UNIT 1 ECONOMY AT THE TIME OF INDEPENDENCE

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1.0 OBJECTIVES

After going through this unit you should be able to :

- Recognise the need for understanding the historical dimensions of the problem of economic development;
- Identify the basic characteristics of rural and urban economy in pre-British India;
- Discuss the conditions that favoured rapid economic development in the Indian economy as it obtained on the eve of the British arrival;
- Explain the circumstances in which the Britishers came to India;
- Discuss the state of different sectors of the Indian economy on the eve of Independence;
- Examine the nature, extent and causes of poverty on the eve of Independence; and
- Discuss the effects of partition of the country on economic development.

1.1 INTRODUCTION

Poverty in India, as we find it today, is not of recent origin. It has roots in the past. Not that India was a poor country always. Contrary to it, volumes have been written by foreign travellers to this land to depict the riches and wealth of India. There was hardly a traveler who was not fascinated by the richness and abundance of this land. How did such a rich country get reduced to the *status of a poor, stagnant, backward and under-developed economy ?* It is a long story. This all began with the arrival of the British in India around the early eighteenth century. In this unit, we will examine

in brief the state of the Indian economy as it obtained before the arrival of the British in India. We will trace the arrival of the British and examine the state of the Indian economy as it obtained on the eve of the independence in 1947. Such a review will help us appreciate the magnitude of effort involved in our fight against poverty and raise average standard of living over the last five decades since independence, and the degree of success achieved by us.

1.2 INDIAN ECONOMY IN THE MID-EIGHTEENTH CENTURY

A simple idea about the state of the economic system as it obtained in pre-British India can be formed by looking at the rural segment and the urban segment of the economy.

1.2.1 Nature of Rural Economy in Pre-British India

A self-sufficient village, based on agriculture carried on with the primitive plough and bullock-power and handicrafts by means of simple instruments, was the basic feature of pre-British Indian society.

The self-sufficient village as the basic economic unit had existed for centuries in India and, except for some minor modifications, had survived till the advent of the British rule. The village population was mainly composed of peasants. The village committee, representing the village community, which was the *de facto* owner of the village land, distributed this land among the peasant families in the form of holdings. Each holding was cultivated by the peasant family by means of the collective labour of its members and with the aid of the primitive plough and bullocks. The peasant family enjoyed a traditional hereditary right to possess and cultivate its holding from generation to generation. Further, village agriculture was mainly produced for the needs of the village. A share of this produce had to be surrendered to the lord of the moment . Besides the peasant families, the village population also included industrial workers-such as a blacksmith, a carpenter, a potter, a weaver, a cobbler, a washerman, an oilman, a barber, and others. They all worked almost exclusively for satisfying the needs of the village population. All exchange of products produced by the village workers, agricultural or industrial, was limited to the village community and hence very restricted in scope. The village population consumed almost the whole of what it produced. Thus, economically, the village was predominantly autarkic. Local produce prepared mainly by means of local labour and resources was almost locally consumed. There was very little exchange between village and outside world. Whatever little trade existed, was carried on, generally, on a specific day of the week, at the market in a big village where a variety of goods from a number of centres were sold.

1.2.2 Nature of Urban Economy in Pre-British India

Amidst an ocean of tiny, autarkic village, a few towns had sprung up and existed. These towns were of three kinds, those of political importance, those of religious significance and others of commercial value. Handicraft industries, complex and diversified, flourished in these towns. In contrast to the artisan industry which had to supply the limited needs of a small village group, it was the urban industry which produced luxury articles for the aristocratic and wealthy merchant strata of the society; which produced equipment for the army, forged weapons of war and undertook the construction of military forts; which erected magnificent places, imposing temples and even such monuments of rare art or engineering as the world-celebrated

Taj Mahal and Qutub Minar. It was the urban industry, which undertook to construct canals. The town handicrafts of India, during centuries of their existence in pre-British India, had reached a high level of development. The fame of their products, which were varied and had the great artistic quality, had spread to distant countries. The Indian industries, consequently, commanded a world market. Perhaps, the most striking feature of the urban industries was the extremely limited character of their market. This was due to the fact that they did not produce articles of daily use for the common people but functioned to meet the specific needs of the social strata and institutions mentioned above. Further, the requirements of the vast mass of the population living in autarchic villages were met by the local artisan industry of the villages themselves, thereby narrowing down the market of urban industries to extremely restricted zones.

1.2.3 Conclusion

In brief, it could be stated that India had a well-knit economic organisation during the early eighteenth century. Although we cannot say that the Indian economy was a "developed" one in the modern sense of the term, we can positively affirm that the Indian economy did possess sufficient vitality to grow at a fast rate. The striking balance and the close harmony between agriculture and industry was a very rare phenomenon. India enjoyed supremacy in the external trade. If proper infrastructure could be developed, it offered vast opportunities for internal trade also. In short, India during the mid-eighteenth century was a country well-equipped to meet the rising demands of fast economic development.

1.3 ARRIVAL OF THE BRITISH IN INDIA

The British commercial expedition to India began on 31st December, 1600 when the British East India Company was granted the monopoly of eastern trade. The Company got itself entrenched on the commercial map of India. The Company's aims and objectives underwent a change. A peaceful trading body was transformed into a power eager to establish its own position by territorial acquisition. The company had its first major success when it fought and defeated the Nawab of Bengal in the Battle of Plassey (1757). By the middle of the nineteenth century they had brought a large part of the country under their control. In 1858, the administration of the Company-controlled areas was transferred to the British Crown. Thus, India became a colony of the British Empire. The British gave a new economic system to India. This was the *system of the market.*

The market system destroyed the earlier harmony between agriculture and industry in Indian economic organisation; instead, cultivators, traders and producers, artisans, agricultural and industrial workers, were all exposed to vagaries of the market forces. The market system opened the floodgates of colonial exploitation of the Indian economy at the hands of its masters, the Britishers. The exploitation was on such a large scale that it came to be known as 'drain' of the national wealth.

Check Your Progress 1

1) Describe in brief the basic features of the pre-British Indian society.

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2) What was the nature of exchange of village products?

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3) What was the nature of exchange of products of Indian Industry?

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4) Was pre-British India a developed economy in the modern sense of the word?

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1.4 INDIAN ECONOMY AT THE TIME OF INDEPENDENCE

The 200 years of unchecked drain inflicted deep wounds on economic organisation. On the eve of independence, the Indian economy was a backward stagnant economy characterised by widespread poverty. Whole of the economic structure was geared to the colonial needs of the British; it was totally a dependent system. The partition of the country brought in its wake insurmountable problems for the economy. Let us examine in detail a few of these aspects.

1.4.1 State of Indian Agriculture

Agriculture has always been the primary industry of India, even from early days, and so it was in 1947, i.e. on the eve of independence. About 70 per cent of the total labour force was engaged in this sector. About 50 per cent of the national product was generated in this sector. Net sown area estimated at about 127 million hectares formed about 43.6 per cent of the total reported land area of the country. Food crops accounted for about 80 per cent of the land area under cultivation, while non-food crops accounted for 19 per cent. Important crops that were produced were wheat, rice, millets, sugarcane, cotton and jute. India produced about 32 per cent of the world's total production of groundnuts, 41 per cent of jute and 27 per cent of rice. India was the largest producer of groundnuts, sugarcane and hemp, the second largest producer of cotton next to USA, and China in the world.

Notwithstanding this predominant position, productivity in the agricultural sector was among the lowest in the world. This is clearly brought out in Table-1 below:

Table-1: Yield in quintals per hectare for 1946

Country	Rice	Wheat	Barley	Maize
Itlay	41.7	13.3	9.7	15.1
Spain	42.2	9.6	12.9	14.8
Argentina	33.9	10.0	11.9	22.3
Japan	36.9	9.7	10.7	12.5
India	12.3	6.0	7.9	6.2

The table-1 clearly brings out the fact of low agricultural productivity in India on the eve of Independence. Low productivity in the agricultural sector could be explained by a number of factors; more important among these were (i) the rising pressure of population on land; and (ii) the neglect of agricultural improvements at the hands of the British Government in India.

i) The mass of Indian handicraftsmen, ruined as a result of the influx of machine-made goods of British industries, could not be absorbed in the indigenous industries. These took to agriculture for subsistence. It was this overcrowding on land, which primarily explained the ruinous subdivision and fragmentation of land resulting in the growth of uneconomic holdings. This, in turn, resulted in a steady decline in the income of the large section of the agricultural population. The impoverishment of the agriculturists, disastrously affected agriculture. The impoverished agriculturist could not renew his livestock or properly manure the field. He and his family lost physical energy due to malnutrition and thereby capacity for labour on the field. Thus, agriculture stagnated, in fact, deteriorated. The yield per hectare steadily declined.

ii) The institutional and the infrastructural framework that obtained in the agricultural sector on the eve of independence were also largely responsible for backward agriculture. The *Zamindari* system, introduced by the British covered 62 per cent of the land. The remaining 38 per cent was under the *Ryotwari* system. The *Zamindars* used to extort as much rent as they could from the cultivators, leaving no surplus and little incentive for the cultivator to bring about any improvements on the land. Further, although a canal network had been laid down, but this was grossly inadequate ; only 17 per cent of the area under cultivation had the benefit of irrigation. Likewise, orderly markets for agricultural produce did not exist, nor were there any government agencies entrusted with this task. For his credit requirements, the farmer depended upon indigenous bankers in absence of any organised credit system. In short, the agricultural sector as a whole suffered decay and stagnation; the economic condition of peasantry was poor. This type of system could prove only a drag on growth and cried for immediate relief and improvement.

1.4.2 State of Indian Industry

Pre-British India was a land of artisans and handicraftsmen. It was during the British period that the modern machine-based industries were established in India. But the industrial development of India was insufficient and lop-sided.

The relative backwardness of industrial development in India may be judged from the fact that in 1948-49 factory establishments accounted for only 6.6 per cent of total national income. The total labour force engaged in such establishments was about 2.4 million or 1.8 per cent of the working population in the country. While in the aggregate India's industrial output may look massive, per head of population it was very much lower than the industrial output in advanced countries. Prior to the First World War the only major industries, which had developed substantially were *cotton* and *jute textiles*, for which the country had exceptional natural advantages. The industrial development since the twenties was associated with the adoption of a more progressive industrial and fiscal policy. The Second World War created conditions for improved utilisation of the existing capacity in Indian industries. This was the major factor responsible for the increase in the recorded industrial production.

this period, but the major effect of the war felt in the sector of medium and small-scale industries. Industrial development during the war and the post-war period was influenced largely by the prevailing inflationary conditions and scarcities, with the result that long term factors such as the most-advantageous location or scale of operation, the availability of raw materials, the size of the market and the adequacy of the financial and technical organisation for successful operation under competitive conditions did not receive the attention they deserved. In the established industries the need during the war period to work multiple shifts and difficulties in the way of securing imports for depreciation and replacement led to a large accumulation of deficit in the maintenance of capacity. It took the country several years to make good this deficit.

The major emphasis in industrial development in India was on *consumer goods industries*, while the development of *basic capital goods industries* lagged far behind. A high and sustained rate of industrial advance could not be achieved without increasing substantially the production of basic industries such as iron and steel, aluminium, ferro-alloys, and other metal-making industries, chemical industries such as caustic soda and ash, fertilisers and petroleum products. In respect of the manufacture of plant and machinery required by various industries only a small beginning had so far been made with the textile machinery industry. The developments in power generation had to depend on generating equipment from abroad. In the manufacture of synthetic drugs and antibiotics and of dyestuffs and organic chemicals, only small beginnings had been made. Thus *industrial growth was neither evenly spread across regions nor across the various industrial sub-sectors*. Industrial structure remained palpably dependent on imports of plant and equipment, raw materials as well as spares.

1.4.3 State of Currency and Banking

Before the British came to India, every independent province had a distinct currency of its own. This prevented any trade transactions outside the limits of those provinces. The East India Company adopted silver rupee coin as the standard unit of currency in 1806. Rupee was also declared the legal tender currency, i.e. everyone was made to accept rupee in various trade transactions. These developments helped to establish a *unified monetary system*, which helped in expansion of the market system.

Banking on the modern lines was introduced in India during the last quarter of the 18th century and the 19th century. In 1840s three *presidency banks* were established, one each in *Bengal* (1840), *Bombay* (1840), and *Madras* (1843). The three banks were amalgamated in 1921 to form a new bank, which came to be known as *Imperial Bank of India* (after its nationalisation in 1955, this bank acquired the name of *State Bank of India*). The Reserve bank of India, which served as the central bank of the country, was established in 1935. Establishment of the chain of commercial banks in the country helped to promote the money and the market system.

1.4.4 State of Industrial Infrastructure

The slow and lop-sided growth of the Indian industry could also be attributed to inadequate availability of infrastructure, specially industrial infrastructure. During the British rule, undoubtedly some steps had been taken to create and spread infrastructure facilities, specifically in the form of irrigation, railways, roads and telephone. But the efforts proved inadequate in relation to the requirements. So that, on the eve of Independence, except for a well laid-down irrigation network in the

of. Communications facilities were outdated and could hardly be of use to facilitate economic transactions by the industrial sector. Likewise, largely because of the indifference shown towards raising generating capacity, power generation in the economy was nearly negligible. It could not have provided a basis for strong industrial growth in future. Similarly, the design of the railway system and the freight policy of the railways, both favoured the movement of manufactured goods and raw materials from and to port towns and not within the country itself. This encouraged export of raw materials rather than their domestic use, and import of industrial products rather than their domestic manufacture. In short, infrastructural inadequacies at the time of Independence proved a formidable challenge for the economic policy-makers in the post-independence era.

1.4.5 State of the Social Institutions

At the time of Independence, the old social institutions of India were in the melting pot. Before the arrival of the British the three prominent social institutions, per se, were the self- sufficient village, the caste system and the joint family system. By the time the British left India, the village community as an isolated, autonomous, self-sufficient unit had almost disappeared. The caste organisation was being increasingly challenged by economic pressure on the one hand, and by the force of new ideas and ideals that contact with Western thought and modes of living had brought with it, on the other. The joint family, though it still had a hold over the rural population, was fast disappearing in the towns and cities.

In short, the social organisation, on the eve of Independence, was in for a change. The economic stagnation that had marked a larger part of the British rule in India prevented a quick change in social norms and ways of living in the direction required of a fast developing economy.

Check Your Progress 2

1) Indicate in brief the major causes of low productivity in agriculture.

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2) Industrial development of India was insufficient and lopsided during the British rule. Comment.

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3) Which types of industries add to the production capacity of the economy?

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1.5 FEATURES OF THE INDIAN ECONOMY ON THE EVE OF INDEPENDENCE

In Section 1.4 above, we have described the situation as it obtained in different sectors of the economy. This description helps us to analyse the basic features of the Indian economy as inherited on the eve of independence in two groups, namely, (i) *India as an underdeveloped and backward economy*, and (ii) *India as a dependent*

economy. This under-development and dependence proved serious constraints on India's ability to remove poverty and provide decent standard of living to its people. This task was further constrained by the fact that the British dealt a parting blow to the economy in the form of the partition of the country that took place along with the independence. While we will study the impact of partition on the Indian economy in the subsequent section, in the present section we focus our attention on analysing the features of the Indian economy as (i) an underdeveloped economy, and (ii) as a dependent economy.

1.5.1 India as an Underdeveloped Economy

The major features that help us classify India as an underdeveloped economy can be identified as follows:

i) Low per capita income, widespread poverty and recurrent famines.

Low per capita income was indicative of the underdeveloped state of the Indian economy. India's per capita income was estimated as Rs.238 in the year 1950 -51 i.e. the average monthly income of an individual in India was less than Rs.20 and the per day average was almost sixty paise in the then prevailing prices. Moreover, income was very unequally distributed. It would mean that every single individual was not in a position to earn even sixty paise a day; some were earning even less than that.

For these reasons, the vast majority of the people lived in extreme poverty. Inadequate and unbalanced diet, primitive housing and often none at all, scanty clothing, bare feet, back-breaking toil, ill health, illiteracy, complete lack of social security and cultural amenities, widespread unemployment and under - employment, class and caste oppression, heavy burden of land revenue, rent and debt, and an unsympathetic and exploitative administration made their life miserable.

Famine was frequent occurrence over the greater part of the British period. When drought, floods and locusts caused extensive damage to crops, lack of income was as much a cause of starvation for large sections of the population, as shortage of food. It was only during the last quarter of the British rule that famine was no longer a frequent calamity. The extension of irrigation (as a remedy for droughts), the spread of railways (which made it possible to rush food from the surplus to the scarcity area), and the establishment of administrative arrangements and procedures to deal with scarcity conditions generally made it possible to avoid famines. However, the serious famine of Bengal in 1943 showed that India was by no means altogether free of famines.

ii) Stagnation in Indian Economy

The growing poverty was the consequence of stagnation that had set in the Indian Economy. Stagnation can be seen from the slow annual compound rates of growth in average per capita income during the British rule.

Table-2 : Annual Compound Rate of Growth of Per Capita Income

Period	Rate (Percentage)
1860-1890	0.64
1890-1920	0.72
1920-1940	0.16
1940-1950	(-) 0.13

Source: *M. Mukherji : "National Income", in V.B. Singh (ed.), Economic History of India, 1857-1956.*

Further evidence of stagnation can be found in the trends of agricultural output and productivity. Total output in agriculture, which was the dominant economic activity of the time, increased by only 10 per cent during the 52 year period of 1893-94 to 1945-46. The index of production of foodgrains came down from 100 in 1894-95 to 1945-46. Per capita output of foodgrains, which is an index of availability shows a decline by 32 per cent during this period. A stagnant agriculture, with ownership concentrated in a small number of absentee landlords, could only result in poverty and backwardness. We can find the evidence of the growing poverty in such things as frequent famines, increasing indebtedness of the cultivator, transfer of land from the cultivating owners to non-cultivating owners, etc. These facts bear testimony to the fact that the Indian poverty was growing.

iii) Mass Illiteracy and High Growth Rate of Population

Poverty and backwardness manifested themselves in mass illiteracy and high birth and death rates. In 1941, at the time of the last population census during the British period, literates were only 17 per cent of the total population, excluding children below 10 years. The percentage was much lower for the rural areas and for women than what the national average suggested. The majority of children did not attend school. This was particularly true of girls. As is generally true of very poor and backward societies, both the birth rate and the death rates were high.

The birth rate was high all through the British period. During 1931-41, the last complete decade of British rule, the birth rate was as high as 45.2 per thousand of the population. This rate was quite close to the biological maximum birth rate. The death rate also remained very high, well over 40 per thousand of the population up to the 1911-21 decade. The death rate began to fall during the last three decades of the British rule. It fell to 36.3 during 1921-31 and further to 31.3 during 1931-41. But this decline was reflection, not of a significant improvement in the living standards but of the considerable success achieved in (i) avoidance of widespread famines, and (ii) control of epidemics. The decline in the death rate added a new dimension to the population problem. Not only was the existing population very large, its growth rate had become very high.

iv) Low Level of Urbanisation

The backwardness of the economy was reflected in a low level of urbanisation. All advanced countries show a high level of urbanisation. In fact, the majority of the population in these countries lived in cities. But under British rule, India, on account of its predominantly agricultural economy, remained overwhelmingly a country of villages. In 1941, the urban areas had only 14.2 per cent of the total population. Thus, six out of every seven persons lived in villages, which were mostly without any modern amenities.

v) Lop-sided Occupational Structure

By occupational structure we mean distribution of workforce among different occupations. These occupations can be divided into three categories: (a) agriculture or primary sector, (b) manufacturing industries or secondary sector, and (c) services, trade and commerce or tertiary sector. In developed countries, larger proportion of population finds role in industries and tertiary sector. In underdeveloped countries, on the other hand, a large part of population depends on agriculture.

Due to the decline of handicrafts more and more people were made to depend on agriculture. This is clear from the following facts: while in 1891 only 60 per cent of

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the working population was engaged in agriculture, in 1901 it rose to 65 per cent, and in 1951 to 72 per cent. In many industrialised countries this percentage had fallen to below 10 per cent. This clearly shows that India was going backward. Indian agriculture could not absorb these increasing numbers. Pressure on land increased. As a result, agricultural productivity suffered. India came to depend on other countries for supply of food - the basic necessity of life. The non-agricultural sector was not only small but also had a very unbalanced structure. The predominant activity in this sector was services (trade, money- lending, transport and communications, administrative, defence and social services, professional services, personal services, etc.) and not industry. Within industry, the vast majority was engaged in household and small industries and not in modern large-scale industries. Further, within large-scale industry, light industries, mostly based on processing of agricultural produce, dominated the scene, while modern metallurgical, engineering, building materials, chemical and petroleum industries were quite insignificant. While Europe, America and other advanced world went through an industrial revolution, India remained a predominantly agricultural country, a sort of agrarian appendage to the industrialised world, particularly Britain.

vi) Semi-Feudal Economy

Another manifestation of backwardness was that at the time of independence, Indian economy was a *semi-feudal economy*. This was true both of the agricultural segment and the non-agricultural segment. Capitalism had penetrated the agricultural sector. The process showed itself, on the one hand, in the emergence and growth of a structure of the more substantial cultivators who carried on cultivation largely by employing hired labour and, on the other hand, in the rise and multiplication of a numerous class of agricultural workers who earned their living principally by hiring themselves out to the cultivators.

Likewise, *foreign capital and enterprise had directly created a capitalist sector*. From about the middle of the nineteenth century, the growing trends towards a market economy had also given rise to an Indian capitalist sector. By the close of the British period, this sector had taken firm root in a sizeable segment of the non-agricultural segment of the economy.

In short, on the eve of the independence the elements of capitalist production relations had indeed appeared in varying degrees, almost all over the country and were gaining strength. However, these were not strong enough yet to get rid completely of well-entrenched growth retarding feudalistic tendencies of the past.

1.5.2 India as a Dependent Economy

During the British rule, the Indian economy had been nourished more as an appendage of the British economy. Notwithstanding some significant changes that took place during the inter-war period, the Indian economy continued to carry the scars of colonialism. It continued to be a dependent economy, marked by the following features:

i) Composition of India's Foreign Trade

Composition of foreign trade of any country tells us about the nature of commodities that are exported and imported. Exports, in turn, throw light on the state of economic development of the country. For example, developed countries generally export manufactured goods and import raw materials and gold. Underdeveloped countries on the other hand export raw materials and gold and import manufactured goods.

Before the British rule, India used to sell large quantities of textile manufactures, luxury and semiluxury items to many countries of Europe. Since these countries did not have much to sell to India, they used to send us gold and silver. After the establishment of British rule in India, the composition of India's foreign trade changed. India began to receive those very commodities as imports, which she used to export earlier, namely, cotton manufactures and sugar. On the export side, most important items were agricultural raw materials like raw jute, cotton, hides and skins, oilseeds, tobacco, foodstuffs and above all gold. This shows a clear colonial character of India.

Furthermore, India's foreign trade came to depend solely upon Great Britain. At the close of the 19th century, England supplied about 69 per cent of India's imports. On the other hand, 29 per cent of India's export went to England. After World War I Great Britain began to lose hold on India's foreign trade. Other countries like Japan, America and Germany began to enter India's foreign trade. But still, on the eve of independence in 1947, England accounted for a large share in India's trade.

ii) **Dominance of Foreign Capital**

Another manifestation of the colonial character of the economy was that foreign (mostly British) capital had entrenched itself in important segments of the modern sector of the economy. The foreign capital investment concentrated on the following sectors of the economy:

a) Economic overheads, like railways, ports, merchant shipping and public utilities like electricity generation and waterworks.

b) Primary production or light manufactures for export, mainly tea, coffee and rubber plantations, jute mills and tanneries.

c) Coal and gold mining.

d) Banking, finance, insurance and trade.

e) A few manufacturing industries catering largely to the domestic market such as cotton and woolen textiles, tobacco, paper and printing industries, engineering workshop and construction firms, to a limited extent.

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It would be seen that the British capital investment concentrated in those industries that performed a complementary role to the industries in England, i.e. the primary objective of the British investment in India was to promote the interests of England alone. World War II had somewhat weakened the hold of foreign capital. But at the time of independence, the Indian economy had by no means freed itself from exploitation by, and influence of, foreign capital.

iii) **Outside Dependence for Capital Goods**

On account of its backward economy, the country was almost completely dependent on the rest of the world for plant and machinery needed for economic development. Even the replacement for worn-out capital goods had to be imported. The country also needed to import many essential items to maintain current life and activity. It was in no position to produce modern defence equipment and depended on the outside world for the means of national security.

1.6 PARTITION OF INDIA

Before leaving India, the Britishers gave her another hard blow. They divided the country into two parts, Indian Union and Pakistan. Pakistan consisted of two wings-West Pakistan and East Pakistan. Since 1971, East Pakistan has broken away from

West Pakistan and is now known as Bangladesh. The partition of India left the Indian Union with about 77 per cent territory and 82 per cent of the population of undivided India.

Partition of the country dislocated the economy. A large-scale movement of the Hindu and Muslim population took place. Lakhs of people from Pakistan crossed over to India. Such a large-scale movement of population had never been seen before. It had grave economic and social consequences. The most serious problem was that of the *refugees*. Given help and assistance, it took little time for this problem to be solved. Other problems were equally serious. Some of these important problems were as follows:

i) **Food Shortage:** Food shortage in India began to be felt after the separation of Burma in 1937. Burma was a rice-producing area. The problem became more serious after the partition. West Punjab and Sind were the *'granaries of India'*. These areas used to supply large quantities of wheat to the whole country. With partition, these areas went to Pakistan. It meant that a very rich source of wheat for India was cut off. As a result, food situation became very serious. It has been estimated that food supply in the Indian Union was deficient by about 25 to 30 lakh tonnes per year. Pakistan, on the other hand, enjoyed a surplus of about 7.5 lakh tonnes.

ii) **Shortage of raw materials:** Another serious problem related to the supply of raw materials. Many agricultural raw materials, specially raw jute and raw cotton, were produced in areas that formed part of Pakistan. The mills were located in areas that formed part of the Indian Union. With partition, the supply of raw materials was cut off for these mills. The two most affected industries were jute and cotton textile. At the time of partition, there were 112 jute mills in undivided India. All of these were situated in areas that formed part of India. Area which produced about 85 per cent of the total jute in undivided India went over to Pakistan. Therefore, immediately after partition, many of these mills were faced with closure. The same was the fate of cotton textile industry. About 94 per cent of the cotton textile mills were located in the Indian Union, whereas this area produced only 60 per cent of raw cotton of undivided India. Moreover, all good cotton-growing areas were in Sind and West Punjab. Shortage of raw materials was also experienced by the paper, leather tanning and some chemical industries in India.

iii) **Dislocation of the Industrial Structure:** A major evil consequence of partition was the dislocation of the entire industrial structure. This can be explained in terms of the following effects of partition:

a) as already seen above, many important industries were *deprived of their raw materials*.

b) some of the industries *lost their markets*. The areas, which went over to Pakistan used to consume large quantities of cotton textile, silk and wool textiles, hosiery, glass, soap, rubber goods etc., partition brought about sudden fall in demand for these goods. Fall in demand was a serious setback for these industries.

c) partition was followed by *large-scale movement of population*. Very large number of Muslim artisans, craftsmen and other skilled labour migrated from India to Pakistan. Factories in East Punjab and West Bengal (forming part of the Indian Union) were left without any trained labour.

d) partition adversely affected the *location of industries*. It became unsafe to locate these industries near border areas. Many such mills had to be shifted from these areas. Otherwise, on economic grounds these areas were more suitable for the affected industries.

In short, the entire industrial structure was dislocated. The problem was more serious in *Punjab and Bengal– the two States that were divided.*

iv) **Adverse Effects on Railways:** The railway network of the undivided India was also disrupted by Partition. Out of the total railways length of 31,313 miles the Indian Union obtained 24,565 miles. Many of the railway lines that crossed over to Pakistan had to be re-laid, the entire railway system of the border areas had to be reframed. Naturally, it involved huge cost in terms of money, time and effort.

To sum up, partition of the country had serious consequences. India's entire economy was completely dislocated. Agriculture, industries, trade, commerce, transportation and communication were disturbed. The most serious consequence of the partition was that it added to the poverty and misery of the people. Indian economy was already very weak. Its strength was further shaken with partition. In short, *on the eve of independence, Indian economy was a very weak one.* It would hardly stand on its own feet. It required to be nourished properly. Poverty, ignorance and disease were required to be fought on a warfooting.

Check Your Progress 3

1) Mention four important features of the Indian economy on the eve of Independence.

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2) Mention three features that establish Indian economy on the eve of Independence as a dependent economy.

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3) Mention four important problems arising out of the partition of the country.

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4) Mention four areas of economic activity where foreign capital concentrated during the British Rule.

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1.7 LET US SUM UP

To sum up, Indian economy was a dependent economy on the eve of independence. It carried all the marks of colonialism and imperialism. It was stagnant and backward. Agriculture was overcrowded. Its productivity was probably the lowest in the world. Urbanisation was at a very low level. There was mass illiteracy and high growth rates of population. There was no industrial structure worth the name. Foreign trade was oriented to feed industrial revolution in England. Thus, on the eve of Independence Indian Economy, was mainly an underdeveloped and dependent economy. At the time of Independence, partition of the country, brought with itself food shortage, raw material shortage and dislocation of Indian Industry.

1.8 KEY WORDS

Autarkic: An arrangement where there is no contact with the outside world.

Commercial crops: Crops that are to be used basically as raw materials in manufacturing industries.

Developed economy: An economy, which is basically an industrial economy making use of advanced technology.

Drain: The term is used to refer to exploitation of the Indian economy by the Britishers.

Famine: Implies non-availability of food for basic subsistence.

Holdings: A unit of cultivation.

Market system: An arrangement wherein all the economic units are to take their own decisions.

Occupational Structure: Distribution of working labour force among different occupations.

Per Capita Income: It is derived by dividing national income by total population.

Self-sufficient Village: An organisation that could produce all the goods that it required for its consumption.

Sterling: The British monetary unit.

1.9 SOME USEFUL BOOKS

Dutt R.C. (1976). *Economic History of India*, Volume I and II, Publication Division, Govt. of India, New Delhi.

Gadgil D.R (1938). *Industrial Evolution of India*, Oxford University Press, Bombay.

First Five Year Plan 1951-56, 1952 Planning Commission, New Delhi. Government of India.

Dharma Kumar (ed) (1982). *Cambridge Economic History of India* Vol. II, Orient Longmans, Hyderabad.

Singh V.B. (ed) (1975). *Economic History of India*, Allied Publishing House, New Delhi.

1.10 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Sub-Section 1.2.1
2) Villages were self-contained production units. All production was consumed within the village itself. There was hardly any outside exchange. See sub-section 1.2.1
3) See sub-section 1.2.2
4) See sub-section 1.2.3

Check Your Progress 2

1) Thoroughly read sub-section 1.4.1
2) Thoroughly read sub-section 1.4.2
3) See sub-section 1.4.2

Check Your Progress 3

1) See sub-section 1.5.1
2) See sub-section 1.5.2
3) See section 1.6
4) See section 1.5.2

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UNIT 2 GROWTH AND STRUCTURAL CHANGES IN INDIAN ECONOMY

Structure

2.0 Objectives
2.1 Introduction
2.2 State of the Indian Economy at the Time of Independence
2.3 Difference between "Growth" and "Development"
   2.3.1 Meaning of Growth
   2.3.2 Formula Used for Growth Rate Measurement
   2.3.3 Meaning of Economic Development
2.4 Measurement of Economic Growth
   2.4.1 Difference between the Current Price and Constant Price Estimates
2.5 Growth of National Income in India and Comparison with other Countries
   2.5.1 Growth Rate in India
   2.5.2 Comparison with Other Countries
2.6 Factors of Economic Growth
   2.6.1 Economic Factors
   2.6.2 Non-Economic Factors
   2.6.3 Recent Policy Changes
2.7 Structural Changes
   2.7.1 Meaning of Structural Change
   2.7.2 Commodity Vs. Services Sector
   2.7.3 Structural Changes within the Principal Sectors
   2.7.4 Other Compositions of GDP
   2.7.5 Sectoral Employment
   2.7.6 International Comparisons
2.8 Let Us Sum Up
2.9 Key Words
2.10 Some Useful Books
2.11 Answers/Hints to Check Your Progress Exercises

2.0 OBJECTIVES

In Unit-1 of this block, you have learnt about the state of Indian economy before independence and also on the eve of independence. In the present unit, we will be dealing with the economic growth and structural changes in India over the past decades. Before we start discussing the subject, it will be better to understand the state of the economy at the time of independence. After going through this unit you should be able to :

- Explain the meaning of the term 'economic growth';
- Distinguish between the term economic "growth" and economic "development";
- Analyse growth rates in national and per capita income;
- Describe the factors of economic growth; and
- Examine the structural changes that had taken place in Indian economy.

2.1 INTRODUCTION

Under the British rule, India had a backward agricultural sector as well as an underdeveloped industrial sector. In 1950-51, the per capita income was very low,

there was mass illiteracy. Both the death rate and birth rate were very high. This was due to lack of medical facilities, and low level of nutritional food due to abject poverty. Indian economy at the time of independence was a poor agriculture- based economy. The level of industrial activity was very low, whatever the little industrial development had taken place was lop-sided. The industrial pattern was marked by low capital intensity. The economic development of a country requires strong *infrastructure like banking, insurance, transport, communications, power,* etc. These facilities were lacking in India at the time of independence. All these facilities and services constitute collectively the infrastructure of an economy and the development and expansion of these facilities are an essential pre-condition for increasing agricultural and industrial production in a country. After independence, there has been a tremendous change in the structure of Indian economy during fifty years of planning. The structural change in the composition of the national income is the consequence of process of economic growth. However, structural changes are taking place at a slow pace.

2.2 STATE OF THE INDIAN ECONOMY AT THE TIME OF INDEPENDENCE

The main purpose of the British rule in India was to use the Indian economy as a source of cheap raw materials and a market for the goods manufactured by their industries. Therefore, the British rulers did not bother to develop the Indian economy. Consequently, India had a backward agricultural sector as well as an underdeveloped industrial sector.

In 1950-51, the per capita income in India, at the then prevailing prices, was only about rupees two hundred and forty. There was a mass illiteracy. In India, just before the start of the first plan, less than 17 per cent of the population was literate.

Due to lack of medical facilities, low level of nutritional food due to abject poverty, both the death rate and birth rate were very high. Between 1941-51, the birth rate was more than 3.99 per cent and death rate 2.74 per cent per annum. Thus natural growth rate in population was about 1.25 per cent per annum.

Indian economy at the time of independence was a poor agriculture based economy. About 75 per cent of the population was engaged in the agricultural sector. In spite of this India was not self-sufficient even in food grains production. The agricultural sector entirely depended on rain for irrigation. As and when the monsoon or winter rain failed the country faced a drought.

Indian industries also did not develop. The level of industrial activity was very low. A big proportion of industries were concentrated in a few cities. For example, the industrial development took place around Calcutta and Bombay. These were the places of plantation (Tea plantation around Calcutta and cotton textile around Bombay).

In case a country has a very low per capita income it leads to a vicious circle i.e. low rate of saving, low rate of investment, low production and low per capita income. India faced this condition at the time of independence. Due to a very low level of per capita income, the rate of saving was also very low. This led to a low level of capital formation (investment). Thus, industry stagnated.

Whatever, the little industrial development had taken place was lopsided. Capital goods sector was underdeveloped. The composition of manufacturing output reflects

the predominance of consumer goods industries vis-_-vis producer goods industries. In 1950, the ratio of consumer goods, to producer goods worked out to be 62:38.

Finally, the industrial pattern in India was marked by low capital intensity. Low capital intensity was reflected not only in consumer goods industries like bakery, cloth, sugar, etc. but also in capital goods industries like iron and steel.

The economic development of a country requires strong infrastructure like banking, insurance, transport, communications, power, etc. These facilities were lacking in India at the time of independence.

Briefly, this was the state of the economy just before the start of the planning era in India. In order to get rid of poverty, the first priority was to develop agriculture and industry, which in turn require as well as help in the development of the infrastructure like transport, communication, banking and trade. Agriculture had to be developed fast as it provides raw material for industry as well as food for the population. Similarly, industrial growth provides sustainable development of the economy. All this helps in raising the per capita income.

In the industrial development, it was required to develop both small-scale industries as well as heavy industries. In the long run, heavy industries produce capital goods and help in further industrialisation. Thus, a balance has to be struck in the development of both.

Along with agriculture and industry, there was also a need to develop transport, power, banking, communication and other sectors of a modern economy. In view of the need for a balanced approach to the development of the economy, India opted for a planned economy and the First Five Year Plan started in April 1951.

Check Your Progress 1

1) In 1950-51, per capita income in India was only Rs.........................

2) In 1950-51, both birth rate and death rate were high due to

   ....

3) State in one sentence, what is a vicious circle of poverty?

   ....

   ....

   ....

4) The economic development of a country requires strong

   ....

2.3 DIFFERENCE BETWEEN "GROWTH AND DEVELOPMENT"

2.3.1 Meaning of Growth

The term "growth" is used more as a quantitative expression of the economic progress. This means that we consider, as in day-to-day terms, the Gross (or Net) National Product (GNP or NNP) and see how or at what rate it increases or decreases from year to year. Net National Product is also called as National Income. When we divide

the total national product (national income) by the population, we get per capita income. As a student of economic growth, one is also interested in calculating the changes or growth rates in the per capita income in a country. Thus, growth rate whether in national product or in per capita income, is more a quantitative term. For instance, when we say the national product of India in 2000-2001 has increased by 6 per cent or per capita income has increased by 4 per cent, we mean that national product in 2000-2001 was higher than the national product in 1999-2000 by 6 per cent.

2.3.2 Formula Used for Growth Rate Measurement

The formula used by economists for the calculation of the growth rate is simple. In case the growth rate is to be calculated only for one year i.e. in 2000-01 over 1999-2000 the following formula is used:

$$\text{Growth Rate (g.r.)} = \frac{\text{NP in 2000-01}}{\text{NP in 1999-2000}} - 1 \times 100$$

In this g.r. stands for the growth rate and NP for national product. As the growth rate is normally expressed in percentage form, we have multiplied the fraction by 100.

However, when growth rate is to be calculated for a time series i.e. for 5 years, 10 years, 15 years, or more, a different formula, as used for calculating compound interest, is used.

The formula used for calculating growth rate and the compound interest rate is the same. Therefore, students familiar with the formula for calculating the compound interest rate may skip over.

The formula used for calculating the growth rate for more than one year is as follows:

We have

$$Y(t) = Y(0)\ (1+r)^n$$

From which we get

$$\text{Log } Y(t) = \log Y(0) + n \log (1+r)$$

$$\text{or } \log(1+r) = \frac{\log Y(t) - \log Y(0)}{n}$$

Therefore

$$r = (\text{anti} - \log \frac{\log Y(t) - Y(o)}{n} - 1) \times 100$$

However, in the actual calculations we go as follows

$$g.r = (\text{anti} - \log \frac{\log Y(t) / Y(o)}{n} - 1) \times 100$$

Steps for calculating g.r.
Take the figure for the terminal year
Divide this by the base year figure,
Take logarithm of the co-efficient,
Divide by tne number of years,
Take anti-log of this.

For example the GDP in

1980-81 = 122,427 (Rs. In crores)

1990-91 = 212,253 (Rs. In crores)

the g.r. for a period of 10 years (1990-91 - 1980-81) is calculated as follows:

1) Take the Ratio of 212, 253 / 122, 427 which is = 1.73371
2) Take log of the ratio (i.e., 1.73371) which is 0.23898
3) Divide this by the number of years = 10

   Which is equivalent to = 0.023898

4) Take anti-log of this = which is 1.05657
5) Subtract 1.05657-1 = which is equivalent is 0.05657
6) Multiply by 100 = 5.66

This is the compound growth rate per cent per annum for the period 1980-81 to 1990-91.

2.3.3 Meaning of Economic Development

No single definition of "economic development" is entirely satisfactory. However, a concise answer may be as follows: Economic development is a process whereby an economy is transformed from a low level of economic activity to a higher level of activity. Development "process" implies the operation of certain forces: these forces operate over a period and embody changes in certain variables. The general result of the process is growth in an economy's national product.

When we focus only on the growth in national product, we are taking a view of the end result of the development process. If, however, we examine the process in more detail, we observe that many other changes, each of a particular character, accompany the rise in output. We may classify these as changes in fundamental factor supplies and changes in the structure of demand for products.

Particular changes in factor supplies comprise of: (i) the discovery of additional resources, (ii) capital accumulation, (iii) population growth, (iv) introduction of new and better techniques of production, (v) improvement in skills, and (vi) other institutional and organisational modifications.

Particular changes in the structure of demand for products are associated with developments in (i) size and age composition of population, (ii) level and distribution of income, (iii) tastes, and (iv) other institutional and organisation arrangements.

In view of the above, one may interpret economic development in terms of specific developments in factor supplies and product demand. Whereas "growth", as stated earlier, is more a quantitative phenomenon and evaluation of the end result is measured in terms of national product, while the concept of "development" is qualitative in its nature. It covers both quantitative changes like increase in per capita income, as well as the changes in the economy which are not quantifiable, like development in the level of health of the population, shift in demand from low quality goods to high quality goods, educational expansion, and so on. *The concept of "development" has*

a wider ambit than the term growth. In fact one may call growth as a subset or the set of development of an economy.

Therefore, a student should understand these terms very clearly. Many persons, unaware of the conceptual difference between the two, use these terms interchangeably. However, as a student of economics these two terms should be kept separate.

Check Your Progress 2

1) Explain the term growth rate. State the formula for the measurement of the growth rate in an economy.

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2) Distinguish between the term growth and development.

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3) Write a short note on the meaning of development of an economy.

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2.4 MEASUREMENT OF ECONOMIC GROWTH

Economic growth can generally be measured in four ways:

Increase in Real National Income. One of the measures of economic growth is the increase in the economy's real national product or income over a period of time. But this is not a satisfactory measure because it does not take into account the growth of population.

Increase in Per Capita Income. The second measure of economic growth relates to an increase in the per capita real income. This implies that the rate of increase in real national income should be higher than the growth rate of population. But increase in per capita income may not necessarily raise the real standard of living of the common man. It is possible that even when per capita real income is increasing per capita consumption may fall. This kind of situation can arise when increased income goes to the few rich instead of the many poor. So, this measure also becomes faulty under such a condition.

Growth in Consumption. Economic growth can also be measured from the viewpoint of economic welfare. It is regarded as a process whereby there is an increase in the consumption of goods and services by individuals. But this method is also not free

from defects. First, the consumption of goods and services depends upon the tastes and preferences of individuals. Second, for measuring economic welfare, we should not only consider what is produced but also how it is produced. The increased output might have raised real costs and social costs in the economy.

Social Indicators. Economists have also measured economic growth in terms of social indicators. These indicators emphasise on the quality of the development process. These include: health, food and nutrition, education, employment, housing, clothing, transportation, social security, etc. But problem here arises about the number of items to be included in such an index.

Question now arises what should be real measure of economic growth. All the measure has their relative merits and demerits. However, the main choice is to be made between 'national income' and per capita income. In our opinion, for developed countries, increase in national income should be taken as an index of economic growth while increase in real per capita income should be accepted as a true index of economic growth in under-developed countries. However, most of the economists favour per capita income as an indicator of economic growth.

2.4.1 Difference between the Current Price and Constant Price Estimates

Before proceeding further, it is desirable that students are also told about the meaning of the estimates of current prices and estimates at constant prices.

Current price estimates are prepared by taking quantity of goods produced and multiplying these by current prices. This means, if 1000 bicycles are produced in 1999-2000 and price per bicycle in the year is Rs.1000, the total production at current prices is Rs.10 lakh.

Now, consider that estimates are to be prepared at 1980-81 prices. In this case, we will take production in 1999-2000 of 1000 bicycles and multiply these with prices in 1980-81. Suppose price in 1980-81 of a bicycle was Rs.800. Then total production in 1999-2000 at 1980-81 prices will be Rs.8, 00,000.

Students must note that national income is measured in money values. It consists of a vast variety of goods and services produced in an economy like coal, cloth, chemicals, cosmetics, paper etc. These goods and services cannot be added together. For example, we cannot add the production of bicycles to the production of books, which are both a part of the national product. However, their money values can be easily added.

But when the value of output is used for measuring the rate of growth between two periods, say 1980-81 and 1999-2000, there is a problem. The prices of goods and services are not the same in the two years. In the above example prices of bicycles are not the same in the two years. Total value of production of 1000 bicycles in 1999-2000 is Rs.10, 00,000 and that in 1980-81 for the same number of bicycles is Rs.800, 000. The ratio of the value of production of bicycles tells us that production of bicycles is 1.25 times more in 1999-2000 than in 1980-81. Is that true? It is only the prices of bicycles, which have increased by 1.25 times. The production has remained unchanged at 1000 bicycles. If the production in both the years was valued by the same set of prices this absence of any change in production would be reflected. Such valuation is done at constant prices i.e. prices of a fixed or base year. In the other case valuation is done at the prices of the year in which the output is produced. In that case any comparison will include the impact of the change in prices.

This distinction should be kept in mind because the real growth in an economy is always taken at constant prices. The current price growth also includes price rise and, therefore, does not reveal the real growth in any economy. In the discussion below we also analyse growth at constant (1980-81) prices.

The CSO has been changing the base year from time to time to the changing needs of the economy. Initially, the 1952-53 prices were used as the constant prices. Since then the years of 1960-61, 1970-71 and 1980-81 have been used as the constant price base. Till 1985-86, the CSO prepared national income estimates at the constant 1970-71 prices. But, in 1988 CSO has taken 1980-81 as the base year. In the year 2000, the base year has now been changed to 1993-94. In this New Series, estimates of national product have been made available for the entire period since 1950-51.

Check Your Progress 3

1) What are the four methods to measure the economic growth?

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2) Explain the difference between current prices and constant prices for measurement of the growth.

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2.5 GROWTH OF NATIONAL INCOME IN INDIA AND COMPARISON WITH OTHER COUNTRIES

2.5.1 Growth Rate in India

We shall now study the trends in the growth rates of national income and per capita income in India.

Central Statistical Organisation (CSO), a government organisation, prepares annual estimates of India's national income and per capita income. It makes these estimates available in its publication entitled "National Account Statistics". CSO estimates these, both at current prices and at constant prices. The estimates at constant prices give us a real picture of growth in national income over a period of time.

Table-1 shows the growth rates of gross domestic product at 1980-81 prices by kind of economic activity. It shows that there was lower growth rate during the first

Table-1 : Growth Rates in the National Product at 1980-81 Prices

(Percent per annum)

Sectors	1950-51 to 1960-61	1960-61 to 1970-71	1970-71 to 1980-81	1980-81 to 1990-91	1990-91 to 1995-96
I. **Primary Sector**	3.0	2.3	1.5	3.6	2.5
1. Agriculture	3.3	2.2	1.7	3.9	2.4
2. Forestry	0.3	3.0	(–)0.9	(–)1.0	(–)1.7
3. Fishing	5.5	3.5	2.8	5.7	7.8
4. Mining and Quarrying	5.6	3.9	4.9	6.7	4.4
II. **Secondary Sector**	6.2	5.4	4.0	6.7	6.2
5. Manufacturing	6.0	5.2	4.0	7.2	6.4
6. Construction	6.3	5.5	3.0	3.6	3.8
7. Electricity, Gas, and Water Supply	10.3	11.1	6.8	9.0	8.5
III. **Tertiary Sector or Services Sector**	4.1	4.6	4.3	6.6	6.8
8. Transport, Communications & Trade	5.3	5.0	4.7	6.4	7.8
9. Banking, Insurance and Real Estate	3.0	3.4	4.0	7.2	7.3
10. Public Administration and Defence	3.1	3.9	3.0	5.5	3.6
11. Other Services	3.1	3.9	3.0	5.5	5.5
Gross Domestic Product	3.9	3.7	3.1	5.7	5.3

three decades of planned development in India. The annual growth rates were 3.9 per cent during the seventies. There has been a marked improvement during the eighties and the nineties. Growth rates were at 5.6 per cent during the eighties and 5.3 per cent in the first half of the nineties. A comparison of the four and a half decades shows that the growth rate in the GDP was lowest in the seventies and highest in the nineties. During the first three decades the annual growth rate was confined to 3-4 per cent whereas over the past one and half decade it has risen to about 5.5 per cent i.e. an increase to more than one and a half time. This appears to be the result of a large improvement in growth rate shown by several non-agricultural sectors particularly, fishing, mining and quarrying, manufacturing, banking and insurance and public administration and defence.

Per capita income at 1980-81 prices and growth rates over the decades are given below in Table-2.

Table-2: Per Capita Income at 1980-81 Prices and Growth Rates

Year	Per Capita Income (Rs.)	Growth Rate (% per year)
1950-51	1,127	–
1960-61	1,350	1.8
1970-71	1,520	1.2
1980-81	1,630	0.7
1990-91	2,222	3.1
1995-96	2,454	2.2
1998-99*	9,738	5.0

Source: *Based on data contained in the Economic Survey, 1999-2000, Government of India, Ministry of Finance.*

These data reveal that growth rate in per capita income was highest during the nineties and lowest during the seventies.

2.5.2 Comparison with Other Countries

For purposes of comparison with other countries, the period considered is 1980 to 1994. For international comparison, the GDP used is also in terms of US dollars.

Table 3 : Selected Growth Indicators, 1980-94

Country	GDP (US $ Bn.)		Average annual growth rate (%) GDP		Per Capita Income ($) 1995
	1994	1980	1990-94	1980-90	
India	293.6	172.3	3.8	5.8	340
USA	66.48.0	2708.1	2.5	3.0	26,980
Japan	4591.0	1059.2	1.2	4.1	39,640
Germany	2046.0	819.1*	1.1	2.2	27,510
France	1330.4	664.6	0.8	2.4	24,990
Itlay	1024.6	452.6	0.7	2.4	19,020
U.K.	1017.3	537.4	0.8	3.2	18,700
China	522.2	201.7	12.9	10.2	620
Korea, Rep.	376.5	63.7	6.6	9.4	9,700
Australia	332.0	159.7	3.4	3.5	1,872
Indonesia	174.6	78.0	7.6	6.1	980
Thailand	143.2	32.3	8.2	7.6	2,740
Israel	77.8	22.7	6.2	3.5	15,920
Malasia	70.6	24.5	8.4	5.2	3,890
Singapore	68.9	11.7	8.3	6.4	26,730
Philippines	64.2	32.5	1.6	1	1,050
Pakistan	52.0	23.7	4.6	6.3	460
Egypt	42.9	22.9	1.1	5	790
Bangalesh	26.2	12.9	4.2	4.3	240
Sri Lanka	11.7	4.0	5.4	4.2	700
Kenya	6.9	7.3	0.9	4.2	280

*Relates to Federal Republic of Germany before unification.
Bn = Billion

India's per capita income in 1995 was $ 340 (Table-3). This is much lower when compared with developed countries. Japan has the highest per capita income at $ 39,640. The other developed countries are US, UK, Germany, etc. In 1995 India's per capita income was lower than that of Pakistan, which got independence along with India.

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Check Your Progress 4

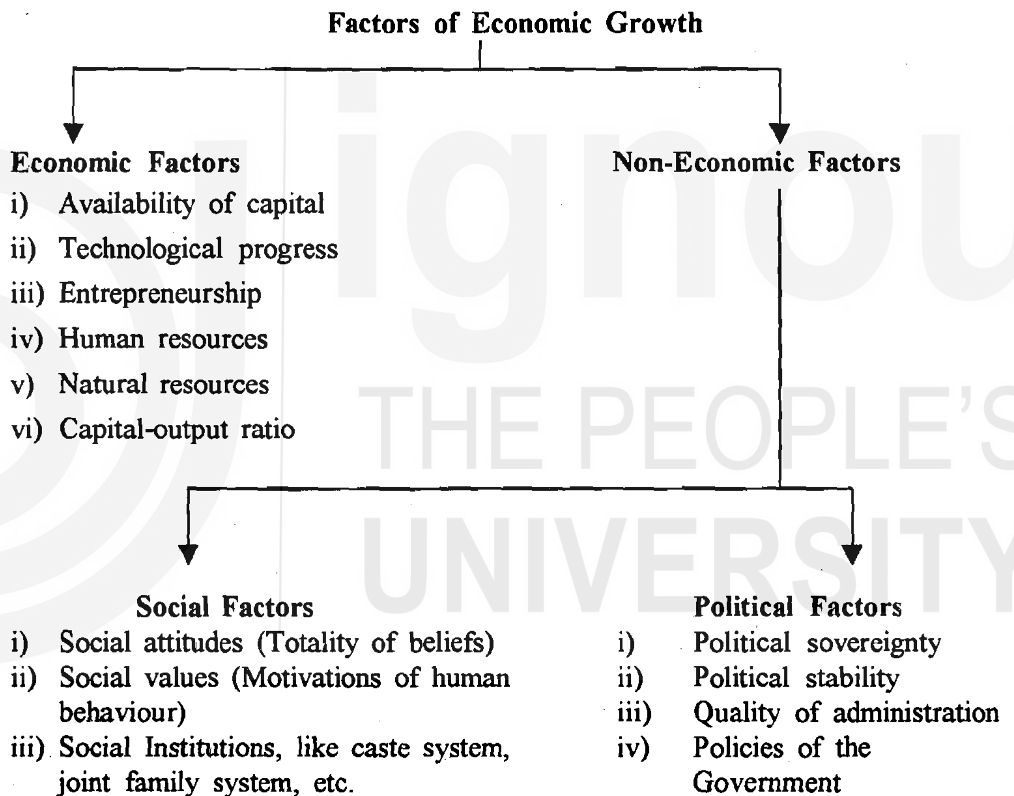
1) The growth rate in the per capita income between 1980-81 and 1990-91 was .... per cent.

2) India's per capita income in 1995 was US$ ....,

   compared to this per capita income in Japan was US $ ....

2.6 FACTORS OF ECONOMIC GROWTH

The process of economic growth is broadly determined by two types of factors– *economic factors and non-economic factors*. Non-economic factors can further be grouped into social and political factors. Economic growth is not possible without these factors encouraging growth.



2.6.1 Economic Factors

Some important economic factors, which have retarded the growth of the Indian economy during the fifties, sixties and the seventies, are as follows:

i) **Availability of Capital:** A major bottleneck in the growth of the Indian economy has been the non-availability of adequate quantity of capital, without adequate quantity of capital; India could not make economic progress to the desired extent. Not only the stock of capital were quite low, the rate of capital formation was also slow.

ii) **Technological Progress:** Technological progress means changes in the methods of production as a result of innovations. It leads to increase in productivity of labour and capital. Indian economy technologically has been backward which restricted the productivity.

   India's policy of globalisation and liberalisation started in 1991 is expected to help in raising the availability of capital by way of inflow of foreign capital and

Check Your Progress 5

1) Economic factors responsible for growth are:

   (i) Availability of capital, (ii) Technological Progress, (iii) Entrepreneurship, (iv) Human resources, (v) Natural resources (vi) Capital, and output ratio.

2) The policy of globalisation indicates outward looking strategy of development. It includes movement of goods, services, capital, technology and labour without having much of control. With the arrival of foreign investment and technology the rate of savings and capital formation is expected to increase.

3) The recent policy changes in the economy started from July 1991 with the announcement of industrial policy. Side by side important policy changes have also been made in various sectors of the economy like trade, finance, insurance, banking, tax rates etc.

Check Your Progress 6

1) Structural change refers to change in the relative significance of different sectors in the economy. Structural change occurs when the contribution of different sectors viz., primary, secondary and territory sectors - to the country's national product changes. Thus, structural change refers to the change in the structure of production.

2) See section 2.6.1 and frame your answer.

3) See section 2.6.2 and attempt your answer.

4) In 1991, 65.5 per cent of the working population was employed in the primary sector.

5) In India in 1994, 30 per cent of GDP came from agriculture from in USA the same was 2-3 per cent agriculture in its GDP and China's share of agriculture in its GDP was 21 per cent

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UNIT 3 CURRENT PROBLEMS AND ISSUES

Structure

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3.0 OBJECTIVES

After going through this unit, you should be able to :

- Define the current structure of the Indian economy;
- Explain the place of the Indian economy in the prevailing global order;
- Identify the various problems that the economy suffers from currently;
- Learn the limitations, which the economic policy makers have to put up with;
- Suggest some important direction and suggestions to policy makers; and
- Find out the linkages between different aspects of the economy.

3.1 INTRODUCTION

In Unit-1 and Unit-2, so far we have observed as follows:

a) Independent India inherited a weak stagnant economy plagued by all-pervasive poverty; and

b) Over the last five decades beginning with the First Five Year Plan in 1951 some significant changes have taken place, both in terms of growth and structure of the Indian economy. However, notwithstanding significant growth and structural changes, the economy has been faced with a number of problems and issues. Some of these problems have been with us as legacy of the past; as a matter of fact these very problems had prompted us to adopt the course of planned economic development, for instance, the problem of all-pervasive poverty is closely linked with and finds expression in problems like widespread unemployment and gross disparities in income distribution. Another set of problems has arisen in the course of the process of economic growth, e.g., problem of a sustained and persistent increase in the price level, poor performance of public enterprises,

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ecological degradation, infrastructural inadequacies, regional disparities in growth, balance of payments difficulties, inadequacy of financial resources with the state, etc. While a detailed discussion of many of these problems and issues will follow later in this course, in the present unit we will give you an over view of the same. This will enable the learners to understand and appreciate the current features of the Indian economy.

3.2 PROBLEM OF POVERTY, UNEMPLOYMENT AND INEQUALITIES

Poverty has been centuries old and deep-rooted in the Indian economy. It has not been possible to remove poverty altogether despite sustained efforts over the last four and a half decades of planned economic growth.

3.2.1 Measurement of Poverty

Poverty is measured with the help of a concept namely poverty line. Poverty line is defined as that level of income, which enables a household to purchase just about the bare means of subsistence. The poverty line in India has been drawn as follows: (i) A minimum level of nutrition necessary for basic subsistence has been laid down on the basis of studies by nutrition experts. For a person living in rural areas this level has been fixed at 2,400 calories per day. For a person living in urban areas this level has been fixed at 2,100 calories per day. Higher requirement of calories in rural areas than in urban areas is justified by the nature of economic activity in the former, as these involve more physical effort; (ii) taking into account the cost of the diet, which can give the required calories, a poverty line has been estimated separately for rural areas and urban areas. It has been estimated at Rs.49.1 per month for rural areas and at Rs.56.6 for urban areas at 1973-74 prices. Apparently, as the general price level moves up, the costs of this minimum diet also move up thus raising the poverty line. Thus, at 1992-93 prices, the poverty line has been estimated at Rs.228.0 and Rs.264.0 per month for rural and urban areas respectively, and (iii) line of poverty has been defined at a household level. A household consists of 5 members for the purpose of this definition. Thus, a rural household will be said to be living below the line of poverty if its annual income at 1992-93 prices is less than Rs.13, 680. This amount is calculated as follows:

Rs.228.0 × 5 members × 12 months = Rs.13, 680/-.

Likewise, an urban household will be said to be living below the line of poverty if its annual income, at 1992-93 prices, is less than Rs.15, 840 calculated as follows:

Rs. 264.0 × 5 members × 12 months = Rs.15, 840

3.2.2 Magnitude of Poverty

The Planning Commission in India has been preparing estimates of the number of people living below the poverty line as defined above. The results are tabulated in Table-1 below:

Table-1: The Percentage of Population below the Poverty Line

	1972-73	1977-78	1987-88	1993-94
Rural	54.10	51.20	39.9	37.27
Urban	41.20	38.20	38.20	32.36
All India	51.50	48.30	38.86	35.97

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It would be seen as follows from Table-1:

1) More than one-third of India's total population lives in poverty.

2) The magnitude of poverty in rural India is higher than in urban India. Thus, whereas about 37.27 per cent of rural population lives in poverty, in urban India the proportion is less at 32.36 per cent.

3) Over the years there has been a little decline in the proportion of persons living below the line of poverty. However, given the fact that the population has been increasing at a fast rate, the absolute number of people living below the poverty line has increased.

3.2.3 Causes of Poverty

Poverty arises from lack of income or low income. Income, in turn arises from work in the form of earnings of the self-employed and wages of the hired workers. It also arises from assets owned by an individual or household in the form of rent or interest. Absence of work, i.e. employment, is therefore one of the important causes of unemployment. Another cause is the distribution of assets. Persistence of poverty in India over the years may therefore be attributed to (i) inadequate employment opportunities, (ii) disparities in the assets distribution, and (iii) slow rate of economic growth has been an equally important cause of the persistence of poverty.

i) **Inadequate Employment Opportunities:** Unemployment implies absence of a source of income and hence it becomes a major cause of poverty. Creation of employment opportunities is, therefore, one of the ways of reducing the incidence of poverty. The employment-creation capacity of growth in the Indian economy has been limited. In a labour-surplus over-populated country like India any fight against poverty could be successful only if growth of the economy brings about new job opportunities. The rate of creation of new job opportunities has to be faster than the rate at which the labour force increases. Only then, it would not only be possible to provide jobs to the already unemployed but also to the new entrants in the labour market. Provision of jobs thus becomes the sure antidote to poverty.

   But if the rate at which new jobs are being created in the economy falls short of the rate at which labour force is increasing, the result is that the magnitude of unemployment in the economy will be on the rise.

   In the Indian economy the rate of labour-absorption has been severely limited, especially in the manufacturing sector of the economy. Therefore, increasing labour force has been falling back on low productivity agriculture for eking out their living. Apparently, the agricultural sector too has failed to absorb them, and consequently there has been widespread unemployment and poverty.

ii) **Disparities in income distribution and ownership of assets:** The state of poverty in India cannot be fully explained without a reference to the distribution of income. The fact that poverty has tended to perpetuate all along the process of economic growth goes to establish the fact that the income generated during this process has not been equally distributed. The asset-owning class has been in a position to corner a larger share of the generated income; where as the asset-less class has been denied these benefits. This fact has been brought out very clearly by a number of studies on the subject; results of a few of these are presented in Table-2 below:

Table-2: Distribution of Income in India

Source	NCAER (1964-65)	World Bank (1994)
Share of top 10percent	33.5	25.0
Share of bottom 20percent	7.5	9.2

It would be seen that whereas 10 percent of the total population at the top of the ladder cornered 25 percent of the total income generated in the economy, 20 percent of the total population at the bottom had to be contented with a meager 9 percent of the total income generated.

Inequalities in the distribution of income could be attributed by and large to the structure of asset ownership in the economy. In the rural areas, land is the asset par excellence. There are sharp inequalities in the distribution of land ownership. Thus, whereas large land holdings with land areas of more than 10 hectares number about 5 percent of the total holdings in the country, they account for about 50 percent of the total cultivated land. On the other extreme, marginal and small holdings with size area of upto 2.5 hectares number about 55 percent of total holdings in the country, but have only about 10 percent of the total land area under cultivation. These facts bring out the prevailing inequalities in the land distribution.

Likewise, in urban areas, inequalities manifest themselves in the form of ownership of capital, skills and technology. Those in possession of these scarce but highly rated economic inputs have been in a position to earn high scarcity rents for their services in the form of high salaries and perks. On the other hand, untrained and unskilled large mass of labour have not been in a position to earn their bare means of subsistence.

iii) **Slow Rate of Economic Growth:** As you have observed in the earlier unit primacy was accorded to economic growth not only to improve the level of living but there was also a need to accelerate it so as to attain a sustained rise in the level of living of the populace. Over the last five decades, the Indian economy has been growing at an annual average rate of about 4 per cent. During this period, India's population too has increased at the rate of about 2 per cent per annum. Therefore, the annual average rate of growth of per capita income in India during the period 1995-2000 works out to no more than 2 per cent per annum. This rate has been inadequate on several counts.

a) it has been less than what we had targeted to achieve in our five year plans,

b) it has been much less than the rates at which other developing economies, specially countries like South Korea, Taiwan, Malaysia, Indonesia, Thailand, Singapore, Hong Kong, etc. have been growing, and

c) More important, the rate of economic growth has been much less than the requirements.

Inadequacy of the effort is proved by the fact that notwithstanding the growth of the economy and the accompanying structural changes it has not been possible to make a sizeable dent on the state of poverty in the country.

3.2.4 Government Policy

The Government policy to fight poverty has been determined by the nature and causes of poverty in India. From this point of view, the whole period of 1951-2000 can be divided in two sub-periods, viz. (i) 1951-75, and (ii) Post-1975.

i) During the period 1951-75, the Government relied primarily on fast economic growth to alleviate the economic condition of the poor. Growth was to be accelerated in different sectors of the economy. It was believed that economic growth itself would create conditions that would generate income among the poor households and help them rise above the line of poverty. This process of growth taking care of the poor was based on the assumption of the working of 'Trickle-down' i.e. income generated in different producing sectors filters down to poorer households. The process of growth was supplemented by certain fiscal measures, which aimed at redistribution of income and productive assets. Simultaneously, an effort was also made to incorporate measures in the policy that would promote and generate new employment opportunities. Apparently, we could not succeed on either of the fronts, relating to the working of trickle-down or employment creation, or redistribution of income. These failures prompted the Government to redesign the strategy.

ii) During the post-1975 period, the important element of the poverty-alleviation strategy has been the direct intervention by the state in favour of poor. This has taken the form of various poverty-alleviation programmes, like the Integrated Rural Development Programme (IRDP), Jawahar Rojgar Yojana (JRY), Employment Assurance Scheme (EAS), Prime Minister' Rozgar Yojana, etc. The various poverty-alleviation programmes seek to generate new employment opportunities for the poor households. The new employment opportunities could be either in the form of wage-employment on state-run labour intensive capital projects, or in the form of self-employment generated out of the capital assets provided by the state. Resources for these programmes come out of the budget as well as from the financial institutions. The Government has renewed its commitment to intervene in the growth process in favour of the poor both in the New Economic Policy statements and the Minimum Common Economic Programme.

Check Your Progress 1

1) How do we measure poverty in a country?

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2) Identify the group of people who normally live below the line of poverty in rural India and urban India.

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3) Mention three important causes of poverty in India.

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3.3 POPULATION PROBLEM

Closely allied to the state of poverty is the problem arising out of large and rapidly growing numbers. Poverty is both a result and a cause of fast-increasing population in the country.

Ordinarily, a large population should be looked upon as an asset, which can contribute to and play a critical role in accelerating the rate of economic growth in the economy. Population is the primary source of the most important and active factor input, i.e., labour. A larger supply of labour ensures a proper utilisation of other factor inputs, especially natural resources. Inadequate availability of labour results in underutilisation of a nation's resources, and hence prevents an economy from growing to its full potential.

Likewise, a large size of population also provides a large domestic market for its products. Presence of a large domestic market provides an inducement for larger investment and thus may help in setting-in of what may be called a virtuous circle of prosperity. Larger investment generates larger employment and income, and thus makes available higher amount of savings for capital formation.

Based on the above arguments, a large population base has always been considered a strong asset and a factor in economic growth.

But, a large population growing at a rapid rate can also become a drag on economic growth. This will be especially so in a situation where complementary resources are not available. In the absence of adequate availability of complementary resources, especially capital, a large proportion of labour force remains unemployed. This part of population does claim a share in the national product without contributing anything to its generation. Consequently, a significant part of investment in an economy is not available to it for the purpose of raising the general standard of living of the people, since this part is consumed away in sustaining the additional work force. This part of investment can be called 'demographic investment'. It is in this sense that a large population become a liability and hence prevents an economy from growing to its potential.

Of the two scenarios drawn above, India's position can be traced to the last one, i.e., a large and rapidly increasing population is becoming a liability on economic growth.

Check Your Progress 2

1) Mention two ways in which large population can contribute to rapid economic growth.

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2) Explain how a large and rapidly growing population retards economic growth?

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3.4 INADEQUATE AVAILABILITY OF INFRASTRUCTURE

All the basic maladies from which the Indian economy suffers and about which we have talked so far could have been easily solved only if the rate of economic growth had been fast enough.

But the growth itself has suffered from inadequate availability of infrastructure. Infrastructure refers to all those supporting structures that help direct production activities like agriculture and industry. Infrastructure can be divided in two groups. viz., (a) economic infrastructure, and (b) social infrastructure.

Economic infrastructure consists of services like power, transport and communications, irrigation, industrial estates and technical parks, etc. Social infrastructure, on the other hand, consists basically of human development services like education, medical facilities, sanitation, sewerage, drinking water, etc.

Non-availability of adequate infrastructure places barriers on the growth process, e.g., movement of goods for exports gets adversely affected if the ports are overcrowded and congested. Likewise, skilled manpower will not be available to industry and the commercial sector in case training facilities for the personnel are not available.

The fact that the supply of infrastructure has fallen short of its requirements can be observed all-around in the Indian economy in the form of growing pressures on all types of services, overcrowded roads, railway wagons, ports and aviation sector, power breakdown, restrictions and frequent cuts, obsolete communication facilities, widespread illiteracy, poor living conditions and growing homelessness, etc.

Inadequate availability of infrastructure in turn can be traced to the fact that in our plan programmes we failed to provide adequate financial resources to build up and match the capacities to the fast-increasing requirements of the economy.

Now, when the Indian economy is increasingly getting globalised, any failure on the infrastructure front may prove disastrous not only for individual enterprises, but for the economy as a whole. Hence, it is imperative that large financial resources are mobilised, both in the public and the private sector to build up infrastructure to the international standards. (for further details see Block-3 Unit-11)

3.5 PROBLEM OF RISING PRICES

Both from the point of view of poverty-alleviation and rapid economic growth, a fast rise in the general price level is a cause for concern. A sustained increase in the general price level over a long period of time is called inflation. Inflation in India had its origin in the development programmes that were formulated and launched towards the mid-fifties. The general price level has been continuously moving upwards since then; what has differed during different periods has been the rate at which the general price level has been rising.

For a developing economy inflation need not be a serious issue of concern, as long as households and investors can anticipate it and provide against it. The problem is that in an underdeveloped economy, given the nature of economic institutions and

of control. In such a situation, different investment decisions are postponed. This may cause stagnation in the economic activity. As India's experience has demonstrated, it is not easy to control inflation once it sets in. A lasting solution to the problem of inflation is to be found in raising the level of productivity and output in the economy. After all, ultimately inflation is a reflection of demand-supply imbalance, and it is this imbalance that need be corrected. (For Further details read the next unit i.e. unit-4))

3.6 ROLE OF THE STATE AND PUBLIC ENTERPRISES

India inherited a weak, depleted economy at the time of independence; in pursuit of its 'tryst with destiny' India sought to achieve rapid economic growth with social justice. The goal could not be achieved without an active participation by the state. The state had to assume an active role in different spheres of economic activity, be it industry or trade. The state had to formulate comprehensive plans of development and also provide means for their implementation. The state had also to fill the entrepreneurial gaps.

Five Year Plans were adopted as a vehicle of growth. The commanding heights were sought to be passed on to the public sector. A comprehensive system of controls and regulations was laid down to channelise private capital and enterprise in desired directions. Inward-oriented growth strategy was formulated. As a part of this growth strategy, import substitution, rather than export promotion, became the focal point of priority. Domestic industries were sought to be developed behind the wall of high protective barriers. Inflows of foreign capital were not allowed except in the form of borrowings and a little in the form of minority equity participation in collaboration with Indian capital.

This model of growth envisaged the state as the pilot of growth machine. It was looked upon as the ultimate decision maker. The state made its presence felt in the economy by arranging to produce things as varied as milk and bread, and heavy electrical equipment and heavy chemicals.

The state ran into difficulties when it could not generate sufficient resources to meet its liabilities, both domestic and international. On the domestic front it began to borrow even to meet its current consumption requirements; internationally current account deficits assumed menacing proportions. The domestic production structure, developed as it had in a highly protected framework, could not stand the winds of competition. This was true both of the public sector and the private sector.

The role of the state came to be defined afresh at the beginning of the 1990s. The state began to withdraw itself from different areas. Initiative was sought to be passed on to the private capital and enterprise. The process is not complete yet. Gradual withdrawal of the state too has brought to the forefront a few critical issues like investment in infrastructure, social sectors and areas of low priority for the private capital, provision of safety nets for the poor and the weaker sections of the society, and the need to pursue the goals of self-reliance and social justice. These issues are still open for debate.

3.7 BLACK ECONOMY AND CORRUPTION

The all pervasive system of controls and state domination as practised in the past has promoted corruption and generation of black income. An independent global survey of 54 economies finds India among the top five corrupt countries. The roots of corruption can be traced to many factors, among which the more important are as

1) lack of transparency in rule and bureaucratic connivance
2) scarcity of goods and services, and control on their distribution
3) red tape which encouraged the use of bribe as speed-money, and
4) the archaic laws.

Corruption as an institution breeds inefficiencies and leads to less than optimum use of available resources. Apparently, it slows down the process of economic development.

Corruption, in turn, contributed to the growth of the black economy. The term *'black economy'* encompassed all those transactions, which are not entered in the books of accounts and are not reported to the competent authorities. The practice occurs either because the transactions are illegal or because the transactors intend to evade the tax liability.

The black economy in India has been a matter of concern for a number of years. It has grown to enormous dimensions. It has become a threat to the ability of the official monetary-credit policy mechanisms to manage demand and prices in several vulnerable sectors of the economy. The fact is that it has permeated every section of society and every sector of the economy.

One of the important causes of black economy can be traced to: (i) high rates of taxation and large dependence on indirect taxes rather on direct taxes; accompanied by massive tax evasion; (ii) the electoral system and need for funds for the political parties; and (iii) general deterioration in the standards of public morality.

The official response to the issue has been to offer both carrot and stick to the holders of the black wealth and income to abandon the parallel economy and travel back on the open, transparent route. But the policy has achieved only limited success.

3.8 PROBLEM OF LOW PRODUCTIVITY

A major factor in the slow growth of the economy has been relatively lower levels of productivity. This is true of all the sectors of the economy, be it agriculture, industry or services. Low productivity in turn can be traced to the use of backward techniques of production and lack of modern technology.

In the agricultural sector, introduction of new technology is restricted by inadequate capital formation. A large part of Indian peasantry lives at subsistence level; they are hardly in a position to make their both ends meet. They have hardly any savings available with them. The large farmers have resources available with them, in the form of surplus income. But a large part of these resources are diverted to non-agricultural activities. Investment in the agricultural sector suffers cumulatively.

In the industrial sector, productivity suffers again due to inadequate investment in technology and modernisation. The modern technology is a capital-intensive and is more suited to those industries, which enjoy economies of scale. Capital-intensive nature of technology makes it imperative that the production units should have access to large funds, which they do not have. Similarly, in order to reap economies of scale they need to have large markets. This again is not available to them both due to limited size of the domestic market and their inability to tap the export market. Poor productivity is further reinforced by poor infrastructure, both economic and social. Poor productivity implies a relatively higher cost of production. This adversely

affects the competitiveness of products, and hence makes it more difficult to adopt productivity-improving techniques of production.

Improvement in productivity holds the key to achieve success in varied development programmes that have been launched. Improvement in productivity alone can help us accelerate the rate of economic growth. This in turn will help us overcome many a problem that owe their origin to limited availability of resources.

3.9 BALANCE OF PAYMENTS CONSTRAINTS

Balance of Payments (BoP) is an annual statement of accounts of a country relating to its economic transactions with the rest-of-the-world. It records the monetary values of all these transactions. A country may export both goods and services, including technology, to the rest-of-the-world, for such exports it receives payment in an internationally accepted foreign currency (also known as hard foreign exchange). Similarly, against its imports of goods and services during a year it has an obligation to make payment to the suppliers in the rest of the world. This payment again is to be made in hard foreign exchange. Apparently, a country needs to earn more of foreign exchange through its exports of goods and services if it needs to import increasingly larger quantity of goods and services.

In other words, the inflow of foreign exchange through exports need to be balanced with the outgo of foreign exchange due to imports. If the inflow falls short of the outgo, the country incurs a deficit in its BoP. This deficit can be financed either by drawing down its own foreign exchange reserves, or by arranging a capital inflow in form of borrowings or investment by foreign residents in the domestic market. As long as a country can arrange an equivalent value of inflows, BoP deficits need not be a constraint on economic growth, specially in the short run, although the long-run implications in the form of debt-servicing and repatriation of investment income cannot be ignored too long.

In a situation, where the funding of BoP deficits cannot be arranged, and also if sufficient foreign exchange reserves are not available with the government, the country would be forced to cut back on its imports. This would adversely affect the pace of economic growth.

India's BoP situation is to be seen in the light of the above. Ever since the process of development planning began in India, with the launching of the First Five Year Plan on April 1, 1951, India needed to import increasingly larger quantities of goods, (consumer, intermediate and capital), to meet its domestic requirements. A developing economy like India could not aspire to meet the rising import-will by its own export-earnings. It had to take resort to borrowings abroad. As a matter of policy, inflow of foreign capital in the form of investment by foreigners was not encouraged. The uninterrupted inflow of foreign debt enabled us to meet our rising burden of BoP deficits. We resorted to large borrowings in the hope that sooner or later the economy would be in a position to generate large export surpluses that would enable us to repay the loans.

But that was never possible and our exports failed to pick up. Our debt obligations went on increasing. Debt servicing began to eat away a large part of our foreign exchnage earnings, leaving little balance to import the goods that we needed for accelerating our rate of economic progress. BoP deficits emerged as the most important constraint on our growth process.

Towards the beginning of the decade of nineties, we formulated a new strategy to overcome the BoP constraint on economic development. As a part of this strategy, export-sector began to be given top-most priority in our developmental efforts. Along with this our policy towards foreign capital underwent a shift. We laid down a red carpet to foreign investment, and extended many an incentive to them. Consequently, the overall economic environment has undergone a change. There has taken place a large inflow of foreign capital in the form of investment by the foreigners in India. Besides the export sector gained a vitality of its own. Consequently, India got some respite from the BoP bottlenecks during this period; an indicator of this is the growing size of foreign exchange reserves. However, the respite is not to be taken as a permanent cure of the problem. The ultimate remedy of the problem lies in our ability to generate large exports that would enable us to meet all our external liabilities in foreign exchange.

3.10 FISCAL CONSTRAINTS

Fiscal situation of a country relates to the finances of the government. Two important aspects of government's finance are: (i) government's revenue, and (ii) government's expenditure. A government collects revenue from different sources like taxes, surpluses generated by enterprises owned by it etc. Likewise, a government has to incur expenditure under various heads like provision of defence, social and community services and economic services of various kinds etc. If the government expenditure during a year exceeds its revenue, it has to take resort to borrowings, both from domestic and foreign sources. In the event that *borrowings do not suffice to cover the deficit between the expenditure and the revenue, a government can resort to printing of new currency notes, often referred to as deficit financing or monetised deficit.*

Borrowing and deficit financing can also be used as instruments of development finance provided, the financial resources raised through these means are employed for the purposes of capital formation in the economy. Such use of the resources in capital formation, on the one hand, generates its own means of repayment and on the other it generates additional supply of goods and services. This helps to keep inflationary forces under check.

However, if by any chance the government is forced to (or is tempted to) make use of these easy means of money to finance its own needs of consumption or to meet its immediate liabilities that do not directly add to the production potential of the economy, these may pose a serious constraint on the developmental efforts of the economy. Increasingly larger part of the revenue to be generated by the government in future would have to be diverted to meet its liabilities arising out of its profligacy. It will have little or no control over its finances, and would not be in a position to contribute to capital formation. The whole growth proceeds would come up against serious barriers.

India too has been faced with a similar situation for some time now. Welfare state as India is, the range and scope of the responsibilities and activities of the government has been continuously increasing. This has involved a manifold increase in government expenditure. Increase in government expenditure has called for the need to generate additional revenues.

Till the end of the seventies, the government revenue used to be more than the government's current expenditure on defence, public administration and other related

economic activities. The surplus of revenue over expenditure was used to finance the capital formation. Capital formation was also funded by borrowings and deficit financing. These helped to raise the production potential of the economy, although at times their adverse effects on the process of economic development, specially in the form of inflationary tendencies, could not be ignored altogether.

The situation headed for a disaster with the on set of the decade of eighties. A large part of the government revenue began to be preempted in such uses as defence, interest payments and subsidies. These commitments could not be negotiated, and consequently there emerged revenue deficits. A part of these deficits had to be met by borrowings, with two immediate effects, one a slowdown in the rate of capital formation, and two a sustained rise in government debt and hence a further drain on government revenue.

The government responded by announcing a package of economic reforms. The new structural adjustment programme seeks to restrict the range and scope of governmental activities, so as to keep a check on expanding governmental activities. Also subsidies are being brought under control. Simultaneously, tax structure has been simplified as also the tax administration has been streamlined to gather larger tax-revenue, both from direct and indirect taxes. An effort is also on to improve the functioning of the public enterprises so that they generate and make available more resources to the government.

On the whole, the fiscal situation at present is precarious. It leaves little or no flexibility with the government to charter the economy along a desired direction.

Check Your Progress 3

1) What is economic infrastructure?

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2) Mention important components of social infrastructure.

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3) How inadequate availability of infrastructure retards economic growth?

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4) What can be identified as the lasting solution to the problem of inflation?

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5) What accounts for the Balance of Payments problems being faced by India?

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3.11 REGIONAL IMBALANCE

Another issue in growth that needs be referred to is the phenomenon of regional imbalance. Regional imbalance refers to unequal or disproportionate development of various regions within a country. Several indicators can be used to assess regional imbalance in India. Table-3 gives some socio-economic indicators of regional imbalance. The states have been arranged in the descending order of per capita income.

Per Capita Income Differences in States

The data reveal that at 1980-81 prices, the per capita income of India was Rs.2,229 in 1991-92 but only 8 states viz., Goa, Punjab, Haryana, Maharashtra, Gujarat, Arunachal Pradesh, Tamil Nadu and Karnataka had per capita income higher than the all-India average. At the other extreme was Bihar with per capita income of the order of Rs.1,091, followed by Orissa (Rs.1,512) and Uttar Pradesh (Rs.1,589). If we treat Goa as one of the small states in the special category, even then the per capita income of Punjab as Rs.3,869 was 3.5 times higher than the per capita income of Bihar as Rs.1,091. The point, which needs to be mentioned, is that in 1980-81, the per capita income of Punjab was Rs.2,674 and that of Bihar was Rs.917. This implies that the maximum minimum ratio was 2.9 in 1980-81. Obviously, the rate of growth of per capita income of Punjab was comparatively much higher than that of Bihar. Consequently, regional disparity has widened.

Poverty Ratios in Various States

The figures of the percentage of population below the poverty line for 1987-88 reveal that for the country as a whole, this percentage was 39.3 but Maharashtra, West Belgal, Orissa, Bihar, Madhya Pradesh and Uttar Pradesh are such states, which have a higher proportion of population below the poverty line than the All-India average. In Bihar, 53.4 per cent and in Orissa 55.6 per cent of the population is poor. Whereas the total number of poor in 1987-88 was Rs. 31.28 crore, 71 per cent of them (i.e., Rs. 22.25 crore were living in seven states - Maharashtra, Uttar Pradesh, Madhya Pradesh, West Bengal, Tamil Nadu, Bihar and Orissa. (Refer table 4).

Data given in table 4 reveal that during 1973-74 and 1987-88, the proportion of population living below the poverty line declined from 54.9 per cent to 39.3 per cent. This implies that during a period of 14 years, poverty ratio declined by 15.6 per cent. Thus, there was a decline of 1.1 per cent per annum in the poverty ratio. But a careful perusal of the data reveal that the maximum rate of decline was 2.0 per cent in case of Kerala and minimum rate was observed as 0.6 per cent in Bihar.

A very encouraging feature of the situation is that in the case of Punjab, the poverty ratio fell to as low a figure as 12.7 per cent, but it is a matter of shame that even after 40 years of independence, the poverty ratio in case of Orissa and Bihar was 55.6 per cent and 53.4 per cent respectively.

Table 3 : Select Socio-economic Indicators of Different States in India

	Per Capita Income at 1980-81 prices (1991-92)	Percentage of population to total population (1991)	Percentage of urban population to total population (1991)	Average Daily Employment of factory workers per lakh of population (1985)	Net Irrigated Area as % of net sown area (1990-91)	Consumption of electricity per capita Kwh. (1992-93)
1. Goa	4800	23.4	41	NA	15	663
2. Punjab	3869	12.7	30	1400	93	863
3. Haryana	3455	16.6	2.5	1630	73	673
4. Maharashtra	3381	40.1	39	1750	11	524
5. Arunachal Pradesh	3012	37.5	12	NA	21	128
6. Gujarat	2412	32.3	34	1890	27	622
7. Tamil Nadu	2322	45.1	34	1400	43	431
8. Karanataka	2255	38.1	31	1340	20	357
9. Himachal Pradesh	2074	15.5	9	NA	17	296
10. West Bengal	2015	44.0	27	1510	36	165
11. Manipur	2002	32.9	28	NA	46	140
12. Meghalaya	1906	34.6	19	NA	23	159
13. Nagaland	1900	34.9	17	NA	31	100
14. Assam	1887	36.8	11	400	21	91
15. Kerala	1826	32.1	26	1080	15	255
16. Andhra Pradesh	1788	27.2	27	910	39	365
17. Rajasthan	1733	34.6	24	520	24	320
18. Tripura	1689	36.8	15	NA	15	84
19. Jammu & Kashmir	1687	23.2	24	NA	41	380
20. Madhya Pradesh	1621	43.4	23	750	22	312
21. Uttar Pradesh	1589	42.0	20	470	61	209
22. Orissa	1512	55.6	13	400	31	226
23. Bihar	1091	53.4	13	600	44	61
24. Mizoram	NA	32.5	46	NA	12	126
25. Sikkim	3369*	34.7	9	NA	17	—
All-India	2229	39.3	26	1050	33	330

* For 1990-91.

Source : *CMIE, Statistics Relating to the Indian Economy, Vol. II (1994), Draft Mid-Term Appraisal of the Eight Five Year Plan (1992-97), Report of the Export Group on Estimation of Proportion and Number of Poor (1993).*

Indicators of Modernisation

There are three principal indicators pertaining to the modernisation of a country or region - the proportion of urban population, average daily employment of factory workers per lakh of population and per capita consumption of electricity. A careful analysis of these figures reveals that the degree of urbanisation in 1991 was 26 per cent of total population in India, but this shows wide variations at the state level. On the one extreme, Himachal Pradesh, Andhra Pradesh, Assam, Tripura, Orissa, Sikkim and Bihar have urban population below 15 per cent of the total population. On the other hand, the states, which have a degree of urbanisation above 30 per cent, are Punjab, Maharashtra, Gujarat, Tamil Nadu, Karnataka and Mizoram. (Refer to

Per Capita Consumption of Electricity

An important indicator of industrialisation is per capita consumption of electricity. There are wide variations among states in this regard. The per capita consumption of electricity in Bihar is 61 kwh, while that in Punjab is 863 kwh. This implies a ratio of 1:14. While the national average is 330 kwh, but in West Bengal, this figure is 165 kwh, just half of the national average. The other states in which electricity consumption is miserably poor are Arunachal Pradesh, Manipur, Nagaland, Assam, Tripura and Mizoram. The very low level of per capita consumption of electric energy in the North Eastern Sector is an indicator of its backwardness.(Refer to table 3)

Average Daily Employment of Factory Workers

Similarly, average daily employment of factory workers per lakh of population can also be treated as an index of industrialisation of the state. From this point of view, the all India average is 1,050. As against it, those states, which have been able to create more factory employment, are: Gujarat, Haryana, Maharashtra, Tamil Nadu, Karnataka, West Bengal and Kerala. On the basis of this criterion, the most backward states are Orissa, Assam, Rajasthan and Uttar Pradesh. They are followed by Bihar, Madhya Pradesh and Andhra Pradesh. (Refer to table 3)

Table 4 : Number and Percentage of Poor - arranged in ascending order on the basis of 1987-88 Poverty Ratio

	Number of poor in lakhs		Poverty Ratio (% of population)		% Reduction in Poverty	
	1973-74	1987-88	1973-74	1987-88	14 yrs	Annual
1. Punjab	40.4	24.6	28.08	12.70	15.38	1.1
2. Himachal Pradesh	9.7	7.6	26.40	15.46	10.94	0.8
3. Haryana	38.2	25.9	35.24	16.63	18.60	1.3
4. Jammu & Kashmir	21.4	16.4	42.59	23.20	19.39	1.4
5. Goa	4.1	2.7	44.04	23.42	20.62	1.5
6. Andhra Pradesh	227.5	167.8	49.25	27.20	22.05	1.6
7. Kerala	135.3	92.2	59.71	32.08	27.63	2.0
8. Gujarat	135.7	128.6	47.21	32.33	14.88	1.1
9. Mizoram	1.8	2.0	50.33	32.52	17.81	1.3
10. Manipur	5.9	5.5	50.01	32.93	17.08	1.2
11. Meghalaya	5.5	5.5	50.25	34.60	15.65	1.1
12. Rajasthan	129.0	141.2	46.33	34.60	11.73	0.8
13. Sikkim	1.2	1.4	50.91	34.67	16.24	1.2
14. Nagaland	2.9	3.4	50.87	34.85	16.02	1.1
15. Tripura	8.5	9.0	51.03	36.84	14.19	1.0
16. Assam	81.9	85.4	51.23	36.84	14.39	1.0
17. Arunachal Pradesh	2.7	2.8	51.96	37.47	14.49	1.0
18. Karnataka	170.3	162.4	54.34	38.14	16.20	1.2

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19. Maharashtra	285.8	294.2	52.94	40.10	12.84	0.9
20. Uttar Pradesh	538.9	537.0	56.98	41.99	14.99	1.1
21. Madhya Pradesh	276.8	265.9	61.90	43.40	18.50	1.3
22. West Bengal	299.1	276.7	63.39	43.99	19.40	1.4
23. Tamil Nadu	246.4	243.2	56.51	45.13	11.38	0.8
24. Bihar	369.8	439.8	61.78	53.37	8.41	0.6
25. Orissa	154.6	168.0	66.24	55.61	0.63	0.7

Source: Compiled and Computed from Planning Commission, Report of the Export Group on Estimation of Proportion and Number of Poor (1993).

3.12 ISSUE OF ENVIRONMENTAL DEGRADATION

The process of growth has thrown up another important challenge for the planners and the policy-makers. As the growth process moves further not only to help meet the basic requirements of fast-rising population but also to raise the average standard of living of the masses the rate of utilisation of natural resources accelerates.

An excessive use of natural resources, leads to an ecological imbalance. As a result not only does the efficiency of various resources get adversely affected, but there also emerge various negative externalities like pollution of air, water, sound etc. These costs have to be borne by the society at large.

The growing realisation of environmental degradation has pushed this issue to the top of the agenda of policy-makers, economists, sociologists, politicians and scientists of all hues and colours. Ways and means are being found to save the environment from further decay and achieve what has come to be called "sustainable development". (For further details see Block-3, Unit-12)

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Check Your Progress 4

1) List five indicators of regional imbalance in India. Which of these are directly related to the industrialisation of the economy ?

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3.13 LET US SUM UP

The problem of poverty has been with us for quite long now. As a result of planned economic development incidence of poverty has declined during the last five decades. But it has not been possible to find a lasting solution to this problem. The problem of poverty, as a matter of fact, is a manifestation of a slow rate of economic growth, creation of inadequate employment opportunities, and growing disparities in income distribution. The process of growth has also thrown up other challenges like rising prices, low productivity, BoP constraints inadequate infrastructure and regional imbalance. Answers to these problems and issues have to be found and economic policies formulated accordingly.

3.14 KEY WORDS

Balance of Payments: A systematic record of account expressed in money terms of all the economic transactions of a country with the rest-of-the-world in a given period i.e. normally a year.

Demographic Investment: That part of investment, which is undertaken to meet the needs of the additional population, estimates at current levels of living.

Inflation: A sustained increase in the general price level over long period of time.

Infrastructure: All those supporting structures that help direct production activities like agriculture, industry etc.

Line of poverty: A level of income that enables an individual buy just about the bare means of subsistence.

Marginal holdings: A unit of cultivation with land area of less than 1 hectare.

Small Holdings: A unit of cultivation with land area between and 1 and 2.5 hectares.

Structural Changes in the Economy: These refer to a change in the relative roles of different production sectors in the economy.

Trickle down: A process whereby the income generated among the top income groups in the society percolates down among the poor.

3.15 SOME USEFUL BOOKS

Government of India (1999). *Ninth Five Year Plan 1997-2000*, Planning Commission, New Delhi.

Government of India (2000). *Economic Survey 1999-2000 (annual)*, Department of Economic Affairs, Ministry of Finance, New Delhi.

Dhingra, I.C.(2000). *Indian Economic Environment*, Sultan Chand & Sons, New Delhi.

Jalan Bimal (1996). *Indian Economic Policy*, Viking, New Delhi.

Joshi Vijay & IMD Little (1996). Indian Economic Reforms, 1991-2001. Oxford, University Press, New Delhi.

3.16 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Sub-Section 3.2.1
2) See Sub-Section 3.2.3
3) See Sub-Section 3.2.4

Check Your Progress 2

1) See Section 3.3
2) See Section 3.3

Check Your Progress 3

1) See Section 3.4
2) See Section 3.4
3) See Section 3.4
4) See Section 3.5, last para.
5) See Section 3.9

Check Your Progess 4

1) See Section 3.11

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UNIT 4 INFLATION IN INDIA

Structure

4.0 Objectives
4.1 Introduction
4.2 Measurement of Inflation in India
4.3 Price Trends in India
 4.3.1 Phase of 1951-66
 4.3.2 Phase of 1966-90
 4.3.3 Phase of 1990 onwards
4.4 Causes of Inflation in India
 4.4.1 Factors on the Demand Side
 4.4.2 Factors on the Supply Side
4.5 Consequences of Inflation in India
4.6 Remedies
 4.6.1 Monetary Policy
 4.6.2 Fiscal Policy
 4.6.3 Production and Distribution Policy
 4.6.4 Administered Price Policy
 4.6.5 Commercial Policy
 4.6.6 Income Policy
4.7 A Note on New Wholesale Price Index (WPI) Series
4.8 Let Us Sum Up
4.9 Key Words
4.10 Some Useful Books
4.11 Answers/Hints to Check Your Progress Exercises

4.0 OBJECTIVES

The unit introduces you to the trends in the general price level in India since the beginning of the First Five Year Plan in 1951. After going through this unit you will be able to :

- Explain the course of inflation in the Indian economy
- Identify the causes of inflationary trends in the Indian economy
- Understand the consequences of inflation on the development prices
- Frame out a policy that can work to bring inflation under control.

4.1 INTRODUCTION

A major objective of economic planning in India has been to promote economic growth in an environment of price stability. Price stability implies an absence of erratic and unplanned movements in the general price level, inflationary or deflationary. A moderate inflation is generally believed to be a necessary condition of economic growth. Moreover, a planned inflation of any degree may not be a reason for concern as the respective plans also provide for the necessary correctives.

However, when the rate of inflation jumps the planned levels it has serious consequences. It may distort the entire frame of the plan. It is therefore not unwarranted to symbolise inflation with a state of crisis. India has been passing through this phase almost for over four decades now. It would be pertinent to diagnose this disease and prescribe suitable measures to correct it.

4.2 MEASUREMENT OF INFLATION IN INDIA

Inflation in India is measured with the help of the wholesale price index (WPI) . The WPI is compiled by the Government of India, on a weekly basis. The WPI is a composite index of 447 commodities; these commodities are divided in three groups, viz., (i) primary articles, (ii) fuel group, and (iii) manufactured products. Primary articles have a weightage of 32.3 per cent while fuel group and manufactured products have 10.7 per cent and 57.0 per cent weights respectively. Currently, the WPI is estimated on the base year prices of 1993-94.

4.3 PRICE TRENDS IN INDIA

Each plan documents in India has sought to ensure that there is no accentuation of inflationary pressures in the course of the plan and that the levels of living of the more vulnerable classes in society are safeguarded. However, even as overall price stability has been an avowed objective of economic planning, the goal has eluded us almost persistently, as would be clear from a review below.

The whole period 1951-99 can conveniently be broken into three phases, viz., (i) 1951-66, (ii) 1966-1990, and (iii) 1990 onwards.

4.3.1 Phase of 1951-66

Inflation, although moderate had its beginning in India with the onset of the heavy investment programme during the mid-fifties.

The WPI, which had gone down by about 22 per cent during the First Plan, went up by about 30 per cent during the five years of the Second Plan. The WPI went up by another 35 per cent during the Third Plan period.

The rising trend of the WPI during this period could be attributed both to inflationary financing of the developmental programmes and shortfall in output, specially of agricultural products. Diversion of resources from development to defence in wake of external aggressions in sixties also contributed to the build-up of the inflationary pressures.

4.3.2 Phase of 1966-90

During this period, price variations cut across the plan periods and had shown considerable volatility. In all, seven sub-phases of price movements can be observed during the period 1966-90.

High rates of inflation were witnessed during the years 1966-67 (13.9 per cent) and 1967-68 (11.6 per cent) followed by four years of declining or gently rising price levels up to 1971-72.

A sudden spurt in the general price level was noticed in 1972-73 to 1974-75 (25.2 per cent). This was followed by a distinct phase of four years (1975-76 to 1978-79) experiencing relative price stability. In 1979-80, again prices shot up by 17.1 per cent and then by 18.2 per cent in 1980-81. The rate of increase though still high, decelerated to 9.3 per cent in 1981.82.

Thereafter, for the years, from 1982-83 to 1986-87, price increases were moderate,

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The foregoing review brings out on interesting aspect of the nature of inflation in India. The periods of high inflation are soon followed by periods of relative price stability. This deems to be the logical consequence of India's economic structure and fairly sensitive policy responses by the authorities to specific disturbances which give rise to macro economic and sectoral imbalances.

4.3.3 Phase of 1990 onwards

Inflation has shown a dogged persistence in the post reforms period. In 1990-91, the year of macro economic chaos, there was a 12.1 per cent rise in the WPI. In the following fiscal year, there was a two -step devaluation of the rupee , which stipulated expectations; WPI went up by 13.6 per cent during the year 1991-92 . In 1992-93 where there was a 6.9 per cent rise in foodgrains output and a 3.9 per cent rise in overall agricultural production, the inflation rate did come down to 7 per cent. During the two subsequent years, the inflation rate averaged 10.6 per cent.

As mentioned above the WPI has three parts- primary articles (weightage of 32.29 per cent), fuel group (weightage of 10.66 per cent) and manufactured articles (weightage of 57.04 per cent). Primary articles - meaning unprocessed crops of food items and fibres plus livestock - are vulnerable to the vagaries of nature. The fuel group comprises mineral oils, electricity and coal. Inflation in this segment always tends to be high. In fact, in six of the last 10 years, inflation rate in the fuel group has averaged more than 10 per cent. However, over the last two years it has dropped. In '98-99, inflation rate averaged 4.3 per cent and in '99-00, it hovered at 8 per cent.

The largest contributor to the low inflation rate, as measured by the WPI, has been the 'manufactured products' group, where prices rose just 0.4 per cent, during 1999-2000 compared to 4.6 per cent in '98-99. This represents a dramatic drop in inflation rate. Manufactured products are also the area that is most significant among the three components of inflation. There are two reasons for this - the high weightage and the fact that this group is vulnerable to structural changes in the economy. That is, the group is more influenced by policy than the primary articles group. What is driving low inflation in the manufactured product items? As such, drawing generalised conclusions is hazardous. If inflation rate in this group is low it's because of certain definitive factors - low input prices, producers' effort to boost demand or even competitive pressures.

The last factor is the most important because it has long term implications about the behaviour of inflation. Evidence suggests that competitive pressures. both internal and external, could have played an important role in keeping manufacturing inflation low. If so, manufacturing inflation is not likely to rise in a hurry in the near future.

Overall, the Indian manufacturing sector is under more competitive pressures, both domestic and external. Categories contributing about 35 per cent of the WPI could be exposed to international competition. And, if one includes domestic competition in sectors like cement, consumer durables and automobiles too, the pricing power of a substantial part of the manufacturing basket could be affected by competitive pressures. Which direction will inflation take in the future? It is not possible to make an accurate forecast for the primary goods category because this section is unpredictable. In four of the last 10 years, inflation in this category exceeded 10 per cent and only in the last two years has it stabilised at less than 5 per cent. So, if one goes by the law of probabilities, inflation in this category is likely to rise.

Prices in the fuels category tend to rise religiously, and so inflation could hover at 8-10 per cent. That leaves the manufacturing sector, the big bogey. A large part of this section is now aligned with global cycles. Therefore, while demand revival should create conditions for manufacturing inflation to rise, it is likely that it may remain at 4-5 per cent levels in 2000-2001, where it has been for the last four years. Overall, therefore, the WPI should stay at 5-6 per cent for the next year. This will be a low for India.

The mid-nineties have witnessed a slowing down the rate of inflation. Although, the WPI has continued to move upwards, the rate of increase has been moderate, 7.7 per cent in 1995-96, 6.4 per cent in 1996-97, 4.8 per cent in 1997-98 and 6.9 per cent in 1998-99.

It would be seen from the above review that India entered the age of rising prices in the mid-fifties. The price level has since been continuously rising. What has differed, however, is the rate at which prices have gone up at different stages. While during the fifties and the sixties, inflation used to be moderate and phases of stable prices intermingled with those of rising prices. The rate of inflation picked up fast during the mid-seventies, and accelerated further during the eighties and the first half of the nineties. The price line has been little smoother in the second half of the nineties.

Check Your Progress 1

1) Is inflation good or bad for economic growth?

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2) How do we measure inflation in India?

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3) Trace the course of inflation in India during the decade of nineties.

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4.4 CAUSES OF INFLATION IN INDIA

Inflation in India has been a mixture of both demand-pull and cost-push factors.

4.4.1 Factors on the Demand Side

1) ***Inflationary financing of government deficits:*** The rising expenditure of the government, ever since the beginning of the First Five-year plan, has resulted in fiscal deficits. A substantially large part of these deficits could be met by taking resort to easy and soft borrowings, both external and internal. But an equally substantial part had to be funded by printing new currency notes. The inflow of new currency, at times out of proportion with increase in output, fuelled demand for goods and services, resulting in an upward movement on the general price level.

2) ***Large supply to bank credit:*** The credit had been required to meet the growing needs of the production sector in the growth process. Likewise, in wake of globalisation and deepening and disintermediation of the financial system, new financial instruments outside the banking system are appearing at a fast pace. All these we add to monetary expansion in the economy .

3) ***Large inflow of non-debt foreign capital:*** Large inflows of foreign capital by way of factor incomes from abroad, direct and portfolio investment add to the available liquidity in the economy. This generates new demand for goods and services.

4) ***Black money:*** The term is used to refer to that money which is acquired after evading taxes. Black money is used to finance largely the non-productive activities like deals in real estate, gold smuggling, hoarding, luxury living etc. These types of transactions divert resources from productive uses to unproductive uses, and hence are responsible for not getting the supply of goods and services increase to their maximum.

4.4.2 Factors on the Supply Side

The important factors on the supply side are as follows:

1) ***Rise in administered prices.*** In our economy a large part of the market is influenced and regulated by government action. This is true both of the agricultural and industrial sector. In the agricultural sector the government regulates the market forces through such measures as minimum guaranteed support price, procurement price, etc. Similarly, the prices of a number of important basic industrial intermediates and raw materials are fixed by the governments. A large part of the inflation in India is explained by a periodical rise in the administered prices.

2) ***Dislocation of infrastructural facilities.*** Notwithstanding the fact that substantial efforts have gone into building up the infrastructural support to the economy and reasonable progress has been recorded a gap between demand and supply continues to exist, having dampening effects on overall production and supply of goods, resulting in higher unemployment and a lower rate of real output.

3) ***Rising import prices of essential commodities.*** In the increasingly globalising economy domestic price level cannot remain insulated from the international price levels whenever the import prices go up. These leave an inflationary impact on domestic cost and price structure.

4) ***Faulty and ineffective management.*** The private entrepreneurs in their zeal for higher profits have never shirked from indulging in such practices as hoarding,

only interfere with the free operation of the market forces. These only lead to the creation of artificial scarcities, from which nobody gains except the private entrepreneurs. The working of the public distribution system, wherever it operates has also been marked by inefficient and corrupt administration.

Check Your Progress 2

1) Inflation in India is a joint result of demand and supply forces. Comment

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2) Mention three factors on demand side that are responsible for inflation in India.

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3) Mention three factors on supply side that are responsible for inflation in India.

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4.5 CONSEQUENCES OF INFLATION IN INDIA

The major consequences of inflation in India can be examined as follows:

One, the effects of rising prices on general consumption standard are usually serious enough on fixed income groups, including the large class of landless agricultural labourers who are remunerated in cash. The rich can always insulate themselves against inflation - through various asset deals and by buying things whose prices rise along with inflation.

Two, inflation generates demand for positional goods. The adverse fallout of this trend would be on articles of consumption of the poor strata as the middle classes in the urban and rural sectors may put greater pressure for diversion of resources towards the production and availability of the articles of their own consumption. In a resource-starved economy of India, the poor may have to tighten their belts further in a situation of rising prices.

Three for a country like India, with the large mass of the people being net debtors, a gradual rise in prices should in part alleviate the burden of debt. Given the structure of production and marketing, however, only a small proportion of the benefit of higher prices accrues to the agriculturist or artisan owing to interception by middlemen and moneylenders.

Four the extent of stimulus to output as a result of high prices is limited by

Five, inflation by distorting the relative price and wage structure has made it difficult for tax authorities to track down money incomes of the various sectors of the economy and helped in the consolidation and expansion of a parallel economy .

Six, the rising levels of non-plan expenditure by the government may also largely be due to inflation. This compels the government to resort to deficit funding by way of printing new currency. This in turn further fuels inflation.

Seven, inflation results in creation of a high-cost economy, which is sapping our competitive capacity in the world market.

Eight, inflation discourages exports and builds up measure for enlarged imports. Overall, weakening export-competitiveness, unproductive activities of business preoccupied with inflationary gains, and the growing frustration of workers confronting a widening disparity in the distribution of income and wealth, all these trends indicate that growth potential of a developing economy like India is being desirously undermined by chronic inflation.

Check Your Progress 3

1) Explain how inflation affects the poor section of the society.

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2) Explain how inflation adversely affects our competitiveness in the export markets.

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3) What is the effect of inflation on self-employed persons?

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4.6 REMEDIES

As we have seen above many factors contribute to inflation. Corrective measures, thus, necessarily have to have a broad sweep.

4.6.1 Monetary Policy

The basic task of monetary policy in a developing economy is to meet the credit needs of the growth sectors on the one hand, and to curb the supply of money to be used in non-productive activities like speculative dealings and hoarding, on the other. Monetary policy in India has been designed on the same principles and hence is

The Reserve Bank has been manipulating various quantitative and qualitative controls to make this policy effective. But in the circumstances prevailing presently in the economy, the monetary policy is subject to the number of limitations.

The proportion of total credit provided by non-banking institutions and agencies is much higher and the linkages between banks and these institutions are not so well developed. The impulses generated by the Reserve Bank have thus limited impact in relation to the totality of transaction that need to be effected.

Credit restraints whenever they are imposed hit most adversely the priority sectors of the economy. Given these considerations, it is almost certain that we cannot depend upon monetary policy alone to contain inflation.

4.6.2 Fiscal Policy

There is a need to curb fiscal deficits. Recent experience has shown that a reduction in fiscal deficit by axing development expenditure can lead to recession and lower revenue yields. In fact, public expenditure on development, particularly on infrastructure, will need to be raised appreciably to revive industrial activity. On the other hand, there is limited scope to slack non-development expenditure. Any saving on this count may be offset by increased requirements of funds for defence.

What is required is that either or both of the following must happen:

a) Government sharply reduces its expenditure by reorganising itself, improving its efficiency, reducing subsidies and other infructuous expenditures; and

b) Government is able to get much higher returns on its investments in the public enterprise system and other parts of the public sector, like railways, posts and telegraphs etc.

4.6.3 Production and Distribution Policy

No scheme worth its name can be successful if it does not aim at increased production and productivity both in the agricultural and industrial sectors of the economy.

Alongwith this there is need for a well conceived distribution policy, We have already experimented with two extreme forms of distribution system, viz., total dependence on private entrepreneurs to undertake the distribution of goods throughout the length and breadth of the country, and total nationalisation of wholesale trade in foodgrains. Our experience has been that both of these systems are fraught with dangers. We would suggest that the distribution system should be left to private enterprise, but at the same time its working should be closely monitored and supervised by the state agencies to prevent malpractices.

4.6.4 Administered Price Policy

In the context of administered price policy it is pertinent to note that the objectives of fiscal stability and price stability do not always coincide. Though the increases in administered prices by the PSUs relieve the exchequer of its obligation to provide budgetary support to them, price hike in key inputs like petroleum products have a cascading effect on the general price situation. Therefore, the price policy to be followed by the government is to be such as to break the tendency to move the administered prices upwards at regular intervals.

4.6.5 Commercial Policy

The export orientation of commercial policy and encouragement to inward inflow of foreign exchange in any forms has come to be clearly established in more recent years. This concern for exports arises largely out of balance of payments considerations. This is as it should be in the prevailing economic scenario.

But in our zeal to earn foreign exchange we cannot afford to let the price situation go out of hand. Given the present level of foreign exchange reserves the domestic supplies of at least essential goods would have to be maintained at levels that do not fuel inflationary expectations. This will require in turn (a) liberal imports of commodities, and (b) export-controls on commodities in short supply domestically.

4.6.6 Income Policy

For maintaining price stability it is important that a proper relationship between different prices, between different incomes and between price structure and income structure be evolved. Given a proper price-income structure, any rise in the income of any factor should be consistent with the rise in productivity. It is also necessary that the rise in money supply should not be more than that required for the genuine needs of the community such as the rise in the volume of transactions associated with an increase in production and increase in the monetisation of existing transactions.

Check Your Progress 4

1) What type of monetary policy would you recommend for price stability?

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2) Outline the components of fiscal policy for price stability.

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3) What type of administered price policy would you recommend for price stability?

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4.7 A NOTE ON NEW WHOLESALE PRICE INDEX (WPI) SERIES

The introduction of the revised series of Index numbers of wholesale prices, with 1993-94 as the base year, is expected to provide a more realistic picture of inflation. The new base year has been chosen based on the well-known criteria, the desired

properties being: (i) a normal year for level of production and trade as also for price variations; (ii) a year for which reliable price and other data are available; and (iii) a year as recent as possible.

With a view to reflecting adequately the changes that have taken place in the structure of the economy since 1981-82 (the base year of the old series), almost all the important items being transacted in the economy have been included in the revised index. The new series with 1993-94 as the base has as many as 435 items in the commodity basket. Thus, the number of items included in the new series is, in fact, smaller than the 447 items in the 1981-82 series. However, the composition of the new series has been rationalised by incorporating newly emerging and important items, deletion of unimportant ones, amalgamation of less important items with similar ones and splitting of certain items.

In all, 136 distinctly new items have been added in the revised series. Besides, a number of varieties/grades, which are merely quotations of some items in the 1981-82 series without having any weight, have been upgraded to the level of commodities in the series. Again, a few items of the earlier series have been amalgamated because of their similarity in characteristics and for making their description more purposeful. As many as 150 items figuring in the 1981-82 series have been dropped due to their insignificant contribution in terms of their relative value of production in the economy. Only 68 per cent of the items/commodities are common in the old and new series. Some of the important items that have entered the WPI commodities basket for the first time are electricity for railway traction, purified terepthalic acid (PTA), injection moulded plastic items, oxygen gas cylinder, railway sleepers (cement), thinner ms/ ss ingots, cold rolled sheets, LPG cylinder, jelly filled telephone cables, colour TV sets, computer and computer based systems. Some of the dropped items are mica, imported petroleum crude, indigenous petroleum crude, khadi handloom cloth, broad gauge open wagons, and wrist watches.

The weight of 'primary articles' has significantly declined while that of 'manufactured products' has gone up considerably in the revised series. This situation has arisen as a consequence of the relatively slower growth in the agricultural sector particularly 'food articles' and 'non-food articles ' in the major group, 'primary articles.' The weight of primary articles group has declined to 22.02 per cent in the new series from 32.29 in the 1981-82 series. On the other hand, the weight of 'fuel power, light & lubricants' group has gone up to 14.23 per cent from 10.66 per cent and that of ' manufactured products' group has gone up to 63.75 per cent from 57.04 per cent. The new weights are in conformity with the structural changes that have taken place in the economy since the introduction of 1981-82 series.

A comparative analysis of the general wholesale price index of the revised series and the earlier 1981-82 series shifted to 1993-94 base shows that the revised series starts off from a level higher than the old series for the year 1994-95 and thereafter, the two series are more in consonance with each other. In fact, the rate of change in the revised series after 1994-95 is slightly lower than the old series as the commodity composition of the revised series reflects better quality products sometimes a little higher in absolute price level.

The Working Group under the Chairmanship of Prof. S. R. Hashim, which finalised the composition of the new WPI series, has stressed the need for more frequent revisions in the wholesale price index because of the greater integration of our

Working Group has also suggested that a serious attempt be made to incorporate services in the index, which occupies nearly one half of income generated in the economy. It has suggested that initially the effort should begin with a restricted number relatively important service industries for which the data are available and eventually a new series of WPI combining the commodities and services may be brought out. (Source : Economy Diary by S.D. Naik , Business Line, and April 25, 2000)

4.8 LET US SUM UP

A major objective of economic planning in India has been to promote economic growth in an environment of price stability. But this goal has largely eluded us. The price level began to rise after the First Five Year Plan and has since been continuously rising. What has differed, however, is the rate at which prices have gone up at different stages. While during the fifties and the sixties, inflation used to be moderate and phases of stable prices intermingled with those of rising prices, the rate of inflation picked up fast during the mid-seventies, and accelerated further during the eighties and the early nineties. Inflation in India has been the mixture of demand-pull and cost - push factors. Therefore, a set of measures need to be taken to restore price stability in the economy.

4.9 KEY WORDS

Inflation: A sustained rise in the general price level

Cost-Push Inflation: A sustained rise in the general price level arising from an autonomous rise in costs.

Demand-pull inflation: A sustained rise in aggregated demand, which results in sustained rise in the general price level.

Real Income: The value of total output measured in 'constant prices' i.e., with the general rate of inflation deducted so as to record the real command over resources.

Administered Prices: Prices, which are established by the conscious decision of some individual or agency rather than by the impersonal play of market forces. Administered pricing is generally possible where a good is sold by a public authority.

4.10 SOME USEFUL BOOKS

Dhingra I.C. (2000). *The Indian Economy: Environment and Policy* (Chapter-10), Sultan Chand & Sons, New Delhi,

Government of India (2000). *Economic Survey; 1999-2000 (Annual).* New Delhi

Jindal, Ajay (2000). *A caged tiger called inflation, the Economic Times*, April 18.

Naik, S.D. (2000). New WPI Series: A more realistic picture of inflation, *Business Line*, April 25.

Planning Commission (19). Ninth Five-Year Plan 1997-2002, New Delhi

Reserve Bank of India (2000). Report on Currency and Finance, 1999 Mumbai

4.11 ANSWERS / HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 4.1
2) See Section 4.2
3) See Sub-Section 4.3.3

Check Your Progress 2

1) See Section 4.4
2) See Sub-Section 4.4.1
3) See Sub-Section 4.4.2

Check Your Progress 3

1) See Section 4.5
2) See Section 4.5
3) See Section 4.5

Check Your Progress 4

1) See Sub-Section 4.6.1
2) See Sub-Section 4.6.2
3) See Sub-Section 4.6.4

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