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Planning in a Liberalised Economy

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Montek S. Ahluwalia has been at the centre of policymaking in India for over three decades now. He came to the Government of India from the World Bank where he had worked closely with Hollis Chenery and specialised in matters relating to poverty and redistribution. After coming to India he has been associated more with the gradual shift from socialist orthodoxy that has characterised Indian planning at least from the early eighties. The high point of course came in 1991 when he was the principal bureaucrat working with Dr Manmohan Singh in the great bonfire of controls. His substantial achievements as one of the principal architects of the liberalised economy are justly celebrated. More recently he has bent his energies at transforming the venerable and graying professorial institution that we call the Planning Commission and he has had a longer tenure as Deputy Chairman than anyone else in the past 50 years.

The Planning Commission has been around for about 60 years and over these years its influence in shaping the rate and pattern of growth has fluctuated. One can distinguish four phases. An exuberant youth that lasted from 1950 to 1965, an awkward adolescence from 1965-1980 when it tried to change as often as the confused politics of this period required, a depressed middle age from 1980 to 1990 when it struggled to remain relevant and now after 1991 a period of maturity, as it tries to reinvent itself to remain relevant in a liberalised economy. A synoptic view of the past, present and future of the Planning Commission is the subject of this contribution to honour its current head who has faced the challenge of defining a role for planning in a liberalised economy.

The Past

The first phase from 1950 to 1965 was the period when the Commission was most effective in shaping policy. It had the ear of an all-powerful Prime Minister, a clearly articulated strategy for development, immense influence over the states, but kept a certain distance from the private sector. The central element of this vision was the gradual articulation of socialist goals.

The First Five Year Plan focussed less on socialism and more on breaking out of stagnation when it said: 'The modern world is changing so rapidly that it is not enough to think in terms of slow changes and marginal adjustments, a minor shake-up here and a little cementing elsewhere. An underdeveloped country which has suffered long from the effects of cramped development desires inevitably to progress rapidly and in many directions; the aim of planning must be to make this possible.'[1]

Even its vision of planning controls is more in terms of price controls rather than direct controls on investment: 'Controls in a word are the means by which Government maintains a balance between various sectional interests. Under certain circumstances the accent may be on the maintenance of certain price ceilings, and through these of the real purchasing power of the incomes accruing to certain classes. Under other conditions, the enforcement of minimum prices might be a necessary corollary to a policy of ensuring a reasonable rate of return on effort in certain lines of economic activity.'[2]

The major change came later in the Second Plan, which is perhaps the most uncompromising statement of the ideology that guided this first phase of planning typified in the following passages from the Plan: 'These values or basic objectives have recently been summed up in the phrase "socialist pattern of society". Essentially, this means that the basic criterion for determining the lines of advance must not be private profit but social gain, and that the pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increases in national income and employment but also in

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1. Planning Commission (1951), Chapter 1, Para 5.
2. *Ibid*., Chapter 1, Para 42.

greater equality in incomes and wealth. Major decisions regarding production, distribution, consumption and investment—and in fact all significant socio-economic relationships—must be made by agencies informed by social purpose.'[3]

The planners were never really as powerful as this passage would have required. In theory, their direct role in the allocation of funds for public investment both by the Centre and the states and the growing share of the public sector in investment should have done this. But in practice, the private sector in India stoutly resisted the discipline of planning and subverted the licence-permit system to make easy profits. The planners had only a modest influence on the detailed design of the foreign trade and investment licensing system or over credit or foreign exchange allocations. The responsibility for these rested with the Finance, Commerce and Industry ministries and these were generally headed by powerful politicians who would not be dictated to by Yojana Bhavan.[4]

The droughts of the mid-sixties changed all this and the second confused phase of Indian planning started in 1965 and lasted till 1980. The vision of an industrialisation led growth strategy faded with the need to give priority to agriculture. The sharp cutback in industrial investments hit the public sector particularly hard. The political environment changed with the emergence of non-Congress governments in some states. The power of the Centre weakened. The dominant ideology of development went through sharp changes—priority for agriculture and rural development to start with, replaced by 'Garibi Hatao' and some doctrinaire socialism as Indira Gandhi took on the old guard and a semi-Gandhian populism, focussed on rural development under the Janata government. These swings in ideology were driven largely by political forces outside the Commission, whose experts had to lurch from one ideological mindset to another, very much like some confused adolescent.

The first two phases lasting about 30 years was when development policy was designed to respond to market failure rather than working with the market. But it was never quite as dirigiste as later critics have

3. Planning Commission (1956), Chapter 2, Para 3.
4. Chibber (2003).

suggested. In practice, the departures from a market mechanism were not as widespread and one can discern broadly three modalities of intervention.

- In the field of infrastructure and large industry, an emphasis on public ownership, direct regulation of private investment through licensing, price and distribution controls and coordination of specific investment decisions through the planning/licensing mechanism. This was the sphere in which departures from a market mechanism were most widespread.
- In the field of agriculture, village and small industries, private ownership with indirect measures to influence decisions through fiscal and monetary measures and public spending on infrastructure and support services, but with some direct intervention through procurement and distribution operations for some products.
- In the field of redistributive measures, a limited use of direct redistribution through land reforms, a progressive fiscal policy and job reservations and greater dependence on public spending on social consumption, subsidies targetted at the poor and rural employment programmes.

The big bone of contention amongst economists of diverse persuasions is the planner's emphasis on import substituting industrialisation. This, it is argued, led to inefficiencies in resource use as measured by the variance in effective rates of protection and it failed to exploit opportunities for labour intensive export production which could have led to a faster growth in manufacturing employment. The economic rationale for this rested on a pessimism about the prospects for exports that prevailed in the early fifties and the possibility that export oriented investments would have required a much more welcoming attitude to foreign capital. This latter possibility was not welcome to most Indian capitalists and to the political leadership influenced by the anti-colonial fervour of the freedom struggle. Hence, the reasons for the import substitution bias are ultimately political. In any case it represented a continuation of a trend that had started much earlier as the driving force of Indian industrialisation before independence was the replacement of imports, typified in the heroic story about the foundation of Tata Steel.

The stress on public sector and industrial licensing was a little different. There was a certain distrust of industrialists and a socialist passion that guided this, even though many politicians were close to and even financed by domestic industrialists. This is what changed in the eighties as the political class was now willing to openly support the case for domestic liberalisation. What as the reason for this fairly quick change of attitude? Was it the failure of socialist initiatives like the takeover of the wholesale trade in food grains? Did the emergence of new politically savvy industrialists who had benefitted from the restraints on more established industrial houses make the difference? Was it the growing power of money in an electoral process that had become much more competitive? Or was it the growing influence of a new set of advisers?[5]

The Planning Commission struggled to maintain its relevance in the changed environment of the eighties and one of the areas that it stepped into with some aplomb from the mid-seventies onwards was the social cost benefit analysis of public investment. Even though the formal responsibility for the approval of public investment was with the Finance Ministry, it deferred virtually the entire responsibility for guiding the discussion to the Planning Commission, perhaps to protect itself from political pressures, which the Commission, at that time, was better placed to resist. The other area of influence for the Commission in this period was energy policy whose importance in development strategy was greatly increased by the oil crisis of 1973-74 and 1979-80. It exercised this influence mainly through a couple of high profile policy committees and to some extent through the foothold it had secured in public investment approvals.

The link between the regulatory environment and economic performance[6] is tenuous given the break in growth performance that occurred around 1980-81. This acceleration of GDP growth in the eighties was not the product of any radical change in the role of the Government in regulating investment and production decisions though some changes were made, the most important being the tax reforms presented in the 1985-86 budget.

5. See Kohli (2006), Sengupta (2003), Sengupta (2008) and McCartney (2010).
6. Desai (2008).

The Present

The big change in the policy regime came after the near bankruptcy of the country in 1991, that forced the newly elected Congress government to go to the IMF. The 1991 reforms presented by Dr. Manmohan Singh in his budget saw massive changes in the licence-permit system with a near complete dismantling of industrial licensing and quantitative trade restrictions. Sharp reductions in tariff rates and major changes in the foreign investment policy. Capital market controls were transferred to an independent regulatory body, SEBI, and stock trading was modernised by the pioneering work of the National Stock Exchange. These changes have been very well decribed in a several writings by Montek S. Ahluwalia[7] and other economists who were associated with the reform process.

The demolition of the licence-permit raj was precipitated by the payments crisis. But it was also the product of a climate of opinion that had built up in the decade before, fed by influential official reports prepared by the early supporters of deregulation like L.K. Jha, M. Narasimhan, Abid Hussain and Vadilal Dagli. Those who blame the bureaucracy should note that the first three, who were civil servants, were more radical in their proposals than Dagli, who was the editor of a pro-business periodical.

However, the growth performance of the economy in the decade after liberalisation did not look much better than the performance in the eighties. There was a short-term growth boom and a marked slowdown after 1995-1996, when the stock market collapsed and Indian industry had to cope with the sudden exposure to international competition. Infrastructure growth continued to be inadequate relative to need. The weather related slowdown in the agricultural economy also played a role in depressing growth. But there were some spectacular success stories in info-tech exports and the beginnings of the telecom boom.

The acceleration of growth after 2004 has lasted for quite some time and must be attributed to some underlying systemic change. One major structural change was the rapid growth in corporate savings from around 4 per cent of GDP to 8 per cent of GDP. This fuelled a huge increase in corporate spending. The second factor was the widening of the base for

7. Ahluwalia (2002) and (2006).

rapid export growth. The restructuring of Indian industry that came after the opening of the economy in the nineties surely helped. One example of this is the emergence of the auto component industry as a major source of export growth after it restructured to meet the demands of the new car producers. The third factor possibly was the vast sums poured into rural India under the NREGA and Bharat Nirman programmes that may have fuelled a consumer goods boom.[8]

The impact of the reforms on the role of the Planning Commission was quite substantial. The shift from public investment as the primary source of investment in infrastructure and core industries to a growing dependence on private investment in these areas meant a shift in the locus of influence from the Planning Commission-Finance Ministry to the sectoral ministries. The private sector responds to business opportunities, not to goals and targets set by the Government. The capacity to micro-manage relative profitability with fine changes in tax rates has been reduced by the very necessary simplification and rationalisation of the indirect tax structure. What determines relative profitability now is increasingly a function of regulatory policies that are implemented by the sectoral ministries and the sectoral regulators. Even in the area of infrastructure, with the growing reliance on public-private partnerships (PPPs), the role of the sectoral ministries is enhanced.

At the same time, the Indian economy is becoming more open and the Indian corporate sector is more vulnerable to global competition. A new element is the global ambition of many corporate houses who want to become multinationals. In this environment, the corporate sector needs coherence in investment even more than before. Its profitability and survival depends on upstream requirements, particularly infrastructure, coming up as planned. It also depends on the sequencing and timing of the opening to the world economy. Take for instance the liberalisation of capital market flows. Clearly, the cautious policies of the Finance Ministry and the Reserve Bank helped to insulate the Indian economy from the upheavals in the global financial system 2008 onwards.

The reform process has basically altered the relationship of the Government with the corporate sector, which now has much more

8. Desai (2010a).

independence in its decision-making. The opening of the economy has also increased greatly the salience of macroeconomic stability as a key policy goal so as to reassure private savers and investors about the safety of their capital from expropriation through inflation. The third element is the substitution of ministerial regulation by supervision by supposedly independent regulatory authorities. All of these are still work-in-progress. Delicensing is a reality but politically exercised controls to protect the environment, or forests or public health or natural resources remain a space where rent-seeking behaviour, both by the politicians and their corporate cronies, is possible. Macro stability has been enshrined in law; but the reality of unsustainable deficits and inflation continue. Statutory regulators have been established for infrastructure sectors; but the political system has not accepted the idea of independence and impartiality in policy implementation.

The Future

From an institutional perspective, the reform process has shifted the levers of power over the real economy to the Finance Ministry and the sectoral ministries. The Finance Ministry, however well qualified its personnel may be as economists, tends to focus on the financial superstructure. This is its job and it is best it sticks to it. The sectoral ministries are in effect lobbies for the sector interest when they work honestly and for favoured client corporates when they do not. The unique characteristic of the Planning Commission is that it is designed to take a comprehensive and holistic view of the real economy. It can look at the impact of policies on interconnected sectors, on regional balance, on poverty and employment, all dimensions that may escape scrutiny in a Finance Ministry centred economic policy system. This competence continues to be relevant even in a liberalised economy.

In fact we need an effective Planning Commission even more now than in the past. An economy that is growing at a cracking pace of 8 per cent plus can quite quickly run into supply bottlenecks, particularly for non-tradable infrastructure and labour skills. A more open economy with even agriculture depending heavily on foreign trade will be more vulnerable to external shocks and anticipating and coping with these coherently will require the broad view of the real economy, that is the special competence of the Planning Commission.

The Planning Commission will undoubtedly continue to prepare economy-wide macro projections though the role of these projections in a liberalised and open economy is open to question. One also finds the animated debates about the choice of growth rates a little surreal. Governments do not determine growth rates in an open market economy. They set policies which influence investment and other choices made by private entities that determine the growth outcome and the real debate should be about these policies rather than some supposed choice of outcomes.

The primary task of planning is still to address potential areas of market failure. In the present context the challenge for the Planning Commission is to develop a consensus on the role of public policy with regard to the following:

- Poverty and inequality,
- Infrastructure development,
- The global competitiveness of Indian producers,
- Human capital, particularly labour skills,
- Scientific and technological capacity,
- The environment,
- The response to economic shocks.

These areas of public policy require systematic and planned intervention by public authorities. Good planning means that the competencies and capacities for doing this are strengthened in specific part of the Central or state administration responsible for that area of policy formulation. But these separate policies are interconnected and need to be driven by a common vision.

In today's India, where the public sector does not dominate the core areas of the economy and the power of the Central government is increasingly constrained by powerful state governments. Policies to be effective must also enjoy a broad measure of support amongst all stakeholders. The Planning Commission wields very little by way of executive power and its influence in the liberalised economy of today depends on its credibility in the eyes of the corporate sector, the state governments, foreign investors and the many NGOs and community organisations that work at the ground level. This is where the Planning Commission, with its battery of expert members, can play a truly important role.

A Planning Commission that is designed to do this must be substantially different from what it is at present. It must lay less emphasis on its role as a glorified Joint Secretary (Plan Finance) dealing with the minutiae of plan budgeting for the Centre and the states. There are other things that it does which needs much more capacity and this includes perspective planning and analytical work, monitoring and evaluation of policy and programme impact, and international economic analysis.

It has always associated industry, academia, trade unions, NGOs and other stakeholders with the processes of plan formulation. This must be extended to become a part of its regular work even in the years in between plan formulation. Its members have a substantial public standing and should be deployed for this purpose and to provide a presence in public debates on development. The risk of occasional embarrassment by some loose cannon should not worry the Government which is surely able to manage minor mishaps.

The Planning Commission cannot become a mere research institution and talk-shop. Even if the role of direct public investment has come down, the role of public policies that affect private decisions has gone up. The Plan framework and the policy reviews undertaken by the Commission can be made to matter if it is made an obligatory basis for policy formulation by all entities in the Central and state administration.

Is this possible in today's political environment? Will a powerful minister from a coalition partner defer to the experts in the Commission? How will states, led by opposition party chief ministers, take to direction from the Planning Commission?

The maintenance of planning discipline at the Centre is largely a matter of how 'coalition dharma' evolves as our political system adjusts to this reality. If it is based on a jointly agreed Common Programme then the discipline can be maintained by an effective Prime Minister, at least to the extent to which the Common Programme and the Plan are compatible. But if coalitions are based simply on a sharing of spoils with each coalition partner free to run its ministries as semi-independent fiefdoms, then it is not just planning but the long-term prospects for sustaining high and equitable growth that is at risk. Planning cannot impose coherence if politics becomes incoherent.

But all is not lost even in this sorry eventuality. A Commission that keeps its doors open to corporates, academia and civil society can act as forum for articulating the public interest partly by providing space for critical comments on the more egregious departures from good policy by venal or misguided ministers and partly by adding its own, more tactfully formulated, suggestions for change.

Centre-state relations cannot be handled simply by the emergence of a sound 'coalition dharma'. Many of them will be run by political parties who are not a part of the coalition at the Centre. Today the states are being run by powerful chief ministers. Some of them are fiscally not heavily dependent on Planning Commission grants. The role of the Planning Commission in Centre-state relations is vital. But it must move beyond the annual ritual of state plan discussions.

The orientation of the dialogue with state governments must be changed. Fiscal discipline, which was the staple of these discussions for long, will have to come from the norms and rules set by bodies like the Finance Commission and RBI. The real challenge is to go beyond a mindset where the officials of the Central government sit in judgment on the work of the officials in the state government, often with little or no impact. Instead the goal of the discussions must be to make the states full partners in the planning exercise. Consider the priority areas for planning mentioned above. At least four of these poverty, infrastructure, human capital and environment—depend largely on the policies of the states and the competencies of the state administration. A Commission that truly cares for outcomes in these areas must spend as much time and effort talking to the state governments as it does in talking with the corresponding Central ministries.

In some ways the idea of a 'coalition dharma' based on a Common Programme can be extended to cover possible role of planning in managing

Centre-state relations. But for this to happen the Commission and the Central government must listen to the views of the states on national matters including the national plan. The National Development Council can provide the frame for this and much more use can be made of the modality of Empowered Groups of Chief Ministers to address national issues.

Our polity needs safety valves like this if a plural and federal democracy is to survive. A redesigned Planning Commission can help to keep together a fragmented polity around a set of shared values and goals. More specifically it should:

- keep together the coalitions that will rule at the Centre,
- act as a honest broker between the Centre and the states,
- engage the corporate sector in meeting national development goals, and
- keep the polarised forces in civil society engaged in the policy dialogue.

Beyond this political role, the Planning Commission must continue its classical role of being an often unpopular countervailing body, acting as a lobby for the poor and a lobby for the future. This is its real value in an economic and political environment where the short-term interest of the powerful tend to prevail.

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