

## Planning and Market Efficiency : An Operational Relevance Approach

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It seems the operational relevance of the Planning Commission has declined over several decades (Acharya Shankar, 2011). Our planners squabble over the scale of gross budget support to the Plan in each years Budget. The Planning Commission is the only organization within the Government charged with crafting a long term vision of India's economic and social development. For this, a positive response from the operating market is essential. An efficient market can generate choice environments through its normal operation. As a result, economic and social development would become broad- based deliberative processes. Market failure will not guarantee this. Market failure is an imperfection in the market mechanism that prevents optimal outcomes (Schiller Bradley, 2011). In the Indian context, there has been some missed link between the plan 'deliverables' and market response. It seems the heart of such failure is either decision deficit or policy insensitivity.

**This Paper** tries to investigate the link between the operational relevance of the Planning Commission and market response. It also discusses the reasons for differences and mismatch between the two and clarifies underlying economic intuition involved in proper decision making. The tools of price theory and the insight from the growing field of behavioral economics would be of great help to policy makers in articulating decision for suitable action

### **Dynamics of Configuration between Government and Market**

The great English Economist John Maynard Keynes once described what drew him to economics, it was, he said, "its intellectual rigour combined with its potentiality for good". The Government has the

responsibility to bring necessary economic change in the economy. Economic change has a real impact on people's lives (Gillespie Andrew, 2011). It affects whether they have a job, what they do, whether they can affect to buy a house, whether they have a good standard of living, and whether they can afford to start a family and so on. Economic analysis is, therefore, important to governments because they have a responsibility for the state of the economy and are often assessed on their economic performance. In fact, how well the economy is doing is a very important factor in determining how people vote.

A Government will set objectives and then try to influence the economy to achieve these using its policy tools. Sometimes, policy decisions do not lead to the result that we expected, especially when we are dealing with as many different relationships as there are within an economy. Let us view this from another angle. At a time when democracies, from India to America, have never had more big decisions to make, epidemic of not deciding properly is a troubling trend. It means that we are abdicating more and more leadership to technocrats or super committees or just letting the market and Mother Nature impose on us decisions that we cannot make ourselves. The latter rarely yields optimal outcomes.

It is true that in the hyper connected world, in the age of Face Book and Twitter, the people are more empowered and a lot more innovation and ideas will come from the bottom up, not just the top down (Friedman Thomas, 2011). Azim Premji, the Chairman of Wipro recently said: "there is a complete absence of decision making among leaders in the government. If prompt action is not taken, the country will face a

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setback." The Planning Commission is supposed to be a store house of decision and execution.

The degree to which governments intervene will depend on political philosophy factors outside economics, but whenever they do it will be important to understand what kind of opportunities people really want to have and to assess the extent to which such choice environments can be generated through normal market processes. Researchers argue that the inefficiencies observed in the market are the result of government's intervention. It is important to correctly identify the source of inefficiency because different sources call for different corrective policies. The question is one of striking a balance between government's action and market responses. Economic planning, if effectively (*effectiveness* means that you determine exactly what you want to do) designed and implemented (implementation is a culture), it can exert influence in striking a positive balance between government's action and market performance.

### **Indian Economic Planning: Design and Execution**

In India, planning has come to have a very specific meaning, one that is patterned largely on the Russian model (Friedman Milton, 1963). It has meant a sequence of five year plans, each attempting to specify the allocating of investment expenditures and productive capacity to different lines of activity. A Planning Commission in New Delhi is charged with drawing up the plans and supervising their implementation. There is some decentralization to the separate states (proved not sufficient at present) but the general idea is centralized governmental control of the allocation of physical resources. To allocate resources efficiently, an economy must get goods to the consumers who value them most highly (ManKiw, 2007).

Though Indian Economic Planning is cut to the Russian pattern, it operates in a different economic and political

structure. Agricultural land is almost entirely privately owned and operated, so are most trading and industrial enterprises. However, the government does own and operate many important industrial undertakings; Parliament has explicitly adopted "the socialist pattern of society" as the objective of economic and social policy.

We should also remember that growth is a process of change; it requires flexibility, adaptability, effectiveness in design and execution, sensitivity, preparedness and the willingness to experiment, above all, is a process of trial and error, model building that requires an effective system for ruthlessly weeding out the errors and for generously backing the successful experiments. But centralized economic planning tends to be cumbersome and rigid. So called plans are laid out long in advance and it is exceedingly difficult to modify them as circumstances change.

It is a well known fact that classical economists were generally opposed to interference with the market mechanism, believing that the free play of market forces would maximize the social good. But fashions change in economics. Planning in developing countries was seen by many as one of the main means by which economic development could be accelerated. The fact that planning may be operated too rigidly, or for too long and go wrong, should not be allowed to obscure the fact that it also has merits and that unfettered free enterprise can also lead to economic disaster and social deprivation. There can be a market failure as well as government failure. What is required in most developing countries is a judicious mix of public and private enterprises.

There is only one prominent professional economist, Professor B.R. Shenoy of Gujarat University, who is openly and publicly and at all effectively opposed to then policies and in favor of greater reliance on a free market. In 1955, when the Second Five Year Plan was in preparation, the Government appointed an Advisory

Committee of 21 professional economists to criticize the draft framework that had been prepared by Professor Mahalanobis. The Committee submitted two reports. One, signed by 20 economists, was largely a restatement of the draft framework and contained hardly any critical comments, though doubtless many of the signers had strong individual reservations on specific points. The other was a minority report by Professor Shenoy, which criticized the fundamental structure of the proposed plan, and pointed out in detail where difficulties would arise and what their character would be. If one reads Shenoy's report now, it sounds like a retrospective description of what happened rather than a forecast. Planning is, no doubt, a holistic process. Will our planners consider this in letter and spirit?

#### **Twelfth Plan: Value Delivery?**

The prospects for the world economy look bleaker day by day. In her latest interview, Christine Lagarde, Managing Director, IMF, said the world economy was in danger and urged Europeans to speak with one voice on a debt crisis that has rattled the global financial system. She also said the IMF's four percent growth forecast for the world economy in 2012 could be revised downward. Emerging countries which had been growth engines for the world economy before the crisis, have also been affected.

The United States is heading towards a difficult election year, which will mean a postponement of the much needed budgetary corrections. Japan's economy clearly remains trapped in a problem and even China is showing signs of a slowdown. India's economic growth, too, is slowing to seven percent or below, though the Indian Government is not in agreement.

Given this backdrop, the chances are that we are in for half a decade of slow global growth. The Planning Commission put its Draft Approach to the 12<sup>th</sup> Plan on its web site for comment. The Overview Chapter is fairly well written, at least in letter than spirit. This

Chapter recognizes most of the major challenges that India has to grapple with to sustain high growth over the next five years. To be very fair, the Approach Paper does not recognize the sudden increase in uncertainty about the global economy. But its projections do not seem to factor in any significant slowdown in export growth or foreign capital inflow. For a nine percent growth, it projects a current account deficit of 2.5 percent of Gross Domestic Product (GDP) more or less the same as the 11<sup>th</sup> Plan projected. In fact, the Approach Paper states, "it should not be difficult to secure the capital inflows necessary to finance a level of current account deficit of 2.5 percent of GDP, relying on stable long term Foreign Direct Investment (FDI) flows." These numbers may look plausible if one looks at the past. However, the fact is that the global economy may be in for a long period of disruption and restructuring that could upset these trends. The Approach Paper talks about the increased openness of the economy, the dynamic outward oriented private sector, and the flexibility provided to entrepreneurs with delicensing as the other driving force that has unleashed productivity enhancing competitive pressures. The proposal to open the economy further may not materialize, given the current state of party politics and the decision making paralysis in New Delhi. India is a Union of States. It goes without saying that in an essentially market based economy like India where the share of state sector has been declining, where the fiscal capability of the Centre has been circumscribed and its political authority has waned, the growth rate of the economy is unceasingly a sum of its parts.

Even in 1950, the introduction to the First Five Year Plan (Launched by Jawaharlal Nehru with the introductory Chapter written by the Late Professor K.N .Raj) ended with the observation. "the fulfillment of the tasks of development between the local authorities, with voluntary social service agencies engaged in constructions work, between the administration and



the people as well as among the people themselves.” But then, between 1950 and today India has traversed the curve with the Center’s ability to implement a National Plan first having waxed and then waned. It should be noted the condition of being developed is as much a state of mind as a physical condition measurable by economic indices only (Thirlwall A .P, 2011).

In the 1950’s Central Planning sought to create a National framework for growth and development that initially delivered impressive results (India’s growth in the 1950’s was superior to that of China and much of Asia). The 1960 and 1970’s was the lost decades when India slowed down and East and South East Asia marched forward. After 1980 the Indian economy regained speed. The importance of 1991 was that it removed the shackles on growth and created new institutions (especially in financial sector) that facilitated more efficient growth. In the past two decades, the India’s growth process has been shaped less by Central Planning and more by State level initiative.

### The Road Ahead

Indian market will look for cues from New Delhi for kickstarting reforms that seems to have been completely grounded after the Foreign Direct Investment (FDI) retail fiasco. The list of must- dos is getting longer and the delay in response is adding to the nervousness, both in local and foreign investor sentiment. To build a new mood, we need clarity in policies and their execution. Indian market operation needs to be well integrated into Government’s Policy initiatives .Bad times require good and realistic Planning. Center’s 12<sup>th</sup> Plan must ensure that the global economic slowdown does not limit India’s growth prospects too much. Planners should remember that 12<sup>th</sup> Plan is not just a plan for growth; it is a planning

for bad time. The key to success of India’s 12<sup>th</sup> Plan lies in what State Governments and markets **can do and will do**. Needless to say the operational relevance of a Plan much depends on effective governing system. It is well understood that government failures result from a paucity of *ethical tone* at the top. (The tone at the top refers to the behavior of an organization, *Government*). The governance practices in the context of Plan design and execution should give more weightage to proper checks and balances. The Twelfth Plan should move in this direction.

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