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Shenoy: Indian Economic Police

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INDIAN ECONOMIC POLICY. By *B. R. Shenoy*. Bombay: Popular Prakashan. 1968. Pp. xviii, 354. Rs. 25.

Seventy per cent of the investment resources of India are allocated to the public sector. The dominating participation of the government in India's mixed economy underscores the necessity for economists to exercise a constant and critical vigil on Indian economic policy. Professor Shenoy's book, therefore, deserves a hearty welcome. However, contrary to the expectations engendered by the title of the book, it is not a comprehensive treatment in coordinated chapters of the Indian government's general economic policy. Instead, it is a collection of Professor Shenoy's articles, published from 1958 to 1966 in daily newspapers as well as in professional journals, in criticism of the government's policies. Consequently, the chapters are at times annoyingly repetitive and often relate to particular policy decisions made by the government on various occasions. However, a theme does emerge from the book as a whole, and it is sometimes supported by excellent analysis. That theme is that the centralized economic planning and the diversion of resources to the public sector have resulted in serious economic and social ills in India.

Professor Shenoy observes that the Indian national income is among the lowest as well as slowest rising in the world. Although nearly one half of it is drawn from agriculture, and although nearly seventy per cent of the population lives on that one half, agriculture has remained neglected. This neglect is evident from the poor allocation of resources to agriculture, while growing proportions of domestic savings and foreign aid are appropriated to the public sector and to the heavy industries in the private sector. The growth of national income (3.2 per cent per annum) has barely kept pace with the growth of population (2.2 per cent per annum); and after these statistics are adjusted to real terms, the actual well-being of the masses appears to have declined. Inflation has been on the increase as a result of the combination of the budget deficits covered by Reserve Bank and commercial bank borrowing, the secondary expansion of credit due to deficit financing by commercial banks on their reserves, and the rupee payments made to the United States Agency for International Development (USAID) in New Delhi for the imports of food grains and other agricultural surpluses from the United States under its Public Law (P.L.) 83-480.[1] Although the P.L. imports have discharged the humanitarian function of making up for crop failures, they have, in Professor Shenoy's opinion, distorted the price structure and induced shortfalls in production, and consequently have created the need for food imports. These imports squeeze the food grain farmer and induce him to shift land and resources away from food crops. Since the shift is artificial, the national product is adversely affected. The need for such imports is likely to continue so long as the policies of forced industrialization continue to the neglect of agriculture. The rise in food grain prices is the result of physical shortages of food grains and inflation, not of any monopoly combination or hoarding on the part of traders and large farmers. Therefore, according to Professor Shenoy, anti-

1. Agriculture Trade Development and Assistance Act of 1954, 68 Stat. 454, codified in 7 U.S.C. §§ 1427, 1431, 1691-94, 1701-09, 1721-24 (1964).

hoarding ordinances would merely shift the hoarding from a comparatively small number of traders and large farmers to householders. Moreover, Professor Shenoy feels, long-range help cannot be expected from the Food Corporation, a public-sector corporation designed to ensure a minimum price to the producer and to protect the consumer from speculative trade. The Corporation, in its effort to meet its high running costs and to show profits, would squeeze both farmers and consumers and would open up fresh portfolios of political partonage and power. The price controls have failed not because there has been collusion between traders and cultivators, but because the government has failed to deal properly with the two major causes of rising prices, mentioned above. In addition, in Professor Shenoy's view, food rationing in urban areas would not help the food crisis, since support for rationing depends on the mistaken theory that hoarding is the cause of the crisis. Indeed, rationing may be worse than no rationing at all, since, on account of the black market, it does not reduce consumption, and since, at the same time, it works against the poor by raising the black-market prices. Professor Shenoy believes that dependence on food imports is both unnecessary and uneconomic, because the food deficit, being only 6.6 per cent of the net domestic production, is marginal in relation to domestic production, and because it is possible to achieve substantial increase in food production at costs much lower than the costs of United States food grains. However, farmers are unable to increase production since the bulk of investment resources from domestic savings and foreign aid is appropriated to the public sector, instead of meeting the capital needs of the farmer, and since the existing laws narrowly circumscribe the activities of private bankers and moneylenders in attending to the needs of the farmer.

According to Professor Shenoy, the state domination of investment activity is the cause of social injustice, because it concentrates economic power in the hands of the politicians and civil servants with the result that those state functionaries gain arbitrary rights of disposal over the employment, livelihood, and welfare of "virtually the entire nation" (p. 38). Moreover, forced industrialization has retarded the growth of the national product by diverting the resources away from agriculture and the consumer goods industries, in which the yields and employment potential are the highest, to the production of capital goods and intermediate products, in which the yields and employment potential are generally the lowest. Appropriation of seventy per cent of the investment resources to the public sector has created excess production capacities in public sector undertakings, has led to wastes through corruption and inefficiency, and has resulted in the capital starvation of agriculture. The overemphasis on industry has, in certain favored areas, pushed industrial production beyond its economic limit and has prevented agricultural production from reaching its proper economic limit. Professor Shenoy believes that exchange controls and import restrictions do not add to the available supply of investment resources, but that, instead, they retard the pace of development, fail to alleviate the adverse balance of payments, and in fact accentuate income contrasts by shifting enormous incomes to the beneficiaries of import licenses. He does not accept the official explanation that the phase of price rise which began in 1955 is the natural consequence of economic development, and he finds the cause of that rise to be in the government's attempts to invest nonexistent resources through the device of budget deficits which result in the expansion of money. The current inflation, he believes, does not result from indiscriminate use of bank funds, and thus the policy of a credit curb against banks is a punishment which they do not deserve. It may be noted here that the larger banks in India have been nationalized since Professor Shenoy's writings.

Professor Shenoy advocates drastic cuts in revenue collections by the state in order to step up national savings and avert the human cruelty involved in cuts in the consumption standards of the masses who are already at the margin of subsistence. He regards progressive taxation as particularly pernicious and deserving of abolition, since

> [i]ts incidence is anti-social in that it virtually closes the route to vertical mobility in the acquisition of income and wealth; tends to freeze the prevailing pattern of income and wealth distribution; deprives the community of the full production advantages of its ablest men as it penalizes talent and efficiency; and thus debilitates a major force of dynamism and growth. [P. 177.]

He thinks that "[m]odern communities have been saved from the full impact of progressive taxation through tax avoidance and illegal tax evasion, though the moral and economic costs of this have been heavy" (p. 177).

The foreign exchange reserves of India have suffered a "swing . . . from abundance to penury" (p. 181). The official explanation for the swing cites defense expenditures, economic development, the food crisis, high imports, and adverse movements in international prices. Professor Shenoy refuses to accept that apology; instead, he sees foreign exchange difficulties as a functional counterpart of inflation. Inflation has overvalued the rupee; and overvaluation of the rupee has handicapped export production and has necessitated exchange control and import restrictions which, in turn, with the help of other general economic policies, have resulted in indiscriminate import substitution, that is, a shift away from export production in order to fill the domestic need created by import restrictions. Despite receipts of foreign aid, the balance-of-payments difficulties have persisted because of the increase in the imports of raw materials and capital equipment due to the expansion of the national product, and because of the inability of the economy to produce sufficient export earnings to pay for the increase in essential imports. The overvaluation of the rupee has thus resulted in (1) a heavy decline in currency reserves, (2) a rise in external prices of Indian exports, (3) an undue cheapening of import goods in relation to the corresponding home products, (4) gaps between the landed costs of import goods and their market prices, and (5) a gap between the internal and external prices of gold which has resulted in illicit imports of gold.

Foreign aid, in Professor Shenoy's opinion, has not been able to achieve its objective of bringing to the masses a relief from poverty and from unemployment. Rather, much of the aid has been misdirected. That misdirection has not been a deliberate act, but a fortuitous outcome of centralized economic planning, extensive controls, phenomenal illicit incomes produced by the controls, undue extension of the public sector to the point that it absorbs seventy per cent of the available investment resources, inflation resulting from attempts to invest nonexistent resources, and overvaluation of the rupee resulting from the past inflation.

In addition to giving his criticisms of the Indian government's economic policies, Professor Shenoy offers his own solutions to the problems he examines. He suggests, for example, that in order to meet the balance-of-payments difficulties, there be a complete stop to overinvestment and a devaluation of the rupee to the equilibrium level.[2] His remedy to the food crisis calls for a stop on inflation and, at the same time, sufficient imports of food grains to cover the food shortages. But he sees no lasting solution to the food problem unless

> first, the colossal public sector appropriations of investment funds are drastically scaled down to permit a larger flow of these funds into agriculture; and, secondly, legislation now crippling the business of agricultural credit by obstructing the flow of credit and capital into farm finance and by imparting [*sic*] the credit-worthiness of farmers is suitably amended. [P. 33.]

He feels that the removal of exchange controls and import restrictions is a necessary prerequisite to accelerated economic and social progress. His solution to inflation requires drastic cuts in the allocation of resources to the public sector in order to stop investment of nonexistent resources. His cure for the foreign exchange difficulties is to stop inflation and to adjust the value of the rupee

2. The rupee has in fact been devalued since Professor Shenoy's writings, and he makes a note of that fact in the preface to his book.

to equilibrium level, preferably through the device of a floating rupee. He suggests these same measures—that is, prevention of further inflation and devaluation of the rupee—as remedies for illicit imports of gold. Professor Shenoy recommends four reforms to meet the problem of overvaluation of the rupee: (1) a policy of zero inflation; (2) a shift back from production for the home market to production for exports; (3) a downward adjustment in the exchange value of the rupee; and (4) elimination of price gaps between the landed costs and the market prices of import goods, and between the official and the market prices of gold. All in all, he wants to "scale down drastically nationalization through the extension of the public sector, governmental interventionalism in the life of the community, and to rely on [*sic*] a much larger measure than now on the market mechanism for the allocation of resources" (p. 189).

Professor Shenoy's criticisms of the Indian government's economic policies are valuable and merit serious attention. Indeed, it is very distressing for me to see, upon visiting my homeland, that the economic lot of the man on the street is less satisfactory than what I expect upon reading the growth statistics of the country as a whole. It is equally disturbing to learn that "black market" is a household word, that that market, particularly in food grains, is more open than clandestine, and that bribery and other forms of corruption are the mode of life at most levels of intercourse with governmental officials.

Despite his valid criticisms, however, Professor Shenoy has failed in his own turn to develop fully the arguments supporting his solutions to the Indian economic problem. As a result, one finds him taking even contradictory positions. For example, he calls for the foreign-aid-giving countries to induce shifts in Indian economic policy through economic diplomacy (p. xiv); and at the same time he deplores such interference (p. xv). His remedy for the food crisis calls for imports of food grains, in addition to stopping inflation (p. 30); but, at the same time, he finds P.L. 83–480 imports to be a cause of inflation (p. 19) and other ills (p. 78). He pleads for drastic cuts in revenue collections by the state in order to step up national savings (p. 177); while at the same time he acknowledges that the masses of the people are at the margin of subsistence (p. 177) and therefore, deductively, not a potential source of savings. Moreover, the person at the margin of subsistence would probably either be exempt from taxation or pay at a low rate under a progressive income tax. Professor Shenoy makes a strong plea for the abolition of progressive taxation (pp. 173-75), but he does not establish that the equities which form the argument for the concept of progressive taxation are not worth pursuing. He criticizes legislation regulating the activities of bankers and moneylenders as a hindrance to the flow of capital to the farmers (p. 32), but he neither specifies the laws involved nor establishes his point beyond simply stating it. Indeed, this reviewer finds a great deal of merit in regulating, for example, usury and other traditional forms of exploitation of the farmer in India. Professor Shenoy criticizes antihoarding ordinances with respect to food grains, because such ordinances merely shift the hoarding from a comparatively small number of traders and larger farmers to householders. The reviewer, however, finds merit in this shift, since there is a significant distinction between a householder accumulating grains to feed his family in harder times to come and a trader arresting the flow of the grains to the householder with a view to profiteering when the harder times do come upon the householder.

Finally, although it is not quite clear from the book, it seems that Professor Shenoy would like to have the state abstain from engaging in the production of goods and services and leave the economic life of the country as much to *laissez-faire* as is possible. However, in order to make a case for abolishing or minimizing the diversion of resources to the public sector of the Indian economy, it is necessary to answer at least two basic questions. First, if the government does not engage in those activities which private entrepreneurs are not willing to undertake, how will that task, vital to the implementation of the public interest, be accomplished? Second, how, if not through the public sector, is it possible in India to muster sufficient investment resources for the country's needed economic development? In this regard, Professor Shenoy does little more than mention capital markets and the market mechanism. Perhaps he does not recommend a complete abolition of the allocation of resources to the public sector in India, but only the restriction of that allocation within certain limits. In that case, it would have been extremely useful if he had presented his thoughts in detail and suggested principles or guidelines for determining the proper economic limits for the public sector.

In the last analysis, then, Professor Shenoy's book is more noteworthy for his valuable criticisms of the economic policies of the Indian government than it is for the remedies he suggests. Yet it certainly must be read by those interested in Indian economics.

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