

India's Experience with Central Planning

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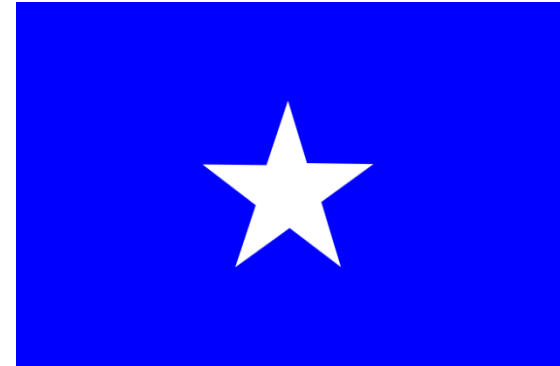
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A Thought Experiment

- Imagine:
 - This is 1947.
 - Prime Minister Nehru has appointed you his Chief Economic Advisor.
 - You have read and understood the lessons of Public Choice.
 - What advise would you have for Nehru?

Then and Now

- “Dissolve the Planning Commission and scrap the disastrous Five-year plan”
 - From the Manifesto of the Swatantra Party, General Elections of **1967**
- “...and therefore within a short period, we will replace the Planning Commission with a new institution...”
 - Prime Minister Narendra Modi, **15 August 2014**



Then and Now



Central Planning

- “by centralization all progress tends to be retarded, all initiative liable to be checked and the sense of responsibility of Local Authorities greatly impaired....centralization conflicts with what may be regarded as a cardinal principle of good government... the higher authority must be less competent than the lower, because it **cannot by any possibility posses the requisite knowledge of all local conditions.**”

– B. R. Ambedkar (1916)

- “... the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess... **We need decentralization because only thus can we ensure that the knowledge of the particular circumstances of time and place will be promptly used.**”

– F. A. Hayek (1945)

Build up to the Plan

- **1938: National Planning Committee**
 - eleven member committee with Jawaharlal Nehru as President
 - convened a series of sub-committees to study and report on all industries
 - strong Gandhian influence at the time, cottage and small scale industries played an important part in its deliberations
- **1944: The Bombay Plan**
 - a group of eight Indian industrialists drafted a 15 year plan for India
 - industry was considered to be the motor of economic growth, whereas agriculture was supposed to be more of a liability than an asset
- **1944: Department of Planning and Development**
 - set up by the imperial government, under the chairmanship of one of the signatories of the Bombay Plan, Sir Ardeshir Dalal
 - its 1945 statement of industrial policy foreshadowed in many ways the IPRs of 1948 and 1956

Build up to the Plan

- **1947 and after: continuation of war time measures**
 - all kinds of controls instituted during the war were retained after the war
 - some of these controls were:
 - exchange controls;
 - control of foreign trade;
 - price, distribution, raw materials and capital issue controls;
 - and food rationing
- **1950: Planning Commission**

Indian Economy at Independence

- **Highly agrarian**, agriculture contributing more than 50% to national income; **organized industry 6%**.
- Close to 65% of labor force in agriculture. **Less than 3% in factory enterprises.**
- Industrial sector in India – 62% of output contributed by consumer goods.
- India an exporter of agricultural commodities and consumer goods.
- **No domestic capital goods sector; importer of capital good and industrial intermediate goods.**

Indian Leaders post-Independence

- **Rajaji** and **Patel** (classical liberals) – favoured a market-directed economy based on dispersed private property
- **Nehru** (1889-1964) – a Fabian socialist, urged Congress party since 1930s to adopt **planned industrialisation for accelerated development**



Economic Policies Post-Independence

- India's new government moved away from market-friendly policies
 - Retained wartime price controls and rationing
 - Nationalised transportation and mining
 - Nationalised life insurance industry
 - Heavy industry – reserved exclusively to government investment
 - Instituted Five-Year Plans (inspired by the Soviet model)
 - December 1954: Congress Party formally endorsed “**a socialist pattern of society**”

Five-Year Plans

- **1950: Planning Commission**
- **1951-56: First Five Year Plan**
 - dismissed as ‘no plan at all’ but rather a collection of projects
 - the major achievements of the first Five-Year Plan were not planned at all...’ prices fell by 17 percent while output rose by 18.4 percent during the period
- **1956-61: Second Five Year Plan**
 - the first real plan, overambitious in nature
 - exchange crisis shortly after its inception

Second Five-Year Plan

- **P. C. Mahalanobis's** plan frame assumed India needed heavy industry for its development
- But heavy industry creates few jobs per rupee invested
- So, the plan combined investment in heavy industry with subsidies to labour-intensive cottage industries to provide more jobs (For example, it proposed to cap the output of textile mills and instead increase the output of handloom cloth)
- Tariffs would shelter the domestic handloom industry from competition

British Raj replaced by PERMIT RAJ

- Nehru's Second Five-Year Plan introduced **Permit Raj**
 - Output quotas were planned
 - **Special permits** were needed to...
 - import equipment,
 - manufacture new products,
 - expand or open a new factory, and
 - close a factory.

Indian Planning

- India's Investment Policy – A compromise between **Nehru's ambition for heavy industry** and **Gandhi's partiality to Village handicrafts** – Wasting resources at both ends
- “This policy threatens an **inefficient use of capital** by combining it with too little labour at one extreme and an **inefficient use of labour** by combining it with too little capital at the other extreme.”
- **Wasting time of businessmen** – who had to figure out ways to evade the restrictions, and **of public servants** – who endlessly tried to plug loopholes that businessmen found

Aims of Planning

○ Four Aims of Planning

1. Abolition of Poverty
2. Liquidation of Unemployment
3. Reduction of Income Inequalities
4. Industrialisation

Income and Consumption

○ Income

	Per capita real income (compound, annual)
Decade ending 1960-61	1.7
Subsequent 12 years	0.8

○ Consumption

	Food grain consumption (ounces per head per day)
1951	13.94
1961	16.53
1965	16.94
1967	14.16

Consumption and Unemployment

○ Pulses

	Pulses consumption (ounces per head per day)
1961	2.43
1974	1.4

○ Unemployment

	Unemployment (million)
Eve of First Plan	3.3
1971	18.7

Stagnation of Living Standards

- Per capita consumption between **1955** and **1965**
 - **Cotton** – 14.4 to 14.8 metres (per head per year)
 - **Food grain** – 14 to 16.4 ounces (per head per day)
- Level of domestically produced food grain availability **CONSTANT** at 14.9 ounces per head per day. Below government-mandated nutritional requirements.
- Increase solely due to rising imports. But rise in the employment share of agriculture – From 68.4% to 72%.

Percentage Output Change (1955-1965)

Sector of Production	Percentage Change
Agriculture	23
Food grains	29
Non-food grains	35
Industry	91
Consumer goods	61
“Basic” industry	203
Capital goods	292

Good	Percentage Change
Textile machinery	440
Machine tools	3525
Sugar-mill machinery	3750
Sulfuric acid	555
Cotton yarn	22
Cotton textiles	19
Tea	25

Income over the Years (India vs. South Korea)

- Real per capita income (India vs. South Korea)

- **1960:** \$891 and \$1,458

- **1990:** \$1,898 and \$9,593

- **2010:** \$3,330 and \$28,870

The Plan Man

“I believe, as a practical proposition, that it is better to have a second rate thing made in our country, than a first rate thing that one has to import.”

- Jawaharlal Nehru
(From a speech in the 1950s)

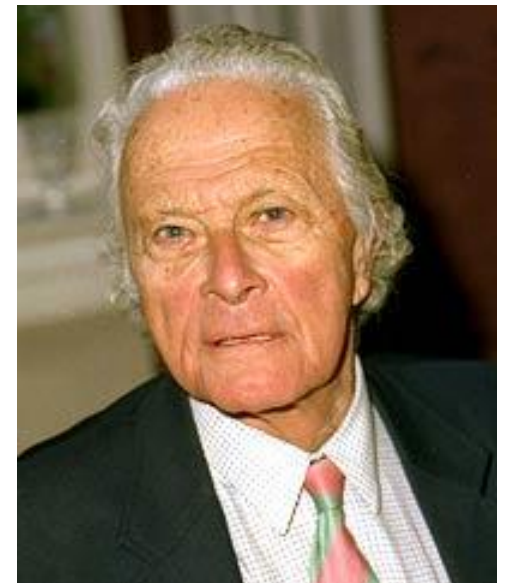


Comparative Costs of Domestic and Imported Products, 1962-69

	Domestic (in Rupees)	Imports (in Rupees)	Difference in Percentage
Refrigerator	2,250	900	150
Penicilin (million units)	1.25	0.1	1150
Sugar (metric ton)	1,150	315	266
Oil engine	3,620	2,200	65
Oil engine and pump (3 hp)	2,390	1,170	104
Pesticide spray pump	1,150	640	80
Fertilizer (metric ton)	860	490-560	54-76
DDT (metric ton)	5,500	2,800	96
Parathion (metric ton)	20,000	9,000	122

Dissent on Planning

- Pro-planning western advice
- Dissenters
 - Milton Friedman (1955)
 - Peter Bauer
 - B. R. Shenoy



Shenoy's Note of Dissent

- **“Note on Dissent to the Second Five Year Plan”, 1954**
- Over-ambitious character of the plan frame
 - Total net investment can't exceed total net savings
- Threats:
 - Inflation through deficit financing
 - Monumental wastages
 - **Individual freedom and democratic institutions (GOI's dilemma)**

How Pursuit of PLANNING undermined FREEDOM in the Constitution

The reason for the constitutional decline in India is that the formal institutions of socialist planning were incompatible with the Constitution.

The political actors undermining the constitution were pursuing socialist planning to its logical conclusion.

In the process, rule of law, federalism, property rights, separation of powers and the independence of the Indian judiciary were adversely affected.

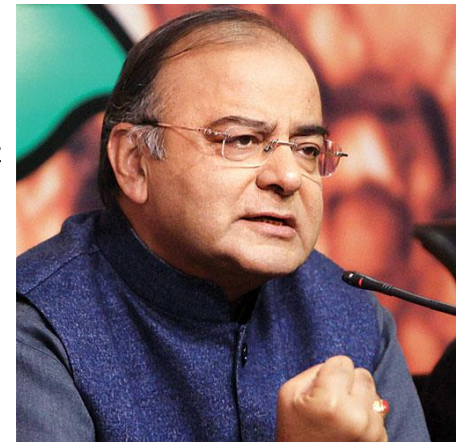
Shruti Rajagopalan in "Incompatible institutions: socialism versus constitutionalism in India"

Table 1 Consequences of incompatibility between socialist policies and constitutionalism in India (1950–1980)

Socialist policy implemented	Constitution provision violated	Consequential amendment
Land redistribution	Right to equality Right to private property	First Amendment
Price controls	Federalism Right to any occupation, trade or business	Third Amendment
Compensation for acquisition of property	Right to equality Right to private property	Fourth Amendment
Centralization of industry	Federalism	Seventh Amendment
Rent control	Right to equality	Seventeenth Amendment
Tenancy regulation	Right to private property	Twenty-fourth Amendment
Parliamentary Supremacy	Power to amend the constitution	
Centralization of powers		
Bank nationalization	Right to private property Right to carry on any occupation, trade or business Supremacy of fundamental rights	Twenty-fifth Amendment
Abolition of privy purses	Transfer of power	Twenty-sixth Amendment
Land ceiling	Right to private property	Twenty-ninth Amendment
Land redistribution	Right to property Right to equality	Thirty-fourth Amendment
Quantity controls	Federalism	Thirty-ninth Amendment
Price controls	Right to carry on any occupation, trade or business	
Currency controls	Right to carry on any occupation, trade or business	Fortieth Amendment
Restriction of monopolies		
Emergency years	Separation of powers	Forty-second Amendment
Economic reorganization	Judicial review	
Political reorganization	Democratic elections Federalism Fundamental rights	
Nationalization of means of production	Deleted right to private property	Forty-fourth Amendment

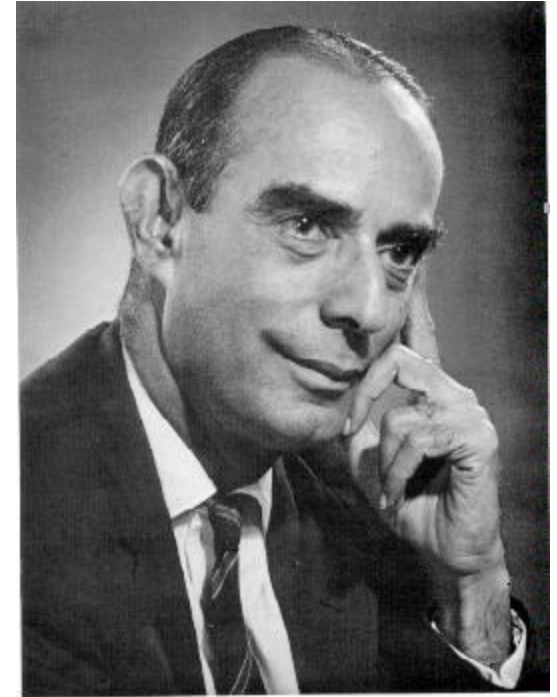
Agriculture

- “...**monopoly procurement**, which would be at controlled price, is apt to enforce the **price penalty on farmers** with ruthless efficiency, much more so than under competitive procurement. Monopoly procurement, therefore, might decelerate output and thereby add to the **upward price pressures.**”
 - B. R. Shenoy (1968)
- “...the states have been asked to delist certain items, which are usually procured through agriculture produce marketing committees (APMC), so that they come into the open market.”
 - Arun Jaitley, Finance Minister (June 2014)



Minoo Masani (1905-98)

- A three time Member of Lok Sabha
- Leading figure in the Swatantra Party, and founding member of the Indian Liberal Group
- Spontaneous journey to liberalism
 - Admirer of the Soviet Union -> A freedom fighter.
 - A socialist in 1930s -> Disillusioned with Soviet Communism.
 - A thoughtful reconsideration of socialism in 1940s -> An anti-communist crusader in early 1950s.



Dialectics of the 3 Is

Private and Political Markets

Interest

Incentives

Information

Public Choice & Central Planning

What lessons?

- Constitutional constraints
- In-period rules
- 3 I's rightly aligned

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Thank You!

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