

Post-war Inflation in India and Dishoarding

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THE way inflation took place in India during the war suggested that in the process of demobilisation, not only would inflation be stopped, but a depression might also set in. Unlike in England and in some of the European countries, there was not much of destruction of property here through enemy bombing. Moreover, most of the inflation that occurred during the war was due to what we may call 'foreign investment—export, of goods against sterling securities, only a minor part being due to the switch-over to production of war materials. This meant that the structure of our economy remained more or less unaffected during the period, except for a certain unreplaced wear and tear of machinery in the private investment sector. Naturally, therefore, one could expect in the circumstances that, as soon as the war and, hence, the occasion for foreign investment would be over, there would be such a large release of goods for domestic consumption as would outweigh the possible dishoarding of money that might be done, in the event of relaxation of controls, by our consumers and private investors, and that, therefore, there would ensue a period of depression and falling prices.

These anticipations have been falsified; the contrary has happened. Not only are prices rising,—what is more significant,—cash turn-over is increasing, too. With base, August, 1939, the index number of prices in 1945 was 244.1; now it is more than 380. Between 1939 and 1945 the price-level rose by 144 p.c. whereas the total cash, including Bank Deposits, increased by 377 p.c., thus indicating a considerable fall in cash turn-over. Since 1945, on the other hand, the price index has gone up by about 57 p.c., whereas the total cash has increased by just about 35 p.c. Thus prices have increased more considerably than cash, balances.

What has happened in the field of investment and consumption that is keeping up the inflationary pressure in our economy and giving it an even more serious turn than did the mid-war forces?

The expenditure of the Government of India—'public investment', as we might call it,—has surely increased since the war. Whereas in the peak year, 1944-45, the total Government expenditure on Indian account was Rs. 580 crores, in the Budget for 1948-49 of Indian Dominion alone the estimated expenditure is Rs. 435 crores. And it is to be feared, in view of unforeseen pressure, that the actual will exceed the estimated expenditure. Part of this excess Governmental expenditure is due to the expansion of the administrative paraphernalia since the attainment of independence and to the implementation of a number of developmental schemes. Mostly, however, it is due to the post-partition borderland disputes such as Kashmir and Hyderabad and the settlement and maintenance of refugees.

Private investment, e.g., replacement of worn-out machinery, use of industrial raw materials and the stocking of goods, has also, it appears, increased, although not to the extent that one would expect. Capital Issue Control and difficulties of importing capital goods from outside, which kept it down during the war, are still there. Political uncertainty is also not altogether absent. In spite of the recent declaration of industrial policy on the part of the Government, our entrepreneurs are not perhaps sure of their status and of the future of the market. And yet, since the war years were years of continuous disinvestment in this sector, some improvement seems to have been inevitable since then.

However, foreign investment has declined so enormously that it is impossible that the in-

crease in the volume of home investment should be anywhere near the balancing mark. Taking account of the financing of the war expenditure of Allied Nations in India, the figure for 1944-45 was Rs. 435 crores, whereas today we are on the verge of having an import surplus. Indeed, according to statistics supplied by the Economic Adviser's Office, during the quarter ended June, 1948, the Dominion of India had an adverse balance of trade of Rs. 1.96 crores.

On the whole, therefore, the post-war years have been characterised by a net decline in investment, and this decline by itself ought to have had a depressing effect upon the economy. But obviously this tendency has been more than counter-balanced by an increased propensity to consume. There was considerable postponement of consumption during the war years partly on account of propaganda and partly on account of the conviction in the minds of the public that the high prices by which they were caught up during the war would not continue after the cessation of war. Except for a few hectic months of 1943 our people did not somehow lose confidence in money during all this period of inflation and as far as possible they saved and waited for its value to rise. But there is a physical limit to the postponement of consumption. You cannot get on indefinitely without even some of your so-called luxuries. Mere passage of time makes it urgent that the pent-up demand should be released. To add to this, the experience of a continued rise of prices even after the war made people lose the sense of a normal price and they naturally started feeling that it was no good waiting after all. This seems to be a plausible enough explanation of our recent inflation, although the tendency may have been reinforced by other factors.

Altogether there are three sources of finance of this excess expenditure: (a) increase in the volume of current money income; (b) increase in the proportion of current money income devoted to spending; and (c) dishoarding, or the release of cash balances out of past income.

Current money income,—at any rate, money income per unit of output,—must have increased. This is shown by the rise in the money wage rate during the period. The first factor is, therefore, operative. Indeed, our industrialists would go to the length of laying upon this factor the major share of responsibility for the post-war rise of prices. Whether or not the second factor is oper-

ative, too, obviously depends upon whether there has been a change in the distribution of income during the period in favour of the lower income group? who are more prone to spend than to save. We have no statistics concerning movements in the distribution of income. But, in view of the wage increase and the increase in agricultural prices, the presumption must be that the proportion of spending out of current money income did have an increase. Yet, in spite of the protestations of the industrialists, we would go off on a false scent if we made too much of these. Two broad facts must be considered in this connection. There is yet a considerable gap between wages and cost of living. Although we have no reliable wage statistics, yet, nobody, except those who have an axe to grind, will contest the general validity of the proposition that wages are still lagging behind cost of living. Secondly, although agricultural wholesale price index is still higher than the non-agricultural retail price index, the ratio between the two is moving against the former; the agricultural parity index, as it is called, is on the decline, having gone down between July, 1947 and July, 1948 from 156 to 120. In the face of these it is difficult not to believe that the operation of the first two factors has been swamped by the third factor, namely, dishoarding.

During the war period, as we have noted cash turn-over fell and the proportion of income held in the form of money balances increased. A part of these balances has surely found its way into the commodity market. Indeed there seems to be no getting out of the fact that dishoarding has been one of the main initiating factors causing inflation in the post-war years. Budget deficit does not fully explain the phenomenon; neither does the increase in private investment, if any. For, the two together would be very far behind the figure that would compensate the decline in foreign investment. They may be contributory causes; but we shall be misjudging the acuteness of the present situation, if we rely too much on them.

What, then, are we to say about the fall in security prices that has taken place since the end of the war? Depression in the securities market has been, indeed, on one of the most important features of our post-war economy. In relation to base, December, 1945=100, the stocks and shares index came down to as low a figure as 61.9 in August, 1943. During the whole of the present year, there has been almost a steady decline in these indices. On the face of it this seems to

contradict our theory of dishoarding. Release of cash balances should ordinarily be accompanied not only by a rise in commodity prices but also by a rise in security prices, for securities and commodities ordinarily form competitive markets. This is true; but it applies to a normal period or inelastic price expectations. When, however, price expectations are elastic,—when, that is to say, people start thinking that the price rise is not to be just a temporary phenomenon but is to continue with greater intensity in the future, a shift from money to commodities causes a shift not to securities but away from them. In times of elastic price expectations, increased expenditure is financed not only out of hoards but also through sale of securities. As a result the security prices fall and the long term rate of interest tends to rise. If, therefore, our analysis of present inflation in terms of dishoarding is correct, then the depression in the securities market, and the consequent rise in the long term rate of interest assume an added significance. They point to a dangerous symptom of economic instability,—a state of elastic price expectations.

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China Turns The Scale

WESTERN Power's reaction to recent developments in China is typical of the West's attitude towards the East. The relentless advance of the Chinese Communists is not interpreted as palpable evidence of the disintegration of a corrupt, regime but as Kremlin's Machiavellian tactics in sovietizing the whole of Asia. The emphasis varies, but the theme is always the same. Sometimes it is argued that the widespread revolt in Asia is inspired, directed and controlled by Cominform with a view to sabotaging the European Recovery Programme. As a variation of this argument, it is suggested—a suggestion which has recently been endorsed by Chiang Kai-shek, that Russia's policy is to gain control over Asia as a stepping-stone to dominate the world; that, in order to dominate Asia, the Kremlin must be in control of China.

China's dominating position in South East Asia is undeniable; the power that controls China can marshal the massive man-power and the rich resources of Manchuria. In most of the South East Asian countries, the Chinese element is large and powerful. The Chinese predominate in Malaya, and in Indo-China; they are an influential minority in Siam and in Indonesia; China has an adjoining land frontier with Burma. Thus, even if it be accepted that Mao-Tse-Tung is not an agent of Moscow, the Communist threat to Nanking can any day develop into a Communist predominance over the vast area from the Amur to Timor.

That explains why America, Britain, France, Holland and Portugal are disturbed and agitated over the widespread popular revolt in Asia. America entered the Pacific during the war. Today, she remains a Pacific Power, and soon it will be clear whether she wants to salvage China out or will entrench herself firmly in Japan, where General MacArthur is the supreme overlord. Britain packed out of China when that country was declared as the seat of Pacific War Command under American strategy. She has since quitted India and Burma, but is holding on to Malaya, and is trying to fortify Bangkok as a substitute garrison to Hongkong. Meanwhile, France and Holland desperately cling on to their former colonies without whose resources the artificial standard of living of these metropolitan powers cannot be maintained. Moscow is still a disembodied voice in South East Asia.