

Planning then and now

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A question frequently asked today is whether planning has any relevance in a world of economic liberalization and the market economy. The short answer is that it does, but not the kind of planning we practised in the past which derived its rationale from the belief that centralized control on resource allocation, with extensive intervention in private sector decision making, was necessary to achieve rapid growth.

Amartya Sen's article, which is reprinted in this volume but which first appeared in the *Seminar* issue on Freedom and Planning almost fifty years ago, provides a flavour of the earlier approach. Sen argued then that planning was necessary not only to achieve distributional objectives – which he points out is a traditional and much discussed basis for state intervention – but also to achieve a high rate of growth. He recognized that the industrialized world had achieved industrialization without planning and acknowledged that we could also follow this path, but warned that if we did, it would take us more than a hundred years to industrialize whereas the experience of the socialist economies showed that a much faster transition was possible with socialist planning.

The superiority of socialism in achieving rapid growth was attributed to two reasons. First, since capitalists seek profit maximization, growth in a capitalist economy is only a by-product of this process, and therefore need not occur at the fastest possible rate. Second, even if capitalists want to maximize growth, they would be less efficient at doing so because individual entrepreneurs do not have all the information necessary to achieve the best results whereas a 'national coordinating planning organization' would have much more information and therefore achieve better ground outcomes.

Sen also warned that planning as practised in India, without a really socialist economy, with a private sector responsible for producing consumer goods and a public sector concentrating on producer goods, was unlikely to achieve results. The model suffered from internal contradictions – the 'middle path', as he put it, had run out and it was necessary to take a stand on whether we really wanted a socialist economy. The case for planning was essentially a case for more comprehensive socialism, and was in his view a strong case, but we would need to move to a socialist economy.

Things have changed enormously in fifty years and not surprisingly attitudes to planning have also changed. The greatest change in perceptions that has occurred since Sen's *Seminar* article of fifty years ago is the discrediting of the technical argument that a centralized planning system, led by a 'a coordinating national planning organization' would be more able to achieve faster growth. The costs of a centralized system of decision-making, relative to a decentralized approach of 'letting a hundred flowers bloom' are now much better appreciated. Centralization is of course particularly dangerous where governance is poor but even when governance is not a serious problem, centralization is likely to be inefficient because bureaucratic decision-making, subject to multiple levels of accountability, is inherently sluggish, rule bound and unlikely to promote risk-taking. It suffers from greater inertia being less likely to acknowledge mistakes and change course when evidence begins to suggest that it should.

Paradoxically, democratic governments are actually much more burdened than authoritarian regimes in this respect, because accountability in a competitive political environment often leads to dilatory procedures designed to ensure transparency and is vulnerable to constant challenges on grounds of bias and ill-intention. This in turn suggests that our democratic system is likely to yield a better economic performance, if it relies on an

economy with greater reliance on market forces, rather than one subject to constant political interference.

Another important change in the plan is that the experience of the socialist countries does not point in the same direction as it did sixty years ago. Communism collapsed first in Eastern Europe in the late 1980s and then in the erstwhile Soviet Union in 1990. Even more directly relevant for our circumstances is the transformation in economic policy brought about by the Communist Party of China, especially after 1984 (later imitated by Vietnam) which suggests that the way to rapid growth in a developing country is more likely to lie in liberalizing economic policy, embracing market forces and encouraging the private sector rather than moving from the mixed economy to something closer to socialism and socialist planning.

Sen proved prescient, however, in the doubts he expressed in 1959 about the effectiveness of planning as practised in India and his misgivings were largely borne out over the next twenty years. Indian planning did not succeed in achieving even moderate targets of five per cent growth set in the early five year plans. Doubts also began to be aired about whether such growth as was taking place was reaching the poor. Prime Minister Jawaharlal Nehru himself, while introducing the Third Plan in Parliament in August 1962, said that per capita income had increased but ‘a legitimate query is made. Where has this gone?’ He went on to observe that he could see that people were better fed and clothed but ‘that does not apply to everyone. Some people have hardly benefited. Some people may even be experiencing various difficulties.’

The need to focus on delivering benefits to the common man led the Indian Planning Commission to prepare a Perspective Plan aimed at bringing everyone up to a minimum level of living within 15 years from 1961 to 1976. The Planning Commission strategy document concluded that because the benefits of growth do not flow equally to all sections, this objective could be achieved for the third decile from the bottom, if the economy grew at an average rate of seven per cent per year over the period. However, even with growth at this rate, which was judged to be feasible, the poorest two deciles would not benefit sufficiently to reach the minimum. Special income transfer mechanisms would be needed to bring this group to the minimum level, but this could be managed without disrupting the growth process.

As it happened, economic performance fell well short of the seven per cent target. The average growth rate in the period 1960 to 1980 was only 3.5 per cent per year, famously described by the late Professor Raj Krishna as ‘the Hindu rate of growth’. Interestingly, the failure on the growth front did not lead, as it should have, to questioning the growth strategy itself. That came much later, though the basic weakness was precisely the one identified in Sen’s article – an effort to control private sector activity excessively leads to conflicting incentives. Initially, the response of the planners was to accept the low growth performance as unavoidable and to shift the emphasis on anti-poverty schemes. This approach had little effect on poverty.

India’s growth performance improved significantly in the 1980s when the economy grew at an average of 5-6 per cent per year. Interestingly, this was not because we became more socialist, but because we learnt from the experience of other countries in East Asia and started to liberalise and give greater play to the market. These trends were initiated in the mid 1980s, when the government became much less suspicious and more supportive of the private sector. The existing framework of controls was not dismantled, but it was administered more liberally.

A much more explicit change in policy occurred after 1991, with an explicit acceptance of the need to bring about a systemic change, *albeit* in a gradualist fashion. The private sector was freed of much of the stifling controls that had been evolved over many years in the name of planning and rational allocation of scarce resources. Much greater room was allowed for entrepreneurs to respond freely to market forces with greater reliance on competition to increase efficiency. The economy was also opened gradually to foreign trade and foreign capital.

Was this a dismantling of planning? Not if one takes the view that the purpose of planning is to put in place policies that seek to exploit the growth potential of the economy and to push it to achieve stated developmental goals. The change in policy was a considered response and the trend has continued despite changes in government. The new approach to policy is evident not only in the Centre but also in the states. The results in terms of economic growth have been impressive, comprehensively refuting the critics who argued that the changes would lead to a collapse in performance and perpetual foreign exchange crises. The average growth rate achieved in the Tenth Plan 2002-03 to 2006-07 was 7.6 per cent per year, marginally short of the target of eight per cent and a very far cry from the so called Hindu rate of growth. The past four years 2004-05 to 2007-08 have seen an average growth rate of close to nine per cent.

Growth is expected to slow down in 2008-09 to around eight per cent or possibly even a little lower and there has been much focus on this deceleration in the press. However, cyclical variations in growth are normal and would still represent an impressive performance in a year when the world economy is slowing down significantly. Most observers agree that India is well set on the path of rapid growth and the Eleventh Plan target of averaging nine per cent growth per year and setting the economy at a 10 per cent growth path by the end of the plan period is eminently achievable, provided supportive policies outlined in the Eleventh Plan are put in place.

The record is less impressive when we focus on distributional outcomes and this is rightly a major concern of policy today. The percentage of the population below the poverty line is falling, but far too slowly. Child malnutrition is very high at 40 per cent in 2005-06, with micro nutrient deficiencies being even higher. Health facilities available to the population are well below what is needed and access to quality education is still limited, especially in rural areas. The recently approved Eleventh Plan recognizes these deficiencies and explicitly sets its objectives in terms of 'inclusive growth'. The plan aims at an average growth rate of nine per cent rising to 10 per cent at the end of the plan period. In addition, to the traditional growth target it also sets 26 other targets for indicators of social development.

This brings us to the question what sort of planning do we need to achieve these objectives? First we must recognise that the instruments of planning must be very different in a market economy that is increasingly integrated with the world. We do not need to set objectives in terms of detailed output targets emerging from multi-sector input output based models of the economy and then try to direct private investment to meet these sub-sectoral growth projections. Sectoral balances aimed at matching demand and supply in 200 sub-sectors used to be the staple of planning exercises in India, but they are meaningless for sectors where the output is importable and foreign trade is liberalized because any excess demand for a particular product can be made good by imports. The planning problem is in effect reduced to the problem of managing the resulting balance of payments.

This is one problem we have actually handled very well. The liberalization of the past fifteen years has clearly established that it is not necessary to control imports as we used to in order to manage the balance of payments. In fact, the complex system of import controls that

was ostensibly designed to conserve scarce foreign exchange, actually served only to provide open-ended protection for domestic producers against foreign competition. It led to a high cost and low quality domestic production structure, which in turn reduced India's capacity to produce exportable quality products at competitive prices. It also promoted extensive corruption associated with running a complex and highly discretionary import control system.

The inappropriateness of import controls in a world of fast changing technology is best illustrated by the experience of Infosys related to me by its founder Chairman, N.R. Narayanamurthy. According to him, Infosys, in the late 1980s applied for a license to import a particular Hewlett Packard computer and received a license specifying the model number. The process took six months and by the time the license was received by the company, HP had come out with a later version having a larger capacity and a lower price. However, Infosys could not import this product against the license because the product had a different model number. Infosys was told it would have to get a fresh license, which would of course take another six months and no one could say what would happen if computer models changed again! We certainly could not possibly have achieved what we have in software if government policies had not changed.

It is worth noting that ever since we adopted import liberalization and a market driven exchange rate in 1993 – a shift that was accompanied by a cacophony of warnings that liberalization would bring a balance of payments crisis – we have actually never had a foreign exchange crisis! The problem, if anything has been the reverse. We have had a surplus of foreign exchange and are debating how best to use it.

Was this liberalization a dismantling of planning? Not really, unless we mistake particular instruments of control for planning. It was in fact a recognition that good planning involves putting in place policies that will allow the economy to perform to its full potential and a private sector dominated economy needs to give much greater freedom to private enterprise within the framework of a competitive economy. This is not to say that reliance on markets will take care of all objectives. It will not take care of distributional objectives since not everyone will benefit sufficiently from exclusive reliance on markets. It also does not take care of market failures, which warrant corrective action. These problems need to be addressed through carefully crafted policies and programmes involving suitably designed government intervention at multiple levels. There is also a role for planning to sketch out a broad perspective of the economy evolving over a longer term which can be called indicative planning.

By indicative planning, I mean defining broad national goals and objectives, and presenting an internally consistent picture of the evolution of the economy in a manner which achieves these national over a defined time horizon. In India, for example, if we could set the goal of achieving some target level of per capita income over a specified period – say increasing our per capita income from \$1000 today to \$5000 over 20 years combined with corresponding improvements in the access of the population to a basic minimum level of living over this period. Indicative planning can then be used to outline broad challenges in achieving this goal.

If population growth over this period averages say 1.3 per cent per year, then GDP will have to grow at an average rate of about 10 per cent per year for per capita income to reach \$5000 in 20 years. It is a legitimate planning exercise to explore the medium to longer term implications of such growth to identify some of the major challenges it poses.

We do not need to develop detailed multi-sector models looking for precise estimates of the domestic production requirement of individual commodities and the inputs needed for

them. However, we do need to examine broad areas of feasibility in terms of the levels of domestic savings and investment needed for this growth, the financial structure and investment climate which that requires in an economy driven by the private sector and open to the world, the implications of such growth for India's interaction with the rest of the world, and finally the effort we need to make to develop the technological capacity to help achieve our national objectives. If India is to become the country with the third largest GDP in the world after China and the USA (in that order), it is relevant to ask what is the nature and quality of our educational and scientific institutions and the interaction between our private corporations and research and development consistent with this goal.

Indicative planning can help to highlight the longer term structural changes that are likely to arise as a consequence of such growth and the challenges they pose in terms of action to be taken sufficiently in advance. For example, what would a 10 per cent growth, and the growth of manufacturing of around 14 per cent per year, mean in terms of the pace of urbanization and are our systems for urban planning capable of responding to this challenge? If our urban population over this period increases by about 150 million, are our urban systems of government, and their financial arrangements, capable of supporting such an expansion especially considering the enormous improvement needed in the quality of urban infrastructure? What are the energy requirements of such growth and can they be met from available energy sources with a modicum of assurance of energy security? If the price of conventional energy is expected to rise sharply will this affect our growth potential and can we take steps to minimise this effect? As pointed out earlier, we do not need to worry about ensuring adequate sectoral supplies of most items that are importable, but we do need to worry about tradable goods such as petroleum and coal which though importable are likely to become globally scarce, and therefore very high priced.

Planning is also needed to ensure adequate growth in domestic capacity in the non-tradable sector, where imports are not an option. This includes development of most basic infrastructure such as roads, ports, airports, telecommunications, electricity and also basic urban infrastructure, including water supply and sewerage. In all these areas, investments involve considerable resources and long time-lags and often require government initiative and support. It is necessary to define the tasks before the government (both Centre and the states) well in advance and to take steps now for the future.

Indicative planning can draw attention to critical areas and identify difficult policy choices for overall goals to be achieved, but it does not necessarily have to specify precise targets and instruments for achieving these goals. Often its role is to draw attention to the problems, indicate a broad direction for the solution and stimulate debate and discussion overcoming these problems, a debate in which numerous stakeholders get involved before workable policies are implemented.

To be relevant, planning today also has to recognize that the private sector, which includes farmers, small enterprises and organized industry, accounts for 75 per cent of total investment and the dynamism of this sector is therefore a critical determinant of overall economic performance. Planning in this environment has to be based on the assumption that decisions in individual firms and farms have to be left to individual entrepreneurs and farmers. The government can play a role in encouraging investment to flow in directions suggested by indicative planning but it cannot expect to direct this flow through direct controls.

The instruments through which some direction is possible include fiscal incentives, special treatment in the matter of credit from the banking system, access to external commercial borrowing which is still controlled, and occasionally special support in providing

common infrastructure. Equally important is the need to remove impediments to private investment. While the most obvious impediments in the shape of investment licensing requirements were removed long ago, there are many other impediments which need to be tackled, many of which are at the level of states.

Policies relating to land availability for industry present major problems at present. It is widely believed that land acquisition policies in the past have been unfair to those whose land is acquired in terms of the compensation paid and also the rehabilitation required. Lack of clarity and demonstrable transparency in this area can seriously impede the achievement of 10 per cent GDP growth since that almost requires expanded availability of land for industrialisation – manufacturing is expected to grow at around 14 per cent. It also implies a substantial increase in urbanization which also involves rational land use policy. This is an area where initiatives are needed both from the Centre and the states since land use is a state subject.

While much of the approach to the private sector is guided by the presumption that the best results are obtained by leaving the private sector to function in a competitive environment, this is not a sufficient response since the activities of the private sector are not necessarily limited to areas where competitive markets prevail or can even be created in principle. For example, there is a potentially large role for private investment in infrastructure development. However, these sectors also have the nature of a limited monopoly and wherever this happens, it is necessary to evolve a policy framework which balances the private sector's need for entrepreneurial freedom and the potential to earn reasonable profits with the consumer's need to be protected from monopolistic pricing and slippages in quality.

The Eleventh Plan emphasizes the need for PPP as a strategy for achieving the large investments that are needed in infrastructure with the limited resources available in the public sector by leveraging these limited resources with private investment wherever possible. A large number of PPP initiatives have been launched in pursuance of this policy in both the Centre and the states. Some of these involve a revenue share accruing to the public sector (e.g. in airports, ports and some highly profitable toll roads). Others involve the government having to bear a part of the cost either by giving a capital subsidy (as in many national highway projects) or by allowing the private sector entrepreneur to earn profits from associated land development, as in some highway projects and metro developments. In all these areas, governments have to play an active role to make things happen and to make them acceptable.

There is often suspicion that the terms of a PPP concession may be too favourable to the operator with not enough protection for the consumer. These suspicions can be overcome through appropriately transparent concession agreements which clearly establish the obligations to be borne by the concessionaire and there is need for a credible regulatory mechanism which can protect the interests of consumers. Further the award of PPP concessions needs to be based on robust competitive bidding and not on negotiated contracts to ensure that the public interest is fully protected. As the Eleventh Plan emphasizes, the PPP strategy can only succeed if it is seen as attracting private resources for public purposes and not diverting public resources for private purposes. How to devise policies which produce such an outcome is a challenging task.

It is evident from the above that planning for the private sector is more in the nature of 'policy planning' and not planning by direction. This process cannot be made the exclusive responsibility of a single planning agency. Policies pertaining to individual sectors where the private sector plays an important role have to be developed through interaction with many stakeholders. Producer representatives, consumer groups, the ministry concerned, the Finance

Ministry, the Planning Commission and the Law Ministry all play a role. Inter-ministerial interaction, rather than hierarchical, top down planning is what is needed to convert indicative plans into policy initiatives.

One reason why the need for planning is questioned in today's environment is the belief that planning must be limited to government decisions and liberalization should involve a drastic reduction in the role of government. This is, however, a simplistic notion since the size of the government measured by the share of government expenditure in GDP, is much larger in the OECD countries than it is in India, once social security expenditure is included, as it must be. Reformers in India as elsewhere have repeatedly emphasized that economic reforms do not imply that the role of the government must be reduced, but only that it must be restructured. The responsibility for planning and monitoring the performance of government in its restructured form remains large.

In a market economy with a mature private sector the government does not have to engage directly in establishing new productive units wherever the private sector can set up capacity and function subject to the discipline of competition. However, there are a number of areas where expansion in capacity is desperately needed and is unlikely to materialize if we rely only on the private sector and market forces. These include investment in education and health, in rural infrastructure, in housing for the poor and in slum development, all areas crucial for achieving distributional outcomes and inclusion. The Eleventh Plan signals a major restructuring of plan expenditure towards these sectors.

This restructuring is most evident in the case of education where the share of total plan expenditure (Centre and states taken together) devoted to education has increased from 7.8 per cent in the Tenth Plan to 19.4 per cent in the Eleventh Plan. The share of expenditure devoted to health is also projected to increase significantly. The increases in expenditure shares for these sectors are accommodated by a decline in plan expenditure devoted to industry and also to certain infrastructure areas where a large part of the increase in investment needed will come from the private sector.

The shift in focus of government activity to the delivery of essential services to the *aam aadmi* also means that the effectiveness of delivery depends on the state governments. If we want to improve the functioning of schools for school-going children and of *anganwadi* centres for pre-school children, of primary health centres and sub-centres and district hospitals, if we want to provide drinking water to our villages and improve sanitation, and if we want to spend on land development and water management projects that will increase income generation capacity in rural areas, the central government can provide resources for these programmes, but the outcome depends on the functioning of local administration, which is entirely within the domain of state governments. It is a common complaint that plans provide resources, but implementation at the ground level is very poor. There are two possible reasons for this. One is that the intervention itself is not designed to achieve its results and the other is that the service providers at the ground level are not accountable to the local community. Both are planning problems.

The issue of programme design is extremely important as we shift into areas such as education and health where there are considerable differences of view on how a particular objective can be best achieved and the end result is not immediately measurable. The success of a steel plant in producing steel is more easily observed once the plant has been set up and even its cost effectiveness relative to other technologies can be relatively easily measured. The same is not true of a school since schools can be built and even function in the sense of having students and teachers but they may not produce good quality education. Independent surveys conducted by organizations such as Pratham have thrown up startling results showing

that a very large percentage of children in class V cannot read material meant to be read by children in class II and much the same holds true for simple arithmetic.

The problem is easy to identify but it is not easy to determine how to remedy the situation. Is our education poor because teachers appointed to these schools do not attend school or, are they too poorly trained? Is it because the motivation level of the children is not high enough or do poor levels of nutrition reduce learning ability? Or is it because the family circumstances of children from poorer families militate against learning achievement? In practice it is possible that all these factors are at work, and have to be tackled simultaneously.

Similar issues arise with regard to programme design in the area of health and nutrition. In short, achieving results in these areas is not simply a matter of spending money or even 'monitoring' the implementation of schemes. Monitoring badly designed interventions does not produce results. We need to remain open to programme redesign keeping in mind the results observed with existing programmes at the field level.

Subjecting government programmes to scientifically based evaluation should be a mandatory part of policy planning and a pre-requisite for continued funding. We need to measure government's contribution to development in particular areas not by the scale of expenditure in programmes in those areas as is often the case, but by the effectiveness with which it achieves results. Such evaluation should in turn feed back constantly in adjusting the design of programmes to improve effectiveness. This task is especially difficult in the social sectors, where interventions have to be designed taking account of numerous social and sociological considerations if we are to deliver end results.

The shift in plan priorities to the social sector also poses important implementation problems because the actual delivery of services takes place at the local level. The relevant machinery is that of the state governments but they too have constraints. It is difficult to find doctors to fill positions in rural areas so we have hospitals without specialists. It is difficult to enforce accountability so teacher absenteeism in primary schools is very high. The solution usually recommended is to devolve control over the finances and functionaries for these services to local elected bodies – the panchayati raj institutions and urban local bodies – and this is currently being attempted, but the success achieved varies from state to state.

Contrary to the image of planning involving centralized control, in fact it involves a complex web of relationships between the central government, the state governments and the panchayati raj institutions in which the scope for enforcing conditions is limited. The central government increasingly provides resources to support activity in the social sectors which are in the domain of state governments and local administrations. Most observers believe that the effectiveness of delivery would be greatly increased if both finances and control over functionaries were to be devolved downwards to panchayati raj institutions. This is generally agreed as a principle, but many state governments are reluctant to implement it in practice. Success will also require considerable efforts at capacity building at the local level, and constant experimentation with considerable variation across the country reflecting region specific circumstances.

The core of the argument sketched out above is that the transition to a market economy does not eliminate the need for planning but makes the challenge of planning very different from what was once envisaged. It is relevant to ask what role does the Planning Commission have in the new dispensation. One thing is clear – the Planning Commission cannot be an overarching control body setting targets for different sectors and enforcing them through some combination of public investment and control over private investment.

However, there are several distinct tasks which need to be performed and in our system, can be performed by the Planning Commission.

One task is to prepare indicative plans which explore the feasibility of and implications of alternative scenarios of faster growth over a longer term horizon. An important change from the past is that the Commission no longer relies more or less exclusively on an in-house plan model. Instead, it draws on the work of many different institutions which have evolved different types of models with interesting differences in methodology and sectoral disaggregation. This quantitative projection role remains highly relevant and needs to be strengthened with greater reliance on independent research institutions.

A second task is preparing plan budgets. This involves negotiation with the ministries on perceived needs and with the Finance Ministry on available resources. The outcome of this negotiation is an agreed level of plan expenditure which is then distributed across competing ministries and also in part to state governments. The Planning Commission also interacts with state governments to persuade them of the need for undertaking sufficient levels of expenditure in critical areas such as agriculture, health, education and infrastructure. The commission's ability to affect state government decisions is limited, but it can in principle play the role of interlocutor, advisor, honest broker, persuader and to some extent, also incentiviser. Incentives to the state government take the form of central government schemes in different ministries which require some contribution from the state government thus encouraging state governments to shift their own resources.

Finally the commission must perform the task of providing a critical evaluation of policies and their effectiveness. Ministries should obviously do this continuously and they do, but a ministry reviewing its own policies cannot always produce an objective evaluation. A second and more independent opinion is surely necessary. This is especially so since policy in one area often impinges on policies in other areas and ministries are often not in a position to assess, let alone argue the case for, the need for changes in policies in other areas. The Planning Commission is particularly well placed to take a cross ministerial view taking account of other constraints on the economy.

Energy policy for example is a classic example where a coordinated approach is necessary. The principles applied for one form of energy should in principle apply also to other forms of energy and where they are different we should be able to rationalize the difference in terms of specific characteristics. Since energy as a subject is dealt with by several different ministries (power, petroleum, coal, atomic energy, non-conventional energy and also involves ministries such as water resources, mining, etc.) the need for a cross-ministerial view is overwhelming.

For all these reasons, planning "now" has to be very different from planning "then". It is in recognition of this difference that China recently renamed the Planning Commission the National Development and Reform Commission. We have not renamed the Planning Commission but then a rose by any other name will smell as sweet! In practice, our system is also moving to achieve the much more difficult task of planning for the new economic environment. It is a process that has to rely more on persuasion than directions and has to be much more consultative than in the past.
