The Unheeded Lesson from B.R. Shenoy

*Title Sentence: We need to heed the prophetic warnings of India's greatest economist that over ambitious plans lead to high inflation.*

**In** the aftermath of Finance Minsiter Arun Jaitley's maiden Budget, our policy makers would do well to read and reflect upon the writings and policy recommendations of B.R. Shenoy (1905-1978). Most readers of this newspaper – or other papers for that matter – are not likely to have heard of his name. Indeed, the same would apply to economics students and even to many economists in India.

**To** elucidate his contributions, and extract what lesson can be drawn for the Indian economy at present, a biographical sketch would be helpful. To begin with, like other great Indians of his generation, he took part in the freedom struggle and was jailed for a while in Nagpur. He stood first in his Masters in economics at Benares Hindu University in 1929, a land mark year being the onset of the Great Depression. Shenoy then went on straight to the London School of Economics and studied there under Friedrich Hayek, the renowned Austrian economist.

In September 1930, Keynes finished both volumes of his Treatise on Money, a precursor and stepping stone to his General Theory of 1936, which transformed economic theory and policy to this day. In Volume I, he laid out what he called his two Fundamental Equations for the price level of consumption goods and output respectively.

Using Keynes' nomenclature and definitions, Shenoy critiqued him in two articles "An Equation for the Price level of Investment Goods" (1931) and "Interdependence of Price Levels" (1933), published in the Quarterly Journal of Economics. Without going into details, Shenoy basically showed that Keynes was wrong in taking the price level of consumption goods to be independent of investment goods, and to take the latter as given. He worked out equations showing their interdependence. Hayek also published his critique in the same journal in 1932. Keynes soon abandoned his

Fundamental Equations of the Treatise, and altered his definition of savings for his subsequent analysis of the General Theory.

With these papers, Shenoy became the first Indian economist to publish in an international journal. But more than that, along with Hayek and Sir Dennis Robertson (Keynes' brilliant critic), he grappled during the 1930s with the tricky issues pertaining to different types of saving -- voluntary, enforced etc. In subsequent books and articles, he wrote extensively on savings, providing different classifications, and analysing the circumstances under which hoarded wealth would add to total savings.

After his London School phase, Shenoy taught in various colleges in Ceylon and India, in particular in Ahmedabad, and joined the RBI in 1945. He worked there through the early 1950s in various capacities, but left around 1954 to resume teaching at Gujarat University, where he continued until 1968. In complete isolation, he battled the prevailing Nehruvian orthodoxy until his death in 1978.

Going by the pedigree of his degree and publications, Shenoy was truly outstanding. But over and above these academic distinctions, the reason I consider him to be India's greatest economist is his real time track record of policy recommendations, discussed below. One can arrive at this conclusion despite being sceptical of some aspects of Hayekian economics, and its blanket aversion to 'artificially created' paper money.

To understand and appreciate his contribution, one needs to not just rewind from the present to 1955, but to pause there for quite a while. For those readers who do not know, in that year, India started a major policy shift leading to the Mahalanobis strategy of Soviet style centralized planning geared to heavy industry, that began to be implemented in the Second Five Year Plan of 1956.

To finance that required resource mobilization and deficit financing on a massive scale, culminating in foreign exchange controls and forced savings through various means. Many of the economic ills, that

India began to legally undo in 1991, under pressure from the IMF, were due to the policy mistakes of this Plan.

In April 1955, a panel of 20 economists submitted the draft for the Second Five Year Plan to the Government of India, based on Mahalanobis' Plan frame. With extraordinary foresight, Shenoy wrote a solitary 'Note of Dissent' on the Memorandum of the panel of economists. His critique was on three grounds – first, the excessive size of the Plan, second the magnitude of deficit financing for the Plan, and finally the policy and institutional implications of the Plan frame.

Regarding the Size of the Plan and its mode of deficit financing, he wrote, *"to force a pace of development in excess of the available real resources must necessarily involve uncontrolled inflation… once inflation begins, it tends to gather momentum. We should therefore be forewarned about the dangers of an over ambitious plan"*. He was staunchly against coercive measures imposed upon the poor, stating *"I am unable, therefore, to agree to my colleagues' recommendations to amend Article 286(3) of the Constitution in order to permit taxation of articles essential to the life of the community".*

On the microeconomic front, Shenoy was for standard free market policies, against *"general extension of nationalisation on principle"*. In particular, and of crucial relevance for the situation today, he opposed State buffer stock schemes (instead of forward markets) to deal with sharp falls in agricultural prices and to smooth out price volatility, *"Price support of agricultural produce is a risky venture, and we should be forewarned of the dangers of it….seasonal interventions may turn into long-term operations…..In the Indian context, a policy of price support of agricultural produce may force the economy down the inclined plane of inflation."* (A clarification is called for. His stress on the inflationary potential of agricultural price support does not contradict his overall view that inflation was due to money creation to finance the Plan deficit, since "*the strain of the subsidy would manifest itself in a shortage of budget resources.*")

Sunil Jain and other writers in this column have been, with commendable perseverance, calling for dismantling the Food Corporation of India and related measures. Shenoy's views regarding food procurement are accepted in policy circles now, India's somewhat stubborn stance by recently rejecting WTO conditions pertaining to food grains trade notwithstanding.

In short, most policy changes since 1991 have been along the lines recommended by Shenoy. Nevertheless, it seems to me what the BJP has failed to accept, like the UPA earlier, are his macroeconomic recommendations: specifically, his repeated insistence on keeping inflation low. He backed his view by providing evidence that the remarkably strong growth of Germany and Japan in the nineteen fifties was accompanied by almost no inflation.

The measures introduced by Prime Minister Modi to speed up clearances are undoubtedly beneficial. They will increase India's long term growth potential and may boost short term growth as well. However, targeting a high growth rate is a mistake. We largely got into this stagflationary mess by pursuing 8-9% growth. It cannot be resolved, but will be aggravated by trying to get back to it.

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This articles draws on Shenoy's publications, edited by R K Amin and Parth Shah and brought out by the Centre for Civil Society, Hauz Khas and other web sources. Primary sources unavailable.

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