

The Planning Process and the Annual Budgets : Some Reflections on Recent Indian Experience†

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ABSTRACT

In the light of a brief historical review of the essential objectives of the planning process, the credibility and consequences of the Seventh Five Year Plan are examined. It is argued that recourse to badly predicted but alarmingly large doses of deficit financing, expenditure on certain subsidies and enormous increases in interest payments have been the direct corollaries of the technical plasticity and unprofessional urges of the planning process in recent years. After exploring the nexus between deficit financing and development, the changes (and turning points) in the rate of inflation between 1981 and 1986 are explained with the help of a simple relationship among the annual rates of increase in fiscally induced monetary expansion, real output and prices. The consequences of inflationary finance and excessive reliance on market borrowing for public debt, saving and investments as well income distribution are briefly indicated. The deficiencies of the budget-making process and the growing irrelevance of the Reserve Bank in the control of money supply are highlighted and suggestions made to correct these defects.

1. THE PLANNING PROCESS

Abstracting from esoteric notions, which belong in the text books and class rooms, the planning process in India must relate to three essential objectives :

First : It must strive and be seen to function as a device, and also be so accepted by the political leadership, to discipline and constrain the inevitably rash urges of the political processes of this

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young democracy, with far too many unresolved economic, social and institutional problems, which, in their essence, are known to the electorate and its representatives.

Second : It must strive to articulate these socio-economic and institutional problems in a time and space perspective. The technocratic dimension of this objective, although important, must not be permitted to cloud the more important contribution the planning process is expected to make in the resolution of conflicts between today and tomorrow and also among different regions and groups.

Third : It must try to evolve practical rules and formulae for the fair division of developmental resources among the constituent units of the federal polity in accordance with the needs of national development.

This is indeed a caricature of the role of the planning process. However, there is nothing grotesque or idealized in this representation. The planning process in India has grappled with these three objectives; sometime with all of them, and with a sub-set of them at other times. The degree of success in the achievement of these objectives, however, has not been uniform over time.

Pandit Nehru, it is now clear in retrospect, understood and adequately protected the planning process in the performance of its role relating to the first objective. He attracted professionals of proven technical competence, wise administrators and mature politicians, known for their deep concern with the human condition, to undertake the daunting task of planned development. The Planning Commission became the confluence for a creative interaction of the nation's best from among the thinkers, doers and coordinators.

Pandit Nehru invested the planning process with great credibility. He had many stalwarts among his political colleagues at the Centre as well as in the States. These were men who were not only extremely knowledgeable, but they were also equally adept in the manipulation of men as well as ideas. Some of them must have felt genuinely impatient with the discipline of the five year plans. Nonetheless Pandit Nehru succeeded in nurturing the planning process as an instrument to curb and restrain many rash urges of the political process. It was not unusual in those days to hear taunts, such as : What is this Planning Commission? Is it some sort of a super Cabinet? Such remarks might be taken as a measure of the stature the planning process seemed to have earned through its professional work under the supervision and political tutelage of Pandit Nehru.

In the early part of the Nehru era, the second objective of the planning process was in evolution and reached a fair degree of sophistication by the early 1960s. The third objective did not appear to call for the exercise of any stringent and pressing options by the Planning Commission during those times of the hegemony of the Congress in the political arena.

Droughts, Devaluation, economic dislocation and political turmoil, as if by conspiracy, all coincided with the assumption of leadership of the Government of India by Mrs. Indira Gandhi. The planning process, the Planning Commission, the Congress Party of the old : all went into decline almost simultaneously. Planning had to be abandoned for some years before its revival under the leadership of a respected social scientist, Professor D. R. Gadgil, and many other able men as part of his team. Gadgil Commission did some very good work, particularly in the articulation of the third objective of the planning process. The Gadgil formula for the distribution of central assistance for the State plans was an appropriate response to the circumstances of the time. However, during those days of heightened political dissonance and general atmosphere of distrust, Mrs. Gandhi was unable to vest the planning process, or the Gadgil Commission, with the confidence and trust that it deserved.

Soon after the emergence of Mrs. Gandhi as the supreme leader of the Congress, the Planning Commission was reconstituted, with Mr. C. Subramaniam as its Deputy Chairman and Minister of Planning. The work relating to the mid-term appraisal of the Fourth Plan was accomplished in a professional manner. With the initiation of the preparatory work on the Fifth Five Year Plan, the planning process seemed to be making quick strides towards fulfilling all the three objectives listed in the beginning of this essay.

Suddenly the leadership of the Commission was changed. Another drought came around. Inflation started to raise its ugly head. The new leader of the Planning Commission was new to Delhi and soon got obsessed with the idea of quick image building for himself. The planning process, rather than continuing with its three basic functions, and tendering sound professional advice on matters of policy, got embroiled into cheap radicalism. The first of the many slogans to emerge from the planning Commission in 1972 was to nationalise the foodgrains trade.

It did not occur to the image-chasers that the advocacy of such a draconian measure in year of the deep drought, with no reserve stocks in the system, was fraught with dire consequences, both economic as well as political. Nonetheless, exercises for designing a strategy and instruments for the nationalization of trade in foodgrains became a source of new excitement in the Planning Commission in place of the quiet and professional work of plan formulation. The foodgrains trade in wheat and rice

was taken over by the Government towards the end of March 1973. It proved to be a miserable failure. In just about three months (by early July 1973) after taking this adventurous step, Mrs. Gandhi seemed to have decided not to touch rice trade. The nation suffered in consequence of this adventure and it also caused a lot of political harm to Mrs. Gandhi's Government. The Planning Commission as the main advocate of this policy, did not exactly recommend itself for earning the trust of the Prime Minister.

The year 1973 was a time of great anxiety in India: prices were galloping, the drought was deepening and the oil crisis was just around the corner. The planners seemed to be totally oblivious of these developments. Their only concern seemed to be to press ahead and seek NDC's approval of the Draft Plan—a plan, which, why speak of the next five years, had no relevance even to the situation of the day on which it was approved. There were, of course, minority opinions in the Commission, who had been calling for work on policies to contain economic and social unrest caused by inflation, rather than rushing through with a plan, which had been made irrelevant by a price rise of about 22 percent in 1973. These opinions were of no consequence and were ridden rough—shod and ignored.

I am certain Mrs. Gandhi knew that the Draft Fifth Plan was a useless document. A growth rate of 5.5 percent with zero net aid, the oil crisis, 30 percent inflation in domestic prices which had already occurred by September 1973 over the base line price structure, the promise of raising the consumption standards of the poorest 30 percent of the population by 60 percent in five years: each one of the targets in the proposed Draft must have offended her sense of proportion and credibility. A reading of the later events might support the view that she lost even the last residue of faith in the Commission that might have been left after the fiasco of the wheat trade take over.

In the summer of 1974, the Government of India came out with a supplementary budget (just within a few months after passing the regular 1974-75 Budget), to deal with the extraordinary economic upheaval which had been in evidence in every part of the country. Some of the proposals in this supplementary budget were in line with the minority views in the Planning Commission which had, nevertheless, been ignored in November 1973. The Deputy Chairman was sacked towards the end of 1974. By its unprofessional deeds the planning process managed to lose Mrs. Gandhi's trust, which it was never to regain during her life time.

Mrs. Gandhi owned up some of the ideas of the Draft Fifth Plan, particularly those relating to the anti-poverty and minimum needs programmes. But she ignored the Draft Plan. Prime Minister's Twenty Point Programme was an illegitimate heir to the Draft Fifth Plan. The Fifth

Plan was not finalized until September 1976. During the Emergency days she did not need the discipline of a five year plan to keep the economic matters on course. Even those colleagues and stalwarts, who had adorned her front office at an earlier time and might have been considered worthy of decorations, could not have dared to give unpalatable advice for fear of detention.

2. THE SEVENTH FIVE YEAR PLAN

Everybody in India was happy to see the curtain fall on the Orwellian 1984. With the dawn of 1985, came new hopes. I was personally delighted with Prime Minister's choice of the new Deputy Chairman of the Planning Commission. Here was a man, who had been a bright student and had all the experience in the world of commerce, finance and monetary affairs. A draft of the Seventh Five Year Plan was already around. It had received some sort of an approval from the NDC in 1984. The new Deputy Chairman started the process for finalising the Seventh Five Year Plan. Early in 1985 I was convinced that the planning process is about to have a new lease of life for the purposeful performance of its advisory and recommendatory roles.

One of the first few announcements to come from the new functional and technical head of the Planning Commission was to the effect that the Draft Seventh Plan inherited by him was Rs. 40,000 crores short on resources and needed to be seriously recast to come to terms with the resources crunch. However, a few months later, the same Rs. 180,000 crores public sector plan, with some cosmetic changes, became the Seventh Five Year Plan. After the conclusion of the NDC meeting (late 1985), the Deputy Chairman announced to the national press that there shall be no shortage of resources for the 180,000 crores plan : We have the will to raise resources and we shall raise all the resources required for the Seventh Plan : I was unable to fathom the magic which might have been invented by the Planning Commission in a matter of months to gain access to additional Rs. 40,000 crores for new plan investments. In retrospect it turns out that phoney bravado had overtaken the professional pride and competence of the Planning Commission.

The peddling of bravado and unprofessional advice could not have been expected to secure for the planning process its legitimate institutional role in constraining the inevitable rash urges of our political processes. If it were possible for the Planning Commission to manufacture additional developmental resources of the order of Rs. 40,000 crores in a matter of months, who could fault the Prime Minister in thinking that even more resources can be raised : Why not distribute handsome packages worth thousands of crores of rupees to the poor States who are going into elec-

tions in 1987 for strengthening the Indian democracy? In view of the powers of alchemy that the Planning Commission had developed within a few months in 1985, it would be somewhat unfair to charge that the political process was promoting fiscal anarchy. However, another matter does need to be addressed: Does the NDC have a role in the distribution of developmental resources to the States? Or is this a matter to be arbitrated on the basis of whims and fancy of the Planning Commission and its Chairman?

The Seventh Five Year Plan (1985-90, Vol. i) declares on page 56 as follows :

"The resources estimated from the various sources add upto Rs. 166,000 crores as against the plan outlay of Rs. 180,000 crores for the public sector. The gap of Rs. 14,000 crores is proposed to be covered through deficit financing. Taking into consideration the current price situation and the trends in the economy, the level of deficit financing, as contemplated, is considered to be within safe limits."

Safe for whom? is a natural question to ask. Nevertheless, let us postpone this question and see what has been achieved during the first two years of the Seventh Plan. The safe limit of Rs. 14,000 crores of deficit financing for the five year period, 1985 to 1990, has already been passed in March 1987. If I am lucky to survive till 1990, I shall not be surprised to read that total deficit financing during the Seventh Plan period amounted to Rs. 35,000 crores. This should come close to the sum of Rs. 40,000 which, in his professional wisdom, the Deputy Chairman had considered short for the 180,000 crores plan in early 1985. However, I am afraid, the satisfaction of having been right in at least one professional prediction was also mortgaged by him in 1985, when in the signed preface to the Seventh Five Year Plan (p. xii) he declared :

"As regards the financing of the Plan, in broad macro terms, the Plan is eminently bankable and credible, as it projects only a modest increase in the rate of investment and domestic savings during the plan period. The rate of investment is projected to go up from 24.5 percent of GDP in 1984-85 to 25.9 percent by 1989-90 and the rate of domestic savings is projected to go up from 23.3 percent to 24.5 percent over the same period. The financing pattern of the plan seeks to limit recourse to deficit financing within limits of safety and prudence".

Mark the words of the eminent Deputy Chairman : "the plan is eminently bankable and credible". The former head of India's central bank seems to be entertaining some strange notions of "bankability."

The over-heated printing machines, turning out currency notes, is a negation of any notion of bankability known to an ordinary economist. The borrowing from the Reserve Bank, has already, just in two years, gone beyond the Rs. 14,000 crores limit, which was considered eminently safe for the full five year period. The possibility of having to borrow another 20,000 crores from his old institution must be staring him in the face these days. I wonder whose safety this "eminently bankable" plan is trying to assure.

The reckless use of the note printing machines shall not only further erode and vanish the resource base of the plan, it will also pile up intolerably high burdens on the poor and the weak through the regressive impact of inflation. The rate of domestic savings in 1985-86, as well as in 1986-87, has already slipped below the base level of 23.3 percent. In view of the current policies of the Government, I wonder how the savings rate would climb up to the target of 24.5 percent in 1989-90.

The credibility of the Plan and the planning process is yet another matter: Not a matter of beautiful words to conceal portions of social and economic reality but to side with and speak the ugly truth to the extent one becomes aware of it. Plasticity and flexibility in professional and technical matters can lend itself to easy abuse. The planning process has allowed itself to be so abused, not only now but over a fairly long period of time. It is not surprising therefore that it has failed to promote fiscal discipline. Rather, it has become the main excuse for the practice of fiscal adventurism and monetary mismanagement: All in the name of protecting the size of the "eminently bankable" Plan!

Enough has been said, at least for the time being, about the planning process and the Seventh Five Year Plan. We shall return to this later. At this point, I wish to address some brief remarks to the nexus between deficit financing and development; and then offer an analytical narration of the recent Indian experience with matters relating to budgetary and fiscal practices of the Government of India and their impact on real growth and inflation.

3. DEFICIT FINANCING AND DEVELOPMENT

The virtues of deficit financing (simple monetary expansion) have usually been argued along two distinct tracks.

Pump-Priming

One of these is the Keynesian pump-priming track. Let us recall that the cornerstone of this argument for reflating a temporarily sick (but fully developed) economy back to its previously healthy, full-employment con-

dition through printing of money was to stimulate demands to coax out much larger output supplies. which the already existing, but temporarily idle, machines and plants had been producing prior to the onset of the great Depression of the 1930s. Although the facts of the Indian situation bear little resemblance to the conditions of cyclical unemployment in mature capitalist economies, some government economists and advisers have been quite vocal in their defence of large doses of deficit financing undertaken by the Government of India in the past many years in a row. It has recently been advocated once again that the level of deficit financing proposed in the 1987-88 Budget may not have any serious impact on prices.

This line of defence seems to be based either (a) on the "supposed" existence of unutilized capacities in many sectors, or (b) on appeals to the recent experience in 1984-85, when, according to them, a large increase in money supply (through a massive budget deficit) produced only a small impact on prices.

One must realize that the rated or name-plate capacity of a plant may be no more than a fiction. The excess of this rated (theoretical) capacity over the highest production actually achieved over a period of years is indeed illusory. However, this illusion has often been brought in, and repeatedly for many years, to have us believe that there is large excess capacity in our industries. The pervasive phenomenon of allround inefficient use of production facilities in Indian industry, however, is altogether of a different species. It cannot be tackled by reflation the economy through deficit financing and monetary expansion : the pump-priming track in the Indian context is totally irrelevant.

Just as one stray shower cannot foretell the whole course of the monsoon, the experience of 1985 cannot be generalized to deny the direct relationship between large budget deficit and inflation. Further, we shall also show that even the experience of 1985 has not been properly interpreted by these advocates of growth through budgetary deficits and monetary expansion.

Use of Surplus Labour for Capital Formation

Another painless path to development through simple expansion of money supply is to use surplus labour for capital formation. Most version of this argument are based on the writings, among others, of Nurkse and Lewis.

Surplus labour, by definition, is costless in real terms. This labour, it is argued, could be used without significant reduction in other outputs, especially in the rural areas in the agricultural off-season. However, labour has to be paid whether it is surplus or not. Nonetheless, if the

surplus labour is used productively to increase the output of goods, the extra money created to pay the workers would be matched by more goods in the system. The impact of increased money supply on inflation would therefore be moderated. However, to the extent that the increased money supply is used unproductively to meet the extra expenditure on administrative services, police and soldiers, with little addition to the volume of goods in the system, the full inflationary consequences would follow.

There are also the second and third round effects of inflation created by the initial dose of deficit financing for the employment of surplus labour. If, at the first stage, surplus labour has been used productively and if the propensity to save rises, the overall inflationary impact would be damped. However, if deficit financing is used to increase unproductive expenditure at the initial stage, with no increase in savings, then its full impact would be felt in increased prices.

The anti-poverty programmes of the Department of Rural Development would seem to come closest to the concept of the use of surplus labour for capital formation in India. A provision of Rs. 1846 crores was made for these programmes in the 1986-87 budget (now revised to Rs. 1875 crores). The revised estimate for the overall budget deficit for 1986-87 has now been put at Rs. 8285 crores—the net increase in RBI credit to government being estimated at Rs. 7250 crores. A proportion of the expenditure of Rs. 1875 crores on the anti-poverty programmes in 1986-87 might be considered as having been put to productive use, whereas the bulk of the budget deficit of Rs. 8250 crores has been spent on meeting the additional expenditure on civil servants, policemen and soldiers. Just as surely, its impact has shown itself in the higher inflation rate during 1986.

The 1987-88 Budget provides Rs. 2050 crores for the rural development programme—an addition of Rs. 175 crores over the 1986-87 revised estimates. The addition is in RLEGP (6%) and NREP (3%), whereas the budget estimates (1987-88) for other rural programmes, such as rural roads in the hill and tribal areas, rural water supply, DPAP and national grid of rural godowns, are lower than the corresponding provisions made during the previous year. Also the revised expenditure estimates (1986-87) for these latter programmes are lower than the figures budgeted for them in February 1986.

The Government of India, it is ironic to note, finds it extremely easy to exceed the budgetary limits on unproductive expenditure by substantial amount whereas it is manifestly incapable of maintaining even the budgeted expenditure levels on anti-poverty programmes for the employment of surplus labour. Further, allowing for the price rise in 1986, the revised expenditure of Rs 1875 crores in 1986-87 is significantly less than

Rs. 1846 crores in 1985 prices. The price increase in 1987 shall certainly more than neutralize the step-up of Rs. 175 crores provided in the 1987-88 Budget.

It might be instructive to call to memory the propaganda blitz that was mounted on Doordarshan right from the moment the Finance Minister started presenting his (1987-88) budget in Parliament. The Finance Ministry economists, manning the television hook-up to relay the budget provisions blow by blow, were agog with excitement over the great increase in the allocation for the rural development programmes allowed by the Finance Minister. A small increase of Rs. 175 crores in the anti-poverty programmes becomes a far more significant event to project in comparison with yet another massive dose (Rs. 5700 crores, as an initial instalment) of fresh deficit financing! The poor were, nevertheless, invited to seek some consolation in a pious promise that the deficit in 1987-88 shall be kept within the budgeted figure. Pious intentions and promises are no substitutes for deeds and achievements. Although there is little in the past experience, as well as in the foreseeable future, to suggest that this promise can be kept, nevertheless, pleasant surprises can never hurt.

4. FISCALLY INDUCED MONETARY EXPANSION, REAL GROWTH AND INFLATION : THE EXPERIENCE IN THE 1980s

India enjoyed almost complete price stability during the calendar year 1978. Between December 1977 and December 1978, the index of wholesale prices was absolutely stable. Although there were marginal increases in the two urban consumer price indices (1.5% and 2.3%, respectively, in CPI-IW and CPI-NME), the consumer price index for agricultural labourers registered a fall of 3.8 percent. In other words, the inflationary potential of the oil shock of 1973-74 and the droughts of 1972-73 and 1973-74 had totally been extinguished by the end of 1977.

The agricultural year 1977-78 was marked by a good recovery in crop outputs; and in the following year, 1978-79, NDP originating in agriculture grew by about 2.8 percent and the total NDP (in real terms) by 5.5 percent. However, the year 1979 witnessed some extraordinary events: An unusual budget, the second oil shock, political instability and a precipitous fall of around 15 percent in agricultural production in the 1979-80 crop season. All these events and exogenous shocks conspired to spark off the fire of inflation, which burned vigorously during 1979 and 1980.

The year 1980-81 witnessed an all-round recovery in the aggregate output; and there was substantial growth in real NDP (over 5%) during the following year. This offered possibilities for cooling-off the inflationary fever in the manner it had been done at an earlier time (Mid 1974

onwards), when an even more virulent inflation had been sparked off by similar external events. The policy response of the Government of India in the 1980s, however, was very different. It took recourse to large doses of borrowing from the RBI, leading to substantial increases in money supply—increases in money supply, which have almost fully been fiscally induced since 1981 on to 1986.

The growth of aggregate monetary resources, M_3 , is a direct function of changes in Reserve Money. In earlier years, right up to 1980, the changes in the net claims of the RBI on government, although not unimportant, were not the overwhelming source of changes in reserve money. The net RBI credit to Government in proportion to stock of reserve money on last Friday in December 1978 and 1979, was around 62 percent. This ratio rose to 78 percent in December 1980; to 93% in 1981 and to almost 100% in 1982. On the last Friday of 1985 (as well as of 1986), this ratio stood at 103.2%. In other words, since 1981 the variations in M_3 have mainly been determined by the size of the fiscal deficit in each year which has been financed through borrowing from the Reserve Bank.

The relationship between fiscally induced monetary expansion, real output growth and prices for the period 1981 to 1986 is explored below. The relevant background data, on which this exploration is based, are given in appendix Tables A.1, A.2 and A.3. A cursory look at appendix Table A.1 should establish the following conclusions :

- (i) The only sector in which the real NDP has grown steadily, between 1977-78 and 1985-86, is Public Administration and Defence. The annual (compound) rate of growth (obtained from end-point to end-point comparisons or through regression analysis) comes to about 11.8 percent. It must nevertheless be understood that the growth of this sector is a cause for real worry rather than a positive development.
- (ii) Real total NDP or NDP minus the NDP originating in Public Administration and Defence, between 1977-78 and 1985-86, has not grown any faster than Rajkrishna's "Hindu Rate of Growth" (3.5 to 4.0 percent).
- (iii) The year to year variations in real NDP are dominated by the ups and downs experienced in the agricultural sector. The years of low growth in NDP are also years of big falls in agricultural output and the years of healthy growth in NDP happen to be the years of good harvests. On the whole, during this period, the annual rate of real NDP in the agricultural sector works out to 1.5 percent on the basis of end to end comparisons and 2.0 percent on the basis of regression estimates. Both these estimates of

the agricultural growth rate are below the known rates of population growth in rural India.

Appendix Table A.2 presents outstanding levels of some important monetary aggregates and Net RBI credit to Government as on the last Friday in December of each year between 1978 and 1986. Absolute and relative variations in these aggregates during the preceding year as well as some other relevant ratios are also provided in this table. It must be noted that from 1981 onwards, the variations in reserve money (Remember that reserve money forms the basis for expansion in money supply) have become a mirror-image of changes in Net RBI credit to Government determined by the size of budget deficits in different years.

Appendix Table A.3 presents all the available data on price movements in India between December 1978 and December 1986. The wholesale price index, two consumer price indices for urban areas and the consumer price index for agricultural labourers (CPIAL), except for some leads and lags which are not yet properly understood, do seem to tell the same story. Since December 1978, the average annual rate of price inflation works out to over 9 percent (WPI = 9.0%, CPI-WI = 9.37%, CPI-NME = 9.17%).

It must, nevertheless, be noted that after the initial inflationary shocks of 1979 and 1980, the annual changes in consumer prices have been relatively more pronounced than in wholesale prices over the period 1981 to 1986. Further, as the changes in consumer prices are better indicators of the effects on human welfare, the analysis of fiscally induced inflation during 1981 to 1986 is better conducted in terms of the indices of consumer prices, CPI-IW or CPI-NME.

Analyses of relationships involving monetary expansion, real growth and inflation are better done with quarterly or half-yearly data. The data on monetary aggregates and prices pose no problems in this regard. However, the data on national product are available only on a financial year basis. Further, the data on agricultural production pertain to the agricultural year (July-June) but get reported in the national accounts as if the agricultural year coincided with the financial year (April-March).

As we noted earlier, the year to year variations in NDP are close reflections of the vagaries experienced in the agricultural sector. Nevertheless the impact of the output realised during an agricultural year, say from July 1983 to June 1984, did not show itself in the financial year 1983-84 (April 1983 to March 1984). It was felt mostly during the calendar year 1984. The Kharif crops of 1983-84 were available from November 1983 onwards and the rabi crops of 1983-84 from May/June 1984 till the Kharif output of 1984-85 became available from around

November 1984 and onwards. In other words, the output data of any agricultural year, say 1985-86, were only marginally relevant to the monetary and price situation in the financial year 1985-86. They were, on the other hand, essentially related to the calendar year 1986. In the absence of quarterly or half-year data on national product, we have conducted our analysis of relationships involving money supply, real NDP growth and inflation on a calendar year basis. In other words, the reported NDP growth in the national accounts for any financial year, say 1985-86, has been assumed to pertain to the calendar year (1986).

The results presented in Table 1 pertain to the years 1981 to 1986. These years represent a period during which a unique, almost fully-controlled, laboratory experiment might be considered to have been unwittingly performed by the Government of India. The monetary expansion (M_2) in each of these six years was almost fully induced by the fiscal deficits financed by recourse to RBI credit.

The analysis presented in Table 1, leads us to the following conclusions :

- (i) There is no relationship between the annual levels of deficit financing (and monetary expansion) and the corresponding rate of growth of real NDP. In other words, there seems to be no evidence in favour of any reactivation of excess capacity or acceleration in capital formation with the use of surplus labour through printing of money in the 1980s.¹
- (ii) The observed annual movements in consumer prices P (CPI or \dot{P} -NME), as expected, have been closely related with the annual differences between rate of monetary expansion (\dot{M}_2) and the real rate of NDP growth (g).
- (iii) A relatively larger growth in the excess of the rate of monetary expansion over the real rate of NDP growth between two consecutive years, $[(\dot{M}_2 - g)_t \div (\dot{M}_2 - g)_{t-1}]$, gets translated into higher rate of inflation, P_t/P_{t-1} . The converse of this proposition also holds in the relevant years during the 1980s.
- (iv) An equally illuminating prediction of the direction of change in the rate of inflation can also be obtained by working with first differences $[(\dot{M}_2 - g)_t \text{ minus } (\dot{M}_2 - g)_{t-1}]$ VS $\dot{P}_t - \dot{P}_{t-1}$ in cols. 10 and 11 of this Table]. All large excesses in the rates of monetary expansion over the real rate of growth between consecutive years,

¹Savings, as a percentage of domestic product had reached its highest level in 1978-79 (25.7% gross and 20.0% net). In all years since 1980-81, the rate of savings has been less than the level achieved in 1978-79. Gross rate has varied between 22.6 percent and 23.0 percent and the net rate between 16.4 and 17.8 percent.

lead to acceleration in the rate of inflation. All reductions (or on change) in the rate of monetary expansion over the real rate of growth between successive years lead to deceleration in the rate of inflation.

In order to facilitate better understanding of the analytical results given in (iii) and (iv) above, I have prepared two graphs. In graph A, we have

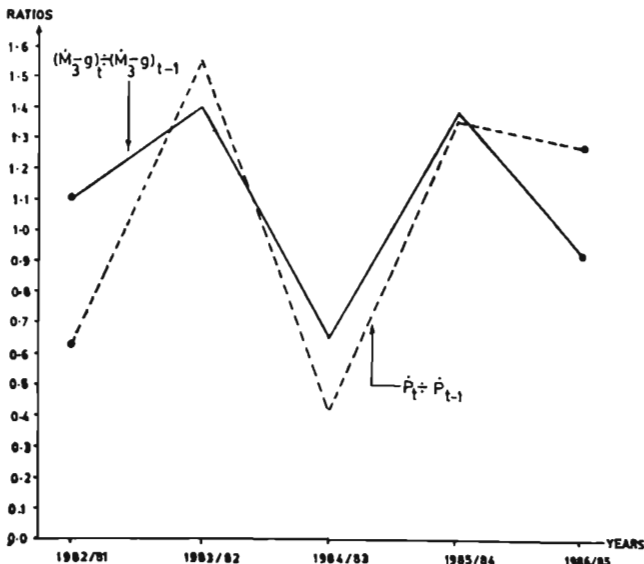


Figure A. Monetary expansion, output growth and inflation.

plotted together the data given in cols. 8 and 9 of Table 1; whereas graph B tells the same story but with data from cols. 10 and 11 of the same table.

The numerical analysis of Table 1 was based on a simple minded theory of inflation. This theory is not considered to be neat or exact. Nevertheless, it has yielded a coherent explanation of the evolution of prices between 1981 and 1985 and also of the direction of changes in the annual rates of inflation between successive pairs of years over the same period.

DIFFERENCES

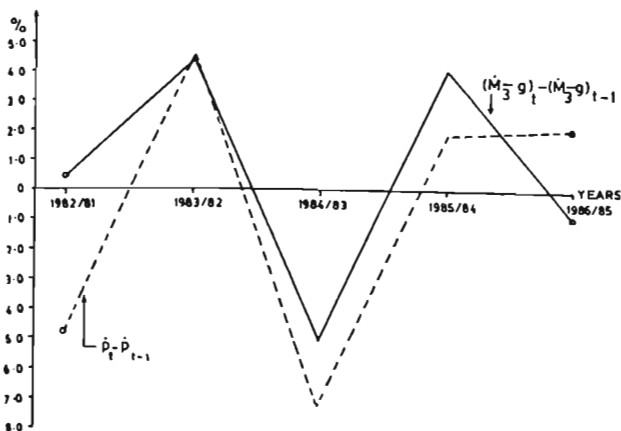


Figure B. Monetary expansion, output growth and inflation.

To conclude, there was nothing unusual about the behaviour of prices in 1985, or in any other year between 1981 and 1986. No alibis of any exogenous shocks need to be invoked, as none legitimately belong to this period. Level of prices in each individual year and the changes in the rates of inflation between one year and the next during this period have been caused by the internal policies of the Government of India. As the ratio between the levels of net RBI credit to Government and Reserve Money have been close to unity since 1981, all monetary expansions between 1981 and 1986 were fully induced by the large budget deficits. Incredibly large actual deficits, many times larger than the budgeted figures, have become a regular feature of the Indian budgetary practice.⁸

⁸Mr. Pranab Mukherjee used to predict deficits in hundreds of crores of rupees but would end up with actual deficits amounting to few thousands of crores. Mr. V. P. Singh, though quite innovative in certain other respects, worsened his predecessor in this area: He would promise a deficit of few thousand crores in the estimates, but would come around next year with revised estimate of the deficit being a hefty multiple of the promised few thousand crores. This is indeed a sad commentary on the techniques of budget making in India. In fact the annual budget in India is fast losing its meaning. During 1986, we had three budgets, one in each session of Parliament and some more in between. It is a crying shame that this country, although full of competent accountants and economists, is unable to produce budget estimates which can hold good even for 3 months.

TABLE I
FISCALLY INDUCED MONETARY EXPANSION, REAL GROWTH AND INFLATION : 1981-1986

S. No.	December to December	Net RBI Credit: Reserve Money %	M_3 % (NDP, PA & D)	$\frac{P}{CPI}$ (NDP, PA & D) %	$\frac{P}{CPI}$ (NDP in Agri-culture) %	$\frac{M_3 - P}{col. 4}$ %	$\frac{P}{CPI}$ (IW) %	$\frac{(M_3 - P)_t}{(M_3 - P)_{t-1}}$	$\frac{P_t}{P_{t-1}}$	$\frac{(M_3 - P)_t}{(M_3 - P)_{t-1}}$ Minus %	$\frac{P_t - P_{t-1}}{P_{t-1}}$ %	Points	Points	Points
(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
1.	1980-81	92.6	17.4	7.0	12.4	10.4	12.8	1.03	0.63	+0.4	-4.8			
2.	1982	99.8	15.8	5.0	4.2	10.8	8.0	1.41	1.56	+4.4	+4.5			
3.	1983	94.0	17.2	2.0	-3.5	15.2	12.5	0.66	0.42	-5.1	-7.3			
4.	1984	94.5	18.1	8.0	11.4	10.1	5.2	1.40	1.37	+4.1	+1.7			
5.	1985	103.2	17.0	2.8	-0.96	14.2	7.1	0.94	1.29	-0.9	+2.1			
6.	1986	103.2	17.5	4.2	+1.2	13.3	9.2							

And these poorly predicted estimates are made in almost total disregard of the expected real output growth in the budget year.

We might also note that it is not a terribly difficult job to predict, in each February, the levels of outputs which might obtain during the coming year. The Finance Ministry and the Planning Commission have singularly failed in applying themselves to this task of short-term forecasting for the budget and the annual plan, inspite of the many useful leads which have been indicated to them by expert groups and committees.³ This country needs to set up a system for forecasting the levels of different outputs, almost quarter by quarter, to do meaningful sums relating to revenue and expenditure policies. The budget deficits and targets for monetary expansion during the budget year should be worked out in relation to the appropriately predicted levels of output. The Government would also do a lot of good to the Indian people by announcing, along with the budget, the rate of inflation it considers to be consistent with its budget proposals.

5. TAX AND BORROWING POLICIES

The consequences of the increased and continuous resort to the printing press in the 1980s have just been analysed, we may also now comment on some aspects of the tax and (internal) borrowing policies of the Government of India in recent years. Perhaps to stimulate investments and give better incentives for work and effort, the personal tax rates have been lowered in recent years; whereas more and more recourse has been taken to borrowing. "Tax less and borrow more" might therefore be considered another major feature of the government policy in the 1980s.

Interest payments (see Table 2) have been rising at a very fast pace—from actuals of Rs. 2210 crores in 1979-80 to Rs. 9550 crores (revised estimates) in 1986-87 and Rs. 10650 crores in 1987-88 (Budget estimates). Since in recent years, the revised estimates have turned out to be far higher than the corresponding budget estimates (+ Rs. 235 crores in

³I can vividly recall the recommendations of the Data Improvement Committee in this regard. The Committee was brought in through the efforts of the late Mr. V. K. Ramaswamy, a man of great analytical skills to adorn the chair of the Chief Economic Adviser to the Government. Unfortunately Mr. Ramaswamy died a few months before this Committee submitted its report. Many distinguished people who have moved up through the Department of Economic Affairs during the last decade and a half, have neither followed up the recommendation of the Committee, nor published its report. Bright minds prefer to order the World around through their gut feelings; forecasts of the numerical variety, based on firm data and explicit theoretical frameworks, might offend their keen intuition and "good" judgements!

TABLE 2
INTEREST PAYMENTS AND RECEIPTS OF INTEREST, DIVIDENDS
AND PROFITS BY GOVERNMENT OF INDIA

(Rs. crores)

Year	Interest Payment	Receipts		
		Interest	Profits and Dividends	(Col. 2+3)
(0)	(1)	(2)	(3)	(4)
1979-80	2210	1369	290	1659
1980-81	2604	1795	292	1987
1984-85	5974	3963	407	4370
1985-86 (BE)	7075	4657	448	5106
(RE)	7400	4802	477	5279
(Actuals)	7503	4856	515	5371
1986-87 (BE)	8750	5521	456	5976
(RE)	9550	5505	461	5966
1987-88 (BE)	10650	6262	520	6782

1985-86 and + Rs. 800 crores in 1986-87), the actuals in 1987-88 might exceed Rs. 11,000 crores. A five fold growth in just seven years! A very large proportion (about 95%) of these interest payments are on the internal debt, which would have grown over four-fold in the same period. (See would Appendix Table A.4).

Most commentators have been appreciative of the prudence India has practiced in keeping the burden of international debt within safe limits. I do not have access to the relevant data to make meaningful comments on India's foreign debt. I am, therefore, going to leave this subject alone. Recently deep concern, however, has been expressed about the high interest burden of the national debt. Some talk about an internal debt-trap has also been heard. A few comments in this regard are addressed below.

It is common knowledge that, in sharp distinction with interpersonal or international debt, there is no "burden" involved in national public debt. We owe it to ourselves and our children and grand children would own it to other future citizens of this nation. Once any national debt has arisen, interest on it has to be paid and these payments can be made by more borrowing, thereby converting the so called "interest burden" into additional national debt. Any further borrowing cannot be distinguished from borrowing to pay interest. The interest payments to our own citizens

are not a subtraction from national income and the national debt is not a subtraction from national wealth. From the vantage point of functional finance, it is the appropriate level of national spending that matters: More interest payments do put additional purchasing power in the hands of the people, but through appropriate changes in tax rates, spending can be diminished to the desired level.

The comments of the previous paragraph, however, should not be taken to mean that the national debt does not matter at all. An excessive growth in national debt can cause lot of distortions in the system. One result from Macro Growth Theory would suggest that the rate of growth of the national debt should not be permitted to get too much out of line with the rate of growth (long-run) of national income. The contrary does seem to be happening in India of the 1980s. The ratio of national (internal) debt to national income in 1979-80 was around 24%; by 1985-86 this ratio had grown to about 32%.

One of the distortions, which are often talked about, is that excessive market borrowing by the government might crowd out some more important needs of the private sector for funds. The argument is based on higher productivity per unit of resources used in the private sector as compared with spending by government. This is a contentious proposition which can be argued around without reaching readily agreed conclusions. Nevertheless, to earn total profits and dividends of Rs. 461 crores from public sector enterprises in 1986-87 on an investment of over Rs. 50,000 crores does lend lot of support to the presence of this distortion in India.

The second distortion relates to the income distribution effects of internal debt. The bulk of bank deposits, bonds and certificates are owned by the rich and the fast-rising amounts of interest on public debt accrue to the rich and this leads to more unequal distribution of income. However, in a regime of progressive rates of taxation, the rates of tax for the rich can be so adjusted as to more than compensate for the inequality produced by the interest payment received by them on the public debt.

Note that the question of tax rates (not total tax revenue) is important in this matter of consequences for income distribution of the fast-rising levels of interest payments on national debt. The 1980s have been an era of fiscally induced inflation (against which the poor had few means of defence), along with a regime of relatively lower tax rates in which interest payments have grown very fast. There are strong indications that income inequalities have grown in the past few years.

A brief mention must also be made of certain factors which tend to limit the size of the national public debt. It is quite conceivable and also rational for the rich to begin to expect that to meet its over-grown repay-

ment and interest liabilities, the government shall have to raise the rates of personal taxation in the not-too-distant future. This rational expectation should inhibit the rich from subscribing to the government bonds and certificates and also induce them to direct their savings more and more into real estate, precious metals, heirlooms and other speculative avenues rather than into financial instruments under the control of the government.

In other words, in order to avoid being locked-up into higher tax liabilities in the future, the investors shall begin to discount the current yields on instruments of national debt by an additional factor determined by the rationally expected tax equivalents foreseen as the consequences of the abnormal growth in national debt. Although the current operative strength of this rational response is difficult to assess in clear terms today, yet this kind of response from the citizens is bound to emerge to thwart the government's borrowing activity and thereby operate as an endogenous factor in limiting the growth of national debt.

Net market borrowings by the Government during the last year were Rs. 5,300 crores. These are budgeted to go up to Rs. 6,300 crores this year—a rise of Rs. 1,000 crores. However, the extra interest payments during 1987-88 are projected to be larger than Rs. 1,000 crores. In other words, extra market borrowing next year may not be sufficient to cover the extra interest liability of the Government. This does look like a slow walk into the debt-trap. Whether we can avoid being so trapped, would depend upon what we do to change our tax and expenditure policies in the coming year.

6. MORE ON THE SEVENTH PLAN

The Central Plan outlays in 1985-86 and 1986-87 as well those provided for 1987-88 are given in Table 3. The amount of Budget support for the Central Plan was Rs. 13,231 crores and Rs. 14,792 crores, respectively, in 1985-86 and 1986-87. Let us note that approximately half of these amounts in each of the two years were the contribution of the note printing press. The contribution by way of Budget support in 1987-88 is supposed to be Rs. 14,923 crores—an addition of Rs. 131 crores over the 1986-87 figures. God alone knows how much of note printing would materialize in this year to make this Budget support of Rs. 14,923 crores possible.

The resources of the public sector enterprises constitute the other main source of funds for the Central Plan. These sources contributed Rs. 6,863 crores in 1985-86 and Rs. 8,833 crores (an addition of Rs. 1,970 crores) in 1986-87. This contribution from the internal resources of the public sector enterprises to the Central Plan is placed at Rs. 9,699 crores for 1987-88—an addition of Rs. 866 crores over the 1986-87 level.

TABLE 3
CENTRAL PLAN OUTLAY AND CENTRAL ASSISTANCE TO
STATE AND UT PLANS

(Rs. crores)

Sl. No.	Item	1985-86 (Revised)	1986-87 (Revised)	Increase over 1985-86 (col. 2 — col. 1)	1987-88 (Budget Estimate)	Increase over 1986-87 (col. 4 — col. 2)
	(0)	(1)	(2)	(3)	(4)	(5)
1.	Budget Support for Central Plan	13,231	14,792	1,561	14,923	131
2.	Resource of the Public Sector Enterprises	6,863	8,833	1,970	9,699	866
3.	Total Central Plan Outlay (1+2)	20,094	23,625	3,531	24,622	977
4.	Central Assistance to State and UT Plans	7,265	8,140	875	8,754	614

Let us look at the resources of the public sector enterprises in some detail. The relevant data are in Table 4. During the year 1986-87, the Government made enormous use of its monopolistic power in raising the administered prices of the products produced in the public sector. Nevertheless, the increase of Rs. 1970 crores in public sector resources in 1986-87 over the 1985-86 figures, largely came through market borrowings; Rs. 1364 from public sector bonds and a fair amount from deposits raised by the enterprises. These interest payments, which will be a prior charge on the revenues of the public sector enterprises, may not leave much of a surplus behind as the contribution of these borrowed funds to the internal resources. Of course, the intentions of the Government for the future are also clear. They will borrow more to pay the interest on bonds and public sector company deposits. In the 1987-88 budget, the internal resources of the public sector are proposed to go up by Rs. 771 crores, most of which would be offset by a projected decrease of Rs. 660 crores in suppliers credits and other foreign commercial borrowing by the enterprises.

The amount to be raised through bonds, on the other hand, is proposed to go up to Rs. 1,500 crores (+ Rs. 136 crores over 1986-87) and the other resources, including deposits raised by public sector companies, will go up from Rs. 957 crores in 1986-87 to Rs. 1,576 crores in 1987-88 (+ Rs. 619 crores).

TABLE 4
RESOURCES OF PUBLIC SECTOR ENTERPRISES FOR THE
CENTRAL PLAN

(Rs. crores)

Sl. No.	Item	1986-87 (Revised)	1987-88 (Budget Estimates)	Increase/decrease over 1986-87 (col. 2 -- col. 1)
	(0)	(1)	(2)	(3)
1.	Internal Resources	5,368	6,139	771
2.	Bonds	1,364	1,500	136
3.	External Commercial Borrowing/Suppliers Credits	1,144	484	-660
4.	Others, including deposits raised by the Enterprises	957	1,576	619
5.	Total (1 + 2 + 3 + 4)	8,833	9,699	866

In other words, almost fifty percent of the so called Budget support to the Central Plan gets translated into extra RBI credit (net) to the Government and the other half is contributed by market borrowings. The contribution to the Plan from the resources of the public sector enterprises, particularly the additional amounts which accrue, is also a euphemism for more borrowing from the public through bonds and company deposits.

To cut the long story short, almost every paise of outlay on the Central Plan has come either from the printing press or from borrowing at home and abroad. The system does not tax or earn enough even for its current needs, however, aided by the planning process we plan to saunter into the twenty first century in fully borrowed plumage.

Much won't be gained if I narrate the targets of the Seventh Five Year Plan. It would be sufficient to note that the rate of domestic savings in 1985-86 (and most probably in 1986-87 as well) has been lower than in 1984-85, which in turn was much lower than the level attained in 1978-79. The real NDP growth (NDP-Public Administration and Defence) was 4.2 percent in 1985-86 and it may not exceed 3.5 percent in 1986-87. Total NDP (including Public Administration and Defence) grew by 5.0 percent in 1985-86, as compared with 3.7 percent in 1984-85. When all the sums are in, the growth of total NDP in 1986-87 may not

exceed 4.5 percent. To put it differently, I am unable to locate the higher growth path (of 5.0 percent steady growth) on which the Indian economy is claimed to have been put by our Government during the 1980s.

7. EXPENDITURE ON GOVERNMENT

We have already noted that the real NDP originating in public administration and defence has growth thrice as fast as NDP as a whole between 1977-78 and 1985-86. The NDP originating in this sector is nothing but the growth of expenditure; and the growth of this expenditure at the double-digit annual rate of about 12.0 percent (in 1970-71 prices) is matter of great worry for the development of Indian economy.

Defence Expenditure

Although much is not known to the public about the defence budget, or its cost—effectiveness in meeting the objectives of national security, the growth in defence expenditure has been extremely sharp in the 1980s. It has doubled in the last three years, and quadrupled in the last eight. This calls for some comment, particularly in view of the dubious slogan recently coined by Mr. L. K. Jha.⁴ While it is difficult to deny the proposition that peace is essential for orderly economic development, Mr. Jha's pet theme during the last month has been that as defence and development go together, we must give high priority to strengthening of defence capability which will become a basis for giving added impetus to development.

I am sure Mr. Jha knows that spending more money on armaments shall be a very poor insurance for securing peace on our borders. Nevertheless, his belief, that even this limited insurance, which we can buy by spending vast sums of money on defence preparedness, would be a positive factor in economic and social development, is rooted in some logic and facts which must be known only to him. Mr. Jha must share his facts with others so that a proper public debate in the matter can take place.

In the year prior to India-China conflict, our defence expenditure was around Rs. 250 crores. On the basis of a study which was done by the late Mr. Pitambar Pant and some others, but not by the defence establishment, the defence budget was raised by a big amount in 1963-64. In a

⁴Mr. Jha has also been one of the defenders of large deficit financing for development. We have dealt with this matter earlier.

couple of years that followed, defence expenditure was further raised to achieve a plateau of around Rs. 1,200 crores.

By 1975-76, i.e. 10 years later, the defence expenditure (see Table 5) reached a level of Rs. 2472 crores—doubling in about 10 years. In 1979-80, actual defence expenditure was Rs. 3164 crores. During the next 7 years the defence expenditure more than tripled—from Rs. 3164 crores in 1979-80 to Rs. 10194 crores in 1986-87 (revised estimates). It is proposed to go up to Rs. 12512 crores in 1987-88 as per the budget estimates, but may go up beyond this figure.

TABLE 5
DEFENCE EXPENDITURE NET OF DEFENCE RECEIPTS BUT
INCLUSIVE OF CAPITAL EXPENDITURES
(Rs. crores)

1961-62	250†
1965-66	1200†
1975-76	2472
1979-80	3164
1980-81	3604
1981-82	4329
1982-83	5021
1983-84	5831
1984-85	6661
1985-86	7987
1986-87 (B.E.)	9013 (1098)
(R.E.)	10194 (1227)
1987-88 (B.E.)	12512 (3988)

†denotes approximate figures.

() figures in brackets refer to capital expenditure only.

Mr. Jha has been a top adviser to the Prime Ministers in the 1980s. We have also shown (Appendix Table A.1) that the real rate of NDP growth during this period has been no better than 3.4 to 4.0 percent per annum. Why did not the growth rate of the economy accelerate in spite of Mr. Jha's expert advice and quadrupling of defence expenditure during the 1980s?

The fact is that the mounting defence expenditures have been eating into the developmental resources of the nation and have been a drag on social and economic development of the country. We must find ways to economise on defence expenditure. The capital expenditure on defence during this year is budgeted to be Rs. 4,000 crores. This is an enormous amount of money to be spent on defence hardware in one year. One hopes much of it won't leak into the kind of channels which have recently been close to being exposed in Parliament and outside.

The Government would do a lot of good to the country to channel the energies of the slogan-makers as well as hard-headed experts into doing professional exercises for affecting economies in defence expenditure. Such exercises can be done without prying into the secrets of the defence establishment. Knowledgeable people know most of what might be worth knowing. Anyway there is a lot of literature about these matters which is already in the public domain.

The Government must also mobilize its diplomatic resources and skills, and use them with finesse to manage the international security environment to its advantage and thereby release resource from defence to development. This again is a serious and professional business. Shouting loud protests about the not-so-invisible foreign hand might improve our lung power, nevertheless this lung power can only help to diminish further our credibility and competence to manage our security environment. Pushing panic buttons and loose talk about 'destabilization,' does not and should not belong to the leadership of a Regional Power of continental dimensions.

8. SUBSIDIES

Revenue receipts of the Government of India are estimated at Rs. 36,688 crores in 1987-88 (B. E.). The budgeted expenditure for defence (about 34%), interest payments (29%) and subsidies (over 15%) will eat up a little over 78 percent of the total revenue receipts (and slightly more than 50% of all receipts, revenue as well as capital). Issues relating to defence expenditure and interest liabilities have already been dealt with. In this section we shall comment on subsidies, particularly on the subsidization of food, fertilizers and export promotion. The expenditure on these subsidies in 1986-87 (R. E.) was Rs. 4681 crores. This is proposed to be raised to Rs. 4780 crores, a rise of about Rs. 100 crores, most of which will be in export promotion. For completeness let us note that the total expenditure on subsidies, including some minor ones, is budgeted to be Rs. 5605 crores in 1987-88.

Export Promotion

A steady growth of 7 to 8 percent in foreign exchange earnings through exports is considered necessary to finance the purchases of essential import items to meet the growth needs of the economy during the Seventh Plan. However, the exports fell in 1985-86. The preliminary findings are that during the first six months of 1986-87, the exports were higher by 10.6 percent in dollar terms. To meet the targets of the Plan this rate of over 10 percent growth in exports, in foreign exchange terms, will have to be achieved in each of the three years till the end of the Seventh Plan. It is being claimed, that without subsidies of the order of Rs. 900 crores a year, the required level of exports would not materialize.

As the foreign exchange budget of the Government of India is one of those super-secret documents, which very few people are privileged to see, it is difficult to comment on the adequacy or otherwise of the proposed level of subsidy and the magnitude of exports sought from it. One hopes that the sums have been done right and that the proposed degree of subsidization will achieve the expected results. Nevertheless, it is worth pointing out that export subsidies are nothing more than a method for returning some of the revenue collected through indirect taxes, or through hikes in administered prices, undertaken to meet the plan targets of internal resources generation in the public sector enterprises. In other words, what the government proposes to take with one hand, will have to be passed back with the other, in order to restore price-competitiveness of our exports. It is good to remember that this price competitiveness can once again be upset when indirect taxes or administered price are hiked.

Food and Fertilizer Subsidies

Expenditure on food subsidy in 1986-87 (R.E.) came to Rs. 2000 crores and the same amount has been provided in the 1987-88 budget. As against the revised figure of Rs. 18.73 crores in 1986-87, a provision of Rs. 1910 crores have been made for the fertilizer subsidies in 1987-88. These are indeed large sums, but considered necessary to achieve targets of food and fertilizer production in the Seventh Plan.

The question of food and fertilizer subsidies in India is a complex one. It is impossible to discuss it, in all its relevant detail and ramifications, in the course of this lecture. I shall nevertheless like to provide a very thin spread of its flavour, not for any other reason, except in sweet memory of Lala Dharm Narain : I am sure he would have like to listen to my uneducated remarks on this subject in which he possessed enormous expertise.

The prices of farm inputs (most of the mare produced in the public

sector) in recent years have been rising faster than the small price increases that have been allowed to the producers of foodgrains. Food subsidy benefits, by and large, have gone to urban consumers. The spread of the public distribution system in the rural areas has been restricted to limited areas in some states. It is worth pointing out that significant reductions in the rate of inflation, or stability in rural consumer prices (changes in CPIAL, for instance), have been noticed only in years of big grain harvests; and not in other years. The adverse unemployment and income effects of reduced agriculture production are far more pronounced and direct in the rural areas. In the presence of large grain stocks with the government, the rural consumer do not suffer from the bad effects of suction of grain (which used to occur in consequences of higher purchasing power of the urban consumer) into the metropolitan areas in years of bad grain harvests. However, the beneficial effects of the buffer-stock policy of the government are far more direct and pronounced in the urban areas.

Without conceding that it could be the right policy to follow let us for the sake of argument assume that the food subsidy is withdrawn or reduced by cutting procurement prices. This might lead to reduction in government expenditure. Nevertheless this policy shall seriously jeopardise the degree of stability in grain production which the Indian farmer has brought about. Can we risk this consequence? Certainly not, in my humble opinion.

As we have noted earlier, the real income originating in the agricultural sector has grown at an average annual rate of about 1.5 percent (end-point to endperiod basis) between 1977-78 and 1985-86. The regression results put this estimate around 2.0 percent. But because of sharp fluctuations from year to year, the regression fit is not tight, and the R^2 comes to about 0.50. Remember this magnitude of the average growth rate in agricultural income (1.5 to 2.0%) is less than the known rates of population growth in rural India, where three-fourths of our population lives and agriculture employs nearly two-thirds of the country's total workforce.

The average per capita real income in the agricultural sector in the 1980s did not grow at all. On the contrary it experienced some deterioration. The farm sector is a price-taker, par excellence. The price per unit of output times the volume of output determines the gross income of the farm sector. Its net income is affected by the prices it has to pay for the modern inputs; and the farm sector has no control on these prices as well. The route towards lower subsidy expenditure on food and fertilizers does not seem to consist either (a) in cutting down support prices paid to grain producers, or (b) in charging them higher prices for the fertilizers. The farm sector's per capita income has been stagnant in the 1980s and

the grain prices received by the Indian farmers have been more or less in line with what might be called the landed price of imported grain.

It is also not clear as to who is the real beneficiary from the fertilizer subsidy: the inefficient producers of these fertilizers, or the farmers who use them? The prices of urea in the gulf area have ruled around 50 per cent of the price charged to the Indian farmer. One might argue, therefore, that in order to cut the expenditure on fertilizer subsidies, let us cut the prices paid to fertilizer producers. This would lead to the closure of domestic fertilizer industry; it will be priced out of the world market. Can we deal with the resultant uncertainty of fertilizer supplies? The uncertainty that surrounds the energy market is not something to trifle with. The uncertainty in fertilizer supplies will certainly destabilize our agricultural production, which this country cannot afford.

Some of the known policy dilemmas, and some less known facts, surrounding the question of food and fertilizer subsidies, have been posed. I must now move on to a riddle, which might illustrate the sorry state into which this economy seems to be gravitating.

We have already noted our concern for stability in foodgrain production. Nevertheless in the past three years in a row (including the current year), foodgrains production has remained below the 1983-84 level. Consumption of foodgrains (per capita per year) in the 1980s, on the other hand, has been no greater than the annual rates of average per capita consumption in the early 1960s: per capita consumption of cereals has gone up a little, but that of pulses has gone down appreciably. The grain stocks with the government, however, have accumulated in the 1980s. At the end of financial year 1983-84, stocks were about 15 million tonnes. In each of the three succeeding years (including 1986-87) this stock level has been a little over 21 million tonnes at the end of March. (Of course these stocks reach much higher levels around June—end or early July)

The riddle is this: in spite of large food subsidy (Rs. 2000 crores a year) and with actual reduction or no growth in grain production in the last three years, the growing Indian population has not been able to consume the grain produced by the system. It is indeed most disturbing that our growing population does not have the purchasing power to absorb the food at current costs which have been kept artificially low by incurring food and fertilizer subsidies of the order of Rs. 4000 crores per year.

The clues towards an answer to this riddle are given in the two earlier sections: one dealing with deficit financing and inflation and the other with the tax and borrowing policies of the government in the 1980s. An average annual rate of inflation of about 9.0 percent, and the injurious income distribution effects of large interest liabilities of high cost market borrowing to finance plan projects and programmes of low productivity, have hit the poor in their stomachs. The poor can reap no direct benefits

from reduction in personal taxes. The purchasing power of the poor, whose demand for foodgrains is income-elastic, was extinguished by persistent inflation. Remember the rich can enjoy larger and larger incomes with only marginal impact on the demand for foodgrains. In the 1980s the poor could not buy more grains they much wanted to eat, while the government piled up stocks, which it is finding extremely expensive to carry.

Will it make sense to raise food prices to cut expenditure on food subsidy when the poor cannot afford to buy enough grain for their needs at the current subsidized prices? The answer to this question, of course, does not imply that all urban consumers need the food subsidy. Neither should I be understood to be saying that the rural rich should not be taxed. However, I would not want this done through higher fertilizer prices. Prices of modern farm inputs are already ruling high and any further increase in the prices of fertilizers would curb the much desired spread of fertilizer use, particularly in the backward areas.

One can suggest policy options, which could induce right kind of correctives in the production structure as well as help improve the fiscal health of the government. This will take us far away from the theme of this lecture and the matter is better left aside for another occasion.

9. SOME CONCLUDING REMARKS

Prudence requires that I should resist the temptation to summarise, point by point, what I might regard the major conclusions of the paper. Although this paper has become too long already, a few concluding remarks may, nevertheless, seem in order :

1. Keeping aside the worrisome increases in defence expenditure, which are eating into the developmental resources of this poor nation, the runaway increases in interest payments, unprecedented and persistent recourse to badly predicted but alarmingly large doses of deficit financing and expenditure on certain subsidies have been the direct corollaries of the irresponsible and unprofessional urges of the planning process in recent years. The planners might like to reconsider their role and style of functioning in order to regain for the planning process its relevance and much needed credibility.
2. As things stand at present, the Seventh Five Year Plan is unable to impart any discipline or sense of direction for sound economic management. Instead, it appears to be the main alibi for introducing all manner of distortions in the economy. In the name of this utterly "unbankable" plan, the Government is increasing its

- responsibilities and this system's liabilities well beyond the "safe" and "prudent" limits, both in relation to the rate of growth of its revenues as well as its institutional competence.
3. The technology of budget making in India, to say the least, leaves an awful lot to be desired. We must hang our heads in shame that, in normal peace time conditions, we are unable to frame estimates of revenue and expenditure, which cannot stay good even for three months. Estimates for fairly simple items, such as the interest liabilities, often go awry by many hundreds of crores of rupees.
 4. It is indeed manifest that the budgetary authority does not have a clue about its legitimate function of expenditure control. Nevertheless, for all practical purposes, it has managed to pre-empt the control of money supply from the RBI—a function which should belong to the independent monetary authority of the nation.
 5. We are in a sorry state : the planners do not bother to check the implementability of the plans they formulate, the budgetary authority has little control on expenditure and even less professional pride in the accuracy of the budget estimates it frames, the independent monetary authority has been reduced to the role of an helpless spectator in the matter of its legitimate function of controlling the nation's money supply. The delicate system of checks and balances, so essential for the sound management of economic, fiscal and monetary affairs of the nation, has pretty nearly been subverted.
 6. The last observation that I wish to make is in the nature of an important post-script. The Indian economic system comprises of two separable economies. One economy is constituted by the small and marginal farmers, landless agricultural labour, particularly the casual labour, petty artisans, the unorganized labour in the urban sector, the unemployed and the under-employed casual workers in the informal sector. All these constitute around 45 to 50 percent of the rural and about one-third of the urban population. All the rest, the not-so-poor and the rich, constitute the other separate economy.

The links between these two separable economies are indeed weak. The reach, scope and effectiveness of most of the usual economic instruments in the first separate economy is severely limited. Aside from the direct benefits that the inhabitants of the first economy might reap from a few thousand crores spent in the anti-poverty programmes and on food subsidy, this economy receives only the backwash effects of the general economic, fiscal and other regulatory operations of the government which are aimed at cajoling, coercing and directing the efforts and activities of

the people belonging to the other separable part.

The effects of the fiscally induced monetary expansions, which lead to inflation, however, are felt almost immediately in the first economy. The poor and the weak, who have no means available to them to neutralize inflation, are hit in their stomachs. Every one percent increase in the rate of inflation, over and above the rate at which the real incomes of the poor might grow, manages to swell their ranks by more than one percent. The direct benefits of the anti-poverty programmes and food subsidy are obliterated many times over even by a modest acceleration in the rate of inflation.

Persistent inflation in the 1980s has been totally policy-induced. It has led to a lot of unrest and furor all over the country, which, for the greater good of all of us, must not be ignored. If the government of India is unable, or does not have the inclination, to come to grips with the problem of abject poverty, it would do well at least to get off the inflationary path it has pursued through its almost doctrinaire attachment to reckless deficit financing and large public borrowing, in more or less complete disregard of the growth in its revenues and real output growth in the system. Although the exact facts would not be known for quite some time, the real NDP growth in 1986-87 may not have exceeded 4.5 percent. If the Government is at all keen to reduce the rate of inflation in 1987 (in comparison with the 9.0 percent rate in 1986), it must limit the growth in aggregate monetary resources, M_3 , to about 10 percent by November 1987 over the outstanding level reached on the last Friday in December 1986.

APPENDIX TABLE A-1
NET DOMESTIC PRODUCT AT FACTOR COST BY INDUSTRY OF ORIGIN AT 1970-71 PRICES
(R. crores)

Sl. No.	Sector	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	Growth Rate %
(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1.	Agriculture, Forestry and Fishing	19689	20245	17527	19694	20520	19810	22073	21861	22119	1.47
	Increments		556	-2718	2167	826	-710	2263	-212	258	
	Percentage Change		2.82	-13.42	12.36	4.19	-3.46	11.42	-0.96	1.18	
	Index Values	100.00	102.82	89.02	100.02	104.22	100.61	112.11	111.03	112.34	
2.	Public Adm. and Defence	2535	2819	3143	3496	3905	4379	4867	5517	6205	11.84
	Increments		284	324	353	409	474	488	650	689	
	Percentage Change		11.20	11.49	11.23	11.70	12.14	11.14	13.36	12.49	
	Index Values	100.00	111.20	123.98	137.91	154.04	172.74	191.99	217.63	244.81	
3.	NDP-Public Adm. and Defence	41602	43774	40951	43830	46031	46971	50714	52137	54342	3.40
	Increments		2172	-2823	2879	2201	940	3743	1423	2205	
	Percentage Change		5.22	-6.45	7.03	5.02	2.04	7.97	2.81	4.23	
	Index Values	100.00	105.22	98.43	105.35	110.64	112.90	121.90	125.32	133.62	
4.	Total NDP	44137	46593	44095	47326	49936	51350	55551	57654	60548	4.03
	Increments		2456	-2499	3232	2610	1414	4231	2073	2894	
	Percentage Change		5.56	-5.36	7.33	5.51	2.83	8.24	3.73	5.02	
	Index Values	100.00	105.56	99.90	107.22	113.13	116.34	125.92	130.63	137.18	

†Based on end points only.

APPENDIX TABLE A-2
**OUTSTANDINGS ON LAST FRIDAY IN DECEMBER AND INCREMENTS DURING THE
 PREVIOUS CALENDAR YEAR**
 (Rs. crores)

Sl. No.	Description	1978	1979	1980	1981	1982	1983	1984	1985	1986	Growth Rate† %
(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1.	M_3 : Aggregate Monetary Resources	38396	45232	52611	61751	71494	83134	99011	115859	136149	17.1
	Increments	7306	6836	7379	9140	9743	12320	15197	16048	20290	
	Percentage Change	23.50	17.8	16.3	17.4	15.8	17.2	18.1	17.0	17.5	
2.	Net RBI Credit to Govt.	7745	9658	13871	18082	22981	24467	28711	38710	44975	24.6
	Increments	640	1913	4213	4211	4899	1486	4244	9999	6265	
	Percentage Change	9.01	24.7	43.6	30.4	27.1	6.5	17.3	34.8	16.2	
3.	Reserve Money	12664	15320	17655	19517	23025	26017	30378	37504	43567	16.7
	Increments	2157	2656	2335	1862	3508	2992	4361	7126	6063	
	Percentage Change	20.5	21.0	15.2	10.5	18.0	13.0	16.8	23.5	16.2	
4.	Ratio of Net RBI Credit to Reserve Money	61.2	63.0	78.6	92.6	99.8	94.0	94.5	103.2	103.2	
5.	M_3/RM	3.03	2.95	2.98	3.16	3.11	3.22	3.26	3.09	3.13	
6.	$\Delta M_3/\Delta RM$	3.39	2.57	3.16	4.91	2.78	4.12	3.48	2.36	3.35	

†Based on end points only.

APPENDIX TABLE A-3
PRICE MOVEMENTS: 1977 TO 1986

Sl. No.	December	Wholesale Price Index	Change†	IW	Change†	Consumer Price Index	Change†	All	Change†
(0)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		Index	%		%	NME	%		%
1.	1977	185.5		330		301		330	
2.	1978	185.3	-0.1	335	1.5	308	2.3	318	-3.8
3.	1979	224.1	20.9	374	11.6	341	10.7	370	16.4
4.	1980	257.1	14.7	408	9.1	376	10.3	408	10.3
5.	1981	279.5	8.7	460	12.8	420	11.7	454	11.3
6.	1982	288.7	3.3	497	8.0	452	7.6	478	5.3
7.	1983	318.7	10.4	559	12.5	500	10.6	521	9.0
8.	1984	338.0	6.1	588	5.2	537	7.4	522	0.2
9.	1985	356.4	5.4	630	7.1	574	6.9	557	6.7
10.	1986	378.0	6.1	688	9.2	622	8.4		
Annual Growth		9.3%		9.4%		9.2%			

rate††

†Change during the previous year

††Based on end points only.

APPENDIX TABLE A-4
 LIABILITIES OF AND CAPITAL INVESTMENTS AND LOANS ADVANCED BY THE CENTRAL GOVERNMENT
 (As at the end of March) (Rs. crores)

Items	1966	1978	1980	1981	1982	1983	1984	1985	1986	1987	1988
										(R.E.)	(B.E.)
Assets											
A. Capital Outlay	6585	21113	25650	29833	34132	38887	44972	52827	62063	72879	84268
B. Loans advanced	5380	19787	26634	29837	33900	40400	45850	52293	61902	71278	79624
I Total Assets (A+B)	11965	40500	52484	59670	68032	79287	90822	105120	123965	144157	163892
Liabilities of Central Government											
Public Debt (1 + 2)	8008	28010	34363	421625	47981	60621	65383	75174	89192	105427	121157
1. Internal Debt	5417	19025	24399	30864	35653	46939	50263	58537	71099	85214	98151
2. External Debt†	2591	8985	9964	11298	12328	13682	15120	16637	18153	20213	23000
II Total Net Liabilities	11027	39904	49915	59449	67886	84572	94961	113141	137314	163958	190591
III Excess of Liabilities Over Assets	-937	-996	-2569	-221	-146	-5285	4140	8021	13349	19f01	26698

†Note. The rupee figures of external debt are difficult to reconcile with amounts stated in foreign exchange, say U.S. dollars.

According to the *World Development Reports* 1985 and 1986, India's external public debt outstanding at the end of 1983 and 1984, respectively, was 21,227 and 22,403 millions U.S. dollars. Even at a notional rate of exchange of Rs. 10 to one U.S. dollars, the external debt in 1984 should come to Rs. 22,509 crores rather than Rs. 15,100.