this paradox in a speech in the last week of August, 1953, before the Commerce Graduates Association in Bombay.

2. Ibid P.288.
"No period since the end of the war has presented economic trends so difficult to determine and to interpret as the past twelve months. Although the level of purchasing power and consequently, the demand for goods is lower, and although industrial and agricultural production has not merely been maintained but has increased, the price movement is showing an uptrend. Rise in prices and increased production would presume better employment but instead unemployment is increasing."

Financial Policy of the First Five-Year Plan.

It was estimated that investment in the country's entire economy was to be between Rs.3500 crores and Rs.3600 crores in five years covered by the first five-year-plan in the public and private sectors the latter including agriculture, large-scale and small-scale industries, trade, banking, housing, construction etc. This works out at Rs.700 to 720 crores a year. But this figure was never reached in any year. In the state sector, in three years ending March, 1954, investment was Rs.885 crores, 40 per cent of the five years' revised total estimate of Rs.2249 crores. Investment in the private industrial sector was Rs.36 crores in three years, i.e. 41 per cent of Rs.233 crores. Figures of investment with regard to all the other items in the private sector are not available. Still, in view of the decline in cottage industries and the conditions of the peasantry, this investment must have been far less than in the public sector and the private industrial sector.

2. Ibid P.164
As against the revised total estimate of Rs. 2,240 crores of expenditure on the Plan over five years, the expenditure to be incurred in 1954-55 and 1955-56, worked out at Rs. 1,364 crores after deducting Rs. 385 crores already spent over the first three years. It was highly questionable whether the programme of development expenditure would materialise to the extent of Rs. 1,364 crores in two years as the progress was relatively slow in the first three years of the Plan.

In the first three years of the Plan, the rate of development expenditure was 253.5 crores, 2369.7 and 353.6 crores respectively.

In the third year 1953-54, much greater hopes had been shown by the Finance Minister when provision for Rs. 413 crores was made in the budget for development expenditure. But the expenditure showed a shortfall of about Rs. 59 crores.

It was expected that, for the purpose of expenditure on the plan, in the first three years, Rs. 1268 crores would be available from normal budgetary resources representing savings from current revenues, surpluses of Government-owned enterprises, loans, small savings and miscellaneous capital receipts. But the amount available from budgetary resources for the centre and the states in three years being Rs. 535 crores, was much below expectation. In other words, so far a little over 60 per cent of the total expenditure was financed from the normal budgetary resources.

The fall in the resources was due to the reduction in savings from current revenues and the surplus from railways and the borrowing of the government from the public were much below expectation. For

1. Ibid P. 10  2. Ibid - P. 10  3. Ibid - P. 15
instance, savings that became available in 1951-54 from current revenues for the centre and the states together amounted to Rs.321 crores against the three years' estimated total of Rs.535 crores. The surplus available from railways was rupees 75 crores against estimated amount of Rs.125 crores. The net borrowing in the three years was Rs.35 crores which represented a lower annual rate than was assumed originally for the plan-period.

As the total development expenditure of Rs.885 crores incurred on the plan, during 1951-54, could not be met from normal budgetary resources, Rs.218.1 crores, that is, a little under 25 per cent of the total expenditure was raised for financing the plan through deficit financing, i.e., drawing down of cash balances, sales of securities held in reserve and short-term borrowing after allowing the balance (about 15 per cent of the total expenditure) being financed from external sources.

For 1954-55, the budgets of the Central and State Government provided for substantially larger development expenditure than in the preceding years, the total of Plan expenditure proposed being Rs.572 crores, that is, as much as Rs.216 crores over the level of expenditure indicated by the revised estimates for 1953-54. For financing the proposed development expenditure in 1954-55, according to the Budget estimate, it was expected that the extent of deficit financing that would be needed, might be about Rs.233 crores. But revised estimates stood lower at Rs.202 crores and the final figures were still lower.
The budget for 1955-56 provided for larger outlays than those in 1954-55. Therefore provision was made in 1955-56 for a larger dose of deficit financing to the extent of Rs.318 crores. Relatively slow progress of investment on the Plan during the first four years shows that there were very definite limitations of investments increasing in the public sector and those became visible only two years after the original estimates had been made. In 1955-56, the extent of deficit financing reached Rs.222 crores. Thus total expenditure increased in the public sector was much below the amount estimated to be incurred in five years.

Some of the obstacles for the shortfall in expenditure were due to the technical and administrative drawbacks. According to the Planning Commission, "to some extent the late finalisation of the plan accounts for the lower expenditure in its initial years." Delay in the implementation of some schemes and administrative drawbacks in projects were some of the factors responsible for the shortfall. In any case, the Five-Year Plan was itself conservative its financial policy during its initial stages, because it synchronised with the period of the post-korean inflation and low production. But a sense of optimism was felt even by the middle of 1953, as a result of the realisation of some of the "physical targets" in different economic sectors. For instance, shortage of foodgrains which had presented formidable difficulties in 1950-51, was solved and industrial production also rose over 30 per cent by the end of 1953-54.

These developments clearly point out that some targets of the Plan were largely realised midway through the Plan and that progress could be accelerated before the economy was conditioned for the Second Five-Year Plan. These developments were not without their defects. There were also other developments in 1953 which compelled a reorientation of policies. The low tempo of the Plan and the bearish tendencies due to change from a sellers' to a buyers' market reacted adversely on employment. The increase of unemployment which was long debated in the Parliament in the second-half of 1953 had, it seemed, decided that the motto, thereafter, should be to proceed in full steam ahead with the development. That is why the Government decided to increase the development expenditure by Rs.180 crores further towards the end of 1953. So long as inflation presented a serious problem, a cautious attitude towards investment expenditure was unavoidable. But since excess money supply was completely liquidated and production was rising, an increase of the rate of expenditure was not only harmless, but also desirable.

Despite of the fact that increases in output materialised with comparatively less investment per unit of output, the shortfall in development expenditure for the last two years in the public sector amounted to Rs.1364 crores, that is, more than 61 per cent of the total estimate of Rs.2249 crores remained to be implemented. If the Finance Minister had simply been a believer in "physical targets" to the exclusion of financial policies involving incentives, he might have had

Ibid P.5
some justification for citing the technical difficulties of enlarging investments in the projects in the public sector as the main bottleneck. But he assured that he would not at the same time ignore the financial implication. And yet, from the end of 1953, the monetary policy of the Government was such that it had failed to keep pace with the "physical targets" of the plan. The effects of the restrictive policy came not be long confined to the agricultural sector where they became visible in the 1st half of 1955. Prices of agricultural products declined very fast. In an agricultural country like India, if relatively lower agricultural prices were allowed to continue for long, consumption as well as production was likely to be adversely affected. However, the timely purchases of wheat, coarse grains at different selected centers, and relaxation of export restriction on agricultural commodities arrested the fall in prices and the upward trend was in evidence towards the end of 1955.

Despite the increase in the deficit financing for 1954-55 of the national economy showed no sign of inflation. Due to budgetary deficits and higher bank-credits, in 1954, the volume of money-supply rose by Rs.129 crores, compared with an increase of only Rs.33 crores in 1953 and a considerable decline in 1952.¹ Bank-credit recorded an expansion of Rs.57 crores in 1954 as against a fall of Rs.10 crores in 1953 and Rs.66 crores in 1952.² It should be noted that, despite the increase in money supply, prices of commodities registered a downward trend, the general index of wholesale prices went down by 6.5 per cent in 1954 as against a rise of 4.8 per cent in the previous year.  

¹ Report of the Reserve Bank of India on trends and progress of Banking in India, 1954 as reproduced in "Commerce" Bombay, June 4, 1955, p.1066  
² Ibid, p.1066
No explanation was offered by the Reserve Bank of India in its report for this paradoxical phenomenon of rising money supply and falling prices. But the Reserve Bank was particular in drawing attention to the contradictory behaviour of money-supply and prices. Even those who welcome the Reserve Bank's objective approach to monetary problems would have liked it to be more positive in its analysis of this aspect of the monetary experience in 1954. The possible explanation might be that the wholesale-price level did not rise due to the increase of industrial production from 135.3 to 146.3 i.e. by 11 per cent, i.e., of the increase of money supply to the extent of Rs. 129 crores in 1954.

On account of this contradictory behaviour of money supply and prices, bankers and industrialists advocated larger deficit financing which according to them, would stimulate consumption. The Finance Ministry of the Government of India seemed to have endorsed that view as it incurred deficit financing of the order of Rs. 222 crores in 1955-56. Money supply recorded a rise of about Rs. 210 crores during 1955 as against a rise of about 129 crores in 1954 and the wholesale-prices rose by 10 per cent since June, 1955. There is no doubt that the incurring of the deficit financing of Rs. 222 crores in 1955-56 was inflationary in the last few months, because real output did not rise more than 3 per cent while the money-supply rose by about 11 per cent in the same year.
The Indian economy is highly sensitive to additions of money supply and not so sensitive to increase of real output. According to a document prepared recently by the Economic Unit of the Indian Institute of Public Opinion, the relation between money-supply prices and output over last five years, was as follows: "For every 10 per cent rise in money supply, when production is constant, there would be a 7 per cent rise in wholesale prices. Again, it would be a 3 per cent fall in wholesale prices." In other words, the ratio of money-supply and output in percentage terms is 7:3.

If we assume this assessment as true, the rise in prices since June 1955 is natural as the real output did not rise more than 3 per cent in 1955 while the money supply rose by about 11 per cent from Rs.1848.39 crores in December, 1954 to Rs.2058.36 crores in December, 1955.

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