DISCUSSION PAPER

ADMINISTRATIVE PROBLEMS OF AN INFLATIONARY ECONOMY

K.N. KABRA & K.L. HANDA

The behaviour of the general level of prices over recent years is too well-known to need recapitulation. A summary view is presented in Table page 46 which shows sectoral and general price behaviour. For purposes of our analysis, it will be useful to look at the process of general price rise in two parts: One for the period 1961-62 to 1971-72—a decade over which the index number for all commodities rose to a level little short of double its base year (1961-62) level; and, second, the period since 1971-72 when the price gallop was discernably and disquieteningly fast. If the first period was one of generation of *inflationary pressures,* the second one is the *actual inflationary period.* The last one year or so, especially since September 1974, may be called a *period of respite* when what one may call *relative price stability* is in evidence.

A great deal of controversy has centred round the casual mechanism behind the unprecedented inflation. We do not intend to join issues with the proponents and opponents of various theses—monetarists, structuralists, etc. However, an analysis of various administrative problems raised by a two digital, self-propelling inflation has to take its point of departure from the economic forces underlying the phenomenon of inflation.

This becomes all the more essential in view of the glaringly simplistic "monetary-expansion-fed-by-mounting-budgetary-deficits-explanations" of the current phenomenon. The trouble with this approach is that the run-away monetary expansion is left hanging by its own boot straps. If one were to say with Berstein and Patel that "this is the basic framework for the inflation process, when aggregate demand for all purposes—consumption, investment, and government—exceeds the supply of goods at constant prices",* one is neither in a position to account for the factors which lead to such an "inflationary gap" nor is able to understand the overall rate and the sectoral speeds of the process. To view the process as "caused by the excessive expectations of government business, or labour in the use of the national product" and to associate it "with the excessive creation of credit"† is to define the process rather than to explain it. For any viable explanation of inflation, it is essential to deal with (*a*) the causes of the inflationary pressures (causative mechanism); and (*b*) the mechanism by which inflation develops (propagation mechanism).

The causes, needless to say, emanate from the basic structure of the economy. Once the inflationary pressures inherent in our development strategy (a mild dose of inflation, or better still price-rise, which are reasonably predictable and manageable) break loose and turn into cumulative inflationary pressures (when the rate and direction of inflation and the distortions caused by it no longer remain reasonably predictable), then the structural barriers and monetary-fiscal process become subsidiary to the distortions of the price system and of allocation of resources induced by the rate and pattern of inflation itself.

Since the Indian economy was attempting to achieve planned rate and pattern of economic development, a certain rate of price rise was built into the system. Stability in this context has to mean a framework which allows the process of development to proceed and cannot in the nature of things be a zero rate of growth of prices. However, stability has to ensure that this mild process does not acquire a cumulative logic of its own. That is to say, the rise in price-level was to be a factor leading to and resultant of the process of growth which was to lead to further lubrication of the wheels of economic expansion rather than be a prelude to its own further spiral and detrimental to growth. The continuous process of struggle between various economic groups like wage-earners and

---

*Berstein and Patel, *IMF Staff Papers*, Vol. 6, 1952, p. 368.

†Berstein, *IMF Staff Papers*, 1958.

profit-earners, agriculturists and industrialists was to take place in such a way that actual and expected price-hikes do not distort their bargaining and decision-making perspectives. Since the State itself operates as the single most important economic agent, the struggle for resources can be extended to that between the public and the private sectors as well. When price rises impose additional burdens on public spending (because of the downward inflexibility of its commitments and secular growth trend of its outlays) and traditional sources of revenue do not show a matching flexibility, deficit budgets add to the process. A close look at the time pattern of price rise in India, presented in Table given at page 46, shows that the above mentioned processes were in operation. Taking 1949 as base, it is found that in twenty years (1969-70) the general price level stood at 215. Though it was certainly more than a modest functional price rise, it can scarcely be considered inflationary. But in May 1975 the price-level, with 1949 base, reached the level of 397. A period of about six years gave a rate of growth of prices which can well rival the earlier two-decades' outcome. The rate of growth of national product of agricultural and industrial output, of savings and investment did not show results which can sustain demands generated by the price rise of the order we have been continuously witnessing. Those who view inflation not tautologically as a situation of persistent and rising excess aggregate demand but as a situation which is "*basically the result of lack of adaptation of domestic supply to a changing pattern and level of demand*"* can see that the Indian economic development since the mid-sixties, as a result of an unfortunate combination of endogenous and exogenous factors, classically fits the latter case.

The sustained price rise did not generate positive elasticities in the supply of critical outputs, especially, the fitful nature of agricultural output (the structural kingpin of the economy) combined with *savings and investment* rigidities and distortions generated a *growth-profile* dimmer than the earlier achieved levels. Thus without prolonging the discussion on a diagnostic analysis of inflation, we can sum up by saying that we succeeded in creating an inflationary economy in our midst not because of a particular

*V. Carbo Livi, *Inflation in Developing Countries*, 1974, p. 13.

TABLE

INDEX NUMBER OF WHOLESALE PRICES

(1961-62-100)

	All Commo-dities	*Food Articles*	*Liquor & tobacco*	*Fuel, power light, etc.*	*Industrial raw mate-rials*	*Chemicals*	*Machinery, Transport Equipment*	*Manufac-tures*
1965-66	137.5	150.3	133.1	130.7	143.6	133.0	120.4	123.5
1969-70	175.7	199.8	188.2	160.1	185.8	193.4	140.2	148.9
1970-71	180.6	199.8	184.9	162.7	191.0	189.5	151.5	160.4
1971-72	192.3	216.5	209.1	178.1	178.5	198.8	162.8	173.4
1972-73	218.5	250.1	249.1	187.6	236.4	208.4	171.6	183.4
1973-74	284.4	321.7	272.2	292.9	322.7	270.8	245.7	234.2
1974-75	306.3	355.7	309.5	322.0	284.7	327.9	267.0	252.2
June 1974	308.7	357.1	305.0	308.8	336.5	286.8	234.9	249.9
June 1975	310.2	367.6	317.4	323.7	278.9	329.4	267.9	249.9

SOURCE : Office of the Ex. Adviser to the Government of India. From *Reserve Bank of India Bulletin*, June, 1975, pp. 500-501.

mix of monetary and fiscal policies alone but because of our overall economic performance.

II

The challenge of an inflationary economy gripped our public policy from the very beginning of the process. The initial years, however, did not come to grips with the mounting challenge. The behaviour of money supply and budgetary deficits (when both were rising alongwith rising prices) lends credence to this view. The credit squeeze and tightening of purse-strings for public expenditure cannot achieve effect strong enough to reverse the inflationary psychosis which had itself become the major cause of run-away inflation. Even situations of good crops did not succeed in restraining price rise because, with black money and smugglers' finance available in plenty, the hoarding of stocks of critical commodities continued unabated on the basis of tomorrows' prices. Restrictive monetary and fiscal policies concentrated on restraining aggregate demand in the organised sectors. A series of political, administrative, economic and regulatory measures to contain inflation were mounted. Even before we briefly refer to these measures, it will be pertinent to underline the fact that, since late 1974, we have been able to obtain some noticeable respite from price-rise. It appears as though a zero-rate of inflation is around the corner. True, the Ratchet effect and also the underlying economic situation do not allow a reverse process of price fall of any appreciable magnitude to materialise. It is a moot point how far such a process of declining prices can be brought about or is desirable in the interest of overall economic performance. Thus it may be asked what was the policy-mix as a result of implementing which we have been able to buy a respite from inflationary price movements. Briefly, a series of measures to curb demand pressure and to generate credibility were undertaken. Demand from the organised working and salaried class in the public and the private manufacturing and tertiary sectors was appreciably frozen. Black money and smuggling, hoarding and profiteering were brought down through stern administrative action. This led to reduction in demand for piling up of inventories and thus augmented supplies to meet genuine demands. Credit squeeze and much greater budgetary discipline also reduced the level of demand. An unprecedent political will was also in evidence.

On the supply side, imports of food, fertilisers and essential industrial raw materials contributed to easing of pressures. Better crops, thanks to weather gods, complemented the process. Current year's crop prospects are also promising though provide only a necessary and not a sufficient condition for price stability. Power position is also improved. Better industrial peace also reduced the supply bottlenecks. Enhanced availability of foreign credits on somewhat softer terms helped the process of improving supplies. Such a constellation of forces prompted the Reserve Bank of India's Annual Report to forecast that we are likely to move from negative, zero and marginal rates of growth of GNP of recent years to an annual growth rate in the next year which, after a long spell, may approach the plan target of 5 to 6 per cent per annum.

It is generally admitted that we have still not turned the corner, that only short-run forces have been mainly relied upon to generate this outcome. In fact, the current Annual Report of the RBI mentions some ominous signs. Important among these are disturbing response of the rate of savings and investment, mounting import bill which is further complicated by oil prices' prospects, non-continuance of export boom and mounting balance of payments deficit (nearly three times the level of last year). The fact that much of the Fifth Plan is yet to be salvaged from the inflationary ravages adds to the keeping one's fingers crossed attitude. A viable and stabilising distributive network fair to the vulnerable sections is still to be set up. It is hard to believe that raids and voluntary disclosures can dry up the *flows* of black money.

Thus the administrative challenges posed by the current inflation (though the hump is past, yet the prospects of smooth sailing are problematic) still face us, though in a changed form and perspective.

III

Let us attempt to spell out some of the major challenges. Just as inflation, once started, is itself its own main sustenance, in an inflationary economy, inflation is itself the first and foremost challenge. The policy of curbing inflation is one of the most intricate problems of policy formulation and implementation which faces an administration.

Monitoring and evaluation of inflationary trends is a very complex task in a multi-structured, vast economy in which various sectors of qualitatively different character interact. The behaviour of the unorganised sector is not the only imponderable because the parallel black economy makes it difficult to have adequate intelligence about price, output, levels of inventories and demands even in the organised sector. Our price data do not reflect retail prices, since the working class price index does not reflect the position of our teeming rural poor. With inadequate and less than reliable data-base, policy options cannot be adequately debated, let alone the question of proper exercise of choices. Therefore, the element of judgement, inevitable in any policy exercise, assumes tremendous importance. For example, the question of the magnitude of black money, the precise *modus operandi* of the parallel economy, the extent to which it enters production, consumption, investment and stock-piling in various sectors, the forms in which it is held, the relationship between its *stocks and flows*, etc., are some of the little explored and little known areas. For want of such knowledge, many debates (*e.g.*, about the efficacy of demonetisation) are forced to remain inconclusive. It leads to non-availability of some drastic but effective steps like demonetisation. The efficacy of the resulting policy-package is seriously affected in the bargain.

Since Indian inflation is qualitatively different from the one afflicting the more developed and homogenous Western capitalist economies, the trade-off between stability and unemployment does not quite present itself to our policy planners. However, there are other kinds of policy conflicts, both short-run and long-run. Price stability, insofar as it entails restraining investments, conflicts with growth. Price stability, it may be argued, is essential for growth, for effective planning and budgeting. However, on reflection, it may be granted that what is needed is not total stability of prices as such, especially when development involves large scale shifts and mobility of resources as between uses and places, but predictable and planned behaviour of prices. Thus stability as such cannot be the chosen goal. Planned *relative* price movements cannot, except by an accident, leave the *general* price level stay out.

However, curbing inflation is undoubtedly a high policy priority. Many a recipe are available for preparing this menu. Goal conflicts in such alternative choices are widely encountered. For example, demand management may impinge on the already low standards of living of the fixed income groups in both rural and urban sectors. Demand restriction in a poor country, with its abnormally highly skewed distribution of income, inelasticity in the supply of basic wage-good (food) and with absence of formal, viable and public system of social security, cannot be pressed beyond a point without inimical social consequences. When public investment is continually cut, not only long run growth is sacrificed but immediate misery is brought to these prospective entrants to the labour force whose only source of getting employment was the fructification of a public investment programme. Thus restrictive policies may amount, in some cases, to protecting the value of money of those who are employed at the cost of new job-seekers.

Inequity in various other forms thrives in an inflationary economy. Most price hikes are caused by actual, anticipated and or artificially created scarcities. To the extent prior cost escalations cause prices to shoot up, only certain demand irresponsiveness can cause them to eat into profits. However, such resistances to prices from the demand side are, *ex-definitione,* no part of an inflationary economy. Thus scarcities—real, imagined or contrived—lead to price escalation which augments the share going to profits. Then, wage-corrections take place only after their real level has come down. Even if the neutralisation is hundred per cent, temporally the workmen lose; neutralisation comes after a chunk of workers' rupee is already eroded. The distortions in consumption and investment pattern and the plight of the poor are inevitable consequences of inflation. The public exchequer also does not benefit because the blackmarkets and corruption account for sizable gains obtained by the business and entrepreneurial classes. Under-the-counter increases in prices prevent a proportional rise in Government's indirect tax revenue. The cuts in public spending may mean cut-back in demand for industrial output but in a generally inflationary situation it does not really matter. But the losses to the prospective job-seekers are immense.

How can an administration meet these problems during the period an economy is forced to live with inflation? Public distribution, rationing, fair price shops, procurements, network of co-operative distribution channels are easier said than done in a country of our size and complexity. Similar fate has been awaiting a prices and incomes policy. These problems become almost intractable in the rural areas and the bulk of smaller towns. These *sui generis* administrative problems are different from organising relief needed in the aftermath of a drought or a natural calamity. Private producers have to be coaxed, cajoled and/or coerced into feeding the publically sponsored supply lines in a seller's market. Checking black-marketing, corrupt practices and re-sale of controlled supplies are staggering problems.

The social and political unrest generated and let loose in such situations of acute social distress may easily threaten our policy. The recent Indian experience has clearly shown the destabilisation propensity of inflationary processes. It is a supreme administrative challenge to successfully overcome such threats which can have all the markings of a popular move and are amenable to opportunistic-populistic exploitation. *The resulting confusion may make policy formulation rather difficult and implementation nearly impossible. The process of controlling inflation itself requires nipping such socio-political distortions in the bud. But, in the last analysis, dealing with the causes alone can help and tinkering with the symptoms can yield temporary and uncertain outcomes only.*

IV

Considering the importance of food prices, let us discuss the question of controlling food prices in some greater details. The agricultural sector is of crucial importance for action to curb inflation. Food articles constitute about three-fifths of the average household expenditure. Agricultural price inflation feeds into the prices of industrial raw materials and also affects adversely the cost of living of industrial and agricultural and other workers, thereby giving rise to a demand for higher wages. To check costpush inflation, therefore, it becomes imperative that urgent measures are taken to control price rise in agricultural commodities. This is important because their weight in the overall price index is very heavy, as inflationary pressures have been originating in this sector and because agricultural prices have been experiencing much faster rate of increase than the prices of other groups of commodities.

Therefore, controlling agricultural prices and particularly those of foodgrains is of paramount importance. On the one side, it is necessary to adopt measures aimed at stimulating production. These may include a determined effort at land reforms, provision of incentives to the small and marginal farmers, adequate and timely supply of inputs through institutionalised arrangements, making available credit facilities, etc. On the other side, it would be desirable to institutionalize arrangements for reaching the essential commodities to the consumers at reasonable prices. In this context, a suggestion may be considered for the sale of foodgrains through *producers' cooperative societies directly to the consumers' cooperative societies thereby eliminating the intermediary wholesale dealers.* These societies may be created specially for the purpose of marketing in foodgrains. *The State machinery instead of directly and totally taking over the wholesale trade should be used to supplement, regulate and promote transactions between these cooperative societies.* The sanction of law would be necessary for enforcing that trading in foodgrains shall be only through producers' cooperatives, consumers' cooperatives and other government agencies like the Food Corporation of India, and its regional counterparts.

The challenge for administration would be to institutionalise such an arrangement by developing the right type of leadership in both the types of comparative societies. This leadership should be committed to the ideology of cooperation and protected from the dominance of a few big landlords or business interests. Land and agrarian reforms are preconditions for such action. Also, evolving suitable internal structures for these cooperative societies and finding ways to provide adequate resources to them would be important problems to be tackled by the administration.

In addition to consumers' cooperative societies, Food Corporation of India could be another purchaser of foodgrains. The operations of F.C.I. may continue to be carried for stabilization purposes and for building up the necessary reserves of foodgrains. By elimination of private trade, cooperatisation and nationalisation of foodgrains trade, the earlier implementational failures of price stabilization operations of passing on of publically held buffer stocks into the hands of private traders in critical times of forthcoming shortages can be avoided. Without restructuring foodgrains distribution system through cooperatives, state trading and public distribution system, fluctuations in food prices and consequent inflationary destabilisation (including adverse impact on cropping pattern) cannot be checked. The determination of fair prices to be charged by the producers' cooperative societies would be another important task for the Administration, which it can discharge only after examining the representations of all the parties concerned by the Agricultural Prices Commission.

As the cooperative societies on both the sides would be functioning to serve the interests of their respective members, it can be reasonably expected that they would keep to the minimum possible their overhead and operating costs. Also, hoarding and black-marketing activities can be effectively checked once foodgrains trade is taken away from private dealers. In brief, institutional restructuring of foodgrains trade is long overdue. The failure of the earlier scheme of take-over of wholesale trade needs to be analysed. Our suspicion is that it was due to the faulty, half-hearted and half-baked nature of the experiment. For a firm fight against inflation, such basic approaches will have to be worked out by the administrators.

V

Management of an inflationary economy poses particular problems for economic and financial administration, more specifically, for budgeting and financial control, especially with reference to plan finances.

Annual budget is formulated with estimates based on the known or the prevailing level of prices. The various sanctioning and operating authorities have to function and exercise their powers within the framework of the authorized budget. In certain cases they are delegated powers for marginal adjustments in the event of variations becoming necessary in the sanctioned estimates. However, the type of inflationary situation which prevailed till a year back, with more than 30 per cent annual price rise, is not covered by the powers of the administrative authorities and executing agencies to allow variations of estimates for budgetary operations. Such an inflation rate very badly upsets the work arrangements planned for the budget year because of wide difference between the prices prevailing at the time of operating the budget and those assumed while framing the budget estimates. In most cases such a significant change brought in financial estimates necessitates starting over again the processes for obtaining sanctions, which results in delays and consequent further increase in costs.

Budget management in an inflationary situation poses a peculiar problem especially when speedy implementation of the tasks of socio-economic development requires finalisation of budget provisions at the pre-budget scrutiny stage and thereafter leaving the administrative authorities and operating officials with adequate powers and facilities for the execution of their assigned tasks. It is sought to avoid delays by eliminating the need for the Finance Ministry's sanctions after budget provisions have been approved by it and authorized by Parliament. But the financial provisions of the budget as related to the physical components of the activities planned for the budget year are rendered unrealistic by the steep rise in price level. The variations becoming necessary in the budget estimates require going through the dilatory processes of obtaining various sanctions afresh. An important issue for discussion, therefore, is how to provide for a built-in flexibility by restructuring delegation of powers within the existing constitutional framework to cut delays in an inflationary situation, in the implementation of developmental programmes.

A strict budgetary discipline is necessary to curb inflation. This is particularly important to meet the challenge of inter-sectoral, inter-ministerial and inter-state rivalries for securing increasing amounts of funds for spending. While these pressures need to be combated, the need for coordination is supreme in order to prevent supply bottlenecks. Whereas cutting arbitrarily the demands of various spending authorities would not be a scientific approach, positive stimulus may be necessary to promote quick increases of output in critical areas. Budget allocation decisions should regulate investment choices so as to promote production of essential goods in preference to investments in assets with long gestation period, or even quick-maturing streams of output of little or doubtful social relevance.

Diversification of public sector investment for mass consumption goods like coarse cloth, soap, edible oils, vanaspati, etc., may become necessary if increased production of these commodities does not seem to be forthcoming from the private sector. The behaviour of India's organised industries in these mass consumption goods industries was hardly conducive to meeting shortages accentuated by inflationary pressures. Their accent appeared to be on *monopoly or scarcity profits,* rather than on genuine profits resulting from satisfying social wants. Any policy-decision in this regard would need to be followed by strategic choices and operational decisions. It would also be necessary to have a mechanism for appraisal and feedback for assessing the impact on supply position of various chunks of outlays.

Measures may need to be taken to utilize a good deal of excess capacity which at present exists in the public sector plants. It may also be necessary to reschedule and rephase plan expenditure as dictated by the needs of the inflationary situation. This would, of course, require a political will of the highest order which exerts itself objectively in favour of maintaining budgetary discipline from a long term perspective to curb inflation rather than influencing the course of public expenditure to serve fleeting, short-term-interests. The question of long-term interests and moving from a tenuous balance between supply and demand to a better and more comfortable balance between supply and demand (which provides goods in the market and purchasing power to the weaker sections to buy it) requires a careful, cautious and forwardlooking approach to plan-finances. Total freezing of plan outlays can hardly be a solution. Hence selective and well-timed, spaced and phased stimulus to public investment is essential to curb the basic causes underlying inflation.

Thus, to conclude, an inflationary economy, in brief, is, analytically, akin to a war economy. However, the conflicting interests of various groups in the society make it difficult to mount administrative efforts at total mobilization with singularity of purpose characteristic of a war economy. But insofar as the seriousness of the challenge is concerned, the war analogy can hardly be improved upon. This, we suppose, sums up the nature of administrative challenges involved in managing an inflationary economy.