CENTRE FOR DEVELOPMENT STUDIES

WORKING PAPER NO.9

THE APPROACH TO THE FIFTH PLAN: FIRST IMPRESSIONS

By

K.N. Raj

Centre for Development Studies
Ulloor, Trivandrum-695011

January 1973

THE APPROACH TO THE FIFTH PLAN: FIRST IMPRESSIONS

By K.N. Raj

The Approach to the Fifth Plan is an important document both for what it explicitly states and what it does not. For the first time the Planning Commission has presented an estimate of the direct and indirect foreign exchange requirements attributable to selective charges in the consumption pattern of the upper strata of Indian society; and attention has been focussed on it as a major consideration governing the choice between the alternative patterns of growth that might be considerrd in the preparation of the Plan. Viewed against the background of the earlier policy formulations relating to planning in India this represents a significant contribution.

Two alternatives (or variants) are described in some detail in the document, one based on the assumption that the distribution of consumption expenditure between the different size-groups (classified according to deciles) would remain the same as in 1968-69 during the Plan period, the other on the assumption of a major shift in favour of the bottom three deciles of the population. The second variant shows considerable improvement in the balance of payments when compared to the first; and it is "preferred" both because it entails greater reduction of poverty (by the assumption regarding the pattern of consumption) and for the reason that the goal of zero net foreign aid can be achieved more quickly.

The reason why the second variant makes for a smaller deficit in the balance of payments, and what it implies, have been clearly stated. "Now that self-sufficiency has been achieved in foodgrains, the consumption pattern of the lower income strata has a much lower import content, compared to the middle and upper income strata, taking into account both imports that directly go into consumption and those that do so indirectly via domestic production of consumption goods. In fact, the attainment of self-reliance to an importa extent depends on how soon the middle and the upper income strata exercise the needed restraint on their consumption, particularly of goods and services that have a significant import content". It has also been pointed out that "this lends support to the hypoth that a part of the requirements for net aid stems from a pattern of consumption weighted in favour of the more affluent sections."

What is the order of the decline in the balance of payments deficit if the preferred variant is adopted? The official document as now published, gives no indication. But the earlier version (apparently prior to its approval by the Cabinet) had been publishe in a leading financial daily early in December;[1] according to it, the deficit on current account in the balance of payments over the Plan period was estimated at around Rs.3000 crores by the Resources Working Group appointed by the Planning Commission. According to the approved official document, the gross external aid assumed for the Plan is Rs.3000 crores; but Rs.1600 crores is expected to be absorbed by debt repayments during the period, and another Rs.400 crores "under other components of the balance-of-payments on capita account", and so the amount of net aid available for financing the current account deficit would be only Rs.1000 crores. One may therefore infer that the estimated reduction in the current account deficit, by adopting the second variant, is Rs.2000 crores (or Rs.400 crores per annum on the average) — particularly since no other estimate of the Resources Working Group appears to have been modified in the official version of the Approach paper now published.

Those interested in the technical details of the exercise would want to know the assumptions on which the estimate has been arrived at. Considering the nature of the data available some of these assumptions are of course likely to have been very much in the nature of "guesstimates". But this is not a feature of this particular estimate alone; even the estimate of investment and saving in the Indian economy are based in part on wild guesses. At least tentatively one may proceed on the assumption that the estimated reduction in imports is feasible provided drastic cuts can be made in certain items of consumption of the middle and upper-income groups.

The second variant may be dismissed by some as nothing but an arithmetical exercise the characteristics and implications of which were already well known. This would be neither fair nor correct. Earlier estimates which indicated that the foreign exchange content of "luxury" and "semi-luxury" consumption was faily high have been hotly contested by many in the profession and have generally not found acceptance. The present estimate may meet the same fate, but what cannot be maintained is that the precise implications of the second variant in the form they have been presented were "always" known and that there therefore is nothing significant about it.

Actually, until now, the practice has been to regard "mainten imports" as something that needed to be given high priority without almost any reference to the ultimate source of demand. In 1966 the lack of adequate foreign exchange for "maintenance imports" was identified as the main reason for under-utilization of capacity in manufacturing industry, without distinguishing between the differ(kinds of demand fo which the existing capacity was oriented; the whole policy package of devaluation, import liberalization, and dependance on massive aid for a period was defended on this ground. Not many who accepted this position have since then cared to re-examine carefully and honestly where and why some of their basic assumptions went wrong. But, in any case, they cannot now deny that the "preferred" variant for the Fifth Plan period rests on a wholly different set of assumptions, and that the differences are important enough for a forthright, open debate of the issues involve(

It would be much more pertinent if, assuming that the estimat(is not far off the mark, one were to ask how precisely the postulate(reduction in the consumption of the upper strata of society is to be brought about. It is not enough to reduce disposable incomes at this level (even if that were possible), because the consequent cut may well be in savings rather than in consumption; moreover, the cut(have to be mainly in consumption with "significant import content" (or export potential).

The National Development Council has been promised another document in the near future setting out in full the policy-frame for the implementation of the approved variant. Perhaps this is the reason why no questions were raised on the very important and down-to-earth questions of policy and implementation which the preferred variant raises. But there are enough hints in the document as to what are likely to be the main constituents of the policy frame; and they do raise issues that should and could have been discussed before the final stamp of approval was put on it by such an important decision-making body in the country.

For instance, though a brief reference has been made to the rationale of the land reform measures already decided upon, it is clear that no major redistribution of wealth or income is anticipated. It has in fact been explicitly stated that since the ratio of savings to income is postulated to go up, and the household sector will have a predominant role in generating savings, "the income of the rich will show an increase"; that "inducements must be given to potential savers to invest their savings in socially productive assets where possibilities of direct investment exist as in the case of agriculture and unincorporated enterprises"; that "the incentives offered to potential savers must be attractive enough to make them invest in financial assets"; and that "purely fiscal devices are unlikely to make a substantial impact on the existing income differentials at the accrual stage". How then is the logic of the proposed re-distributive growth process to be translated into practice?

The Approach paper recognizes that the basic problem of economic policy is to ensure that "such a logic gets translated into observable reality." But the further thoughts of the Commission on this crucial issue are rather vague. One suspects that, unless the Commission has deliberately chosen to hide something very important it has up its sleeve, what it will ultimately come up with in the next document on the policy-frame may not be so very different from the kind of general recipes that have been offered in the past. This fear is strengthened by the statement that the attainment of self-reliance depends to a large extent on "how soon the middle and the upper income strata exerc the needed restraint on their consumption". If restraint and other such individual virtues are to be the main instruments of policy the results are likely to be no different than in the past.

There is a brief reference to the production pattern being controlled such that "inessential but expensive articles of consumpti are not made available", and to the "licensing policy and other instruments at the disposal of the Government being used for this purpose". This is perhaps the most concrete suggestion for bringing about the postulated redistribution. But it raises some questions. Can physical controls over production be effective in curtailing supplies when there is considerable demand for the products concerned and the controls imposed may have themselves the effect raising the profitability of manufacturing the necessary intermediate goods or of diverting illegally the imports from other uses? What would one do with the considerable capacity already installed in industries catering to these requirements? The latter is perhaps not quite so serious a problem as the former, since it may be possible to divert to more essential uses at least part of the capacity installed for th production of "luxury" and "semi-luxury" goods (such as by producing more buses and trucks with the capacity installed for manufacturing cars); part of the output can also probably be exported, though it is difficult to see who could be the potential importers (unless the socialist countries anxious to achieve higher standards of consumption are willing to oblige, in exchange for India importing from them the capital and intermediate goods essential for the Plan). The Commission itself seems to visualize the solution mainly in terms of promoting the exports of the "luxury" goods.

If the incomes of those in the middle and upper income strata cannot be prevented from growing, an alternative course that could be adopted to check consumption of articles with high direct or indirect import content is to raise their prices relatively to those of others by imposing much higher indirect taxes on them. In this way part of these incomes could also be mopped up. If the indirect taxes are pitched high enough to serve these purposes their effective administration (e.g. of excise duties) may of course pose many difficult problems. On the other hand these problems will be no different in character, and possibly not any more severe, than those involved in directly controlling the production pattern.

It is not very clear what precisely are the articles of consumption of the upper and middle income strata on which the axe will have to fall in order to bring about the required reduction in the import bill. Perhaps the more disaggregated material balances, to which the document refers, will throw some light when they are published. Some of the broad implications of the contemplated redistribution can however be inferred even without going into the details.

The top three deciles of the population (arranged according to levels of per capita consumption) covers a spectrum that would include not only the very rich and the upper income groups (who might at best form the top 5 per cent of the population) but large numbers who would be regarded as among the lower strata of the "middle classes" or even lower. This will be evident from estimates of the average per capita monthly consumer expenditure of the population belonging to each of the top three deciles. The following table shows rough estimates for an average family of five members belonging to each of these deciles, and to the top and bottom halves of the first and third deciles, in the last year of the Fourth Plan (assuming that the rate of growth in the last two years of the Plan period is realised as postulated in the *Approach* paper):

Monthly Consumer Expenditure of a Family of Five Members Belonging to the Top Three Deciles in 1973-74 (at 1971-72 prices)
(in rupees)

First decile		Rs.640.5
Top half of the decile	Rs.766.5	
Bottom half of the decile	Rs.526.5	
Second decile		Rs.418.5
Third decile		Rs.338.5
Top half of the decile	Rs.392.5	
Bottom half of the decile	Rs.284.5	

Obviously, if the cut in consumption expenditure, however small, is designed to fall on all those belonging to the top three deciles, it will inevitably affect even families with annual income of no more than about Rs.3000 to Rs.3500.

The Approach document makes it clear that the second variant would involve a cut of approximately 5 per cent in the per capita consumption of those belonging to the top three deciles of the population taken as a whole. But no indication has been given of how the incidence of the cut is proposed to be distributed among them. On this will depend the range of the items that will need to be covered and the extent of the cut required in each case. For instance, if all the cuts in consumption are to fall only on the top 5 per cent of the population, and the rest of those in the top three deciles are allowed to maintain their per capita consumption constant at the level reached in 1973-74, the per capita consumption expenditure of this top 5 per cent of the population will have to be reduced by nearly 15 per cent; it is mainly the luxury and semi-luxury items consumed by them that will then have to bear the brunt of the cuts in consumption and related imports. On the other hand, if the incidence is spread more widely, a wider range of items may need to be covered.

In fact it is when one probes deeper into these and other such implications of the "preferred variant" that one could wonder how far it is feasible politically. If this variant is to be implemented, the marginal rate of saving of the top three deciles of the population during the Plan period will probably have to be over 100 per cent, since their per capita consumption expenditure in 1978-79 will have to be lower than in 1973-74 even though their income per capita is presumably expected to be higher. (The Approach paper leaves open the question of the pattern of income generation and the consequent relation between income consumption and savings; but, as indicated earlier, it does say that the "income of the rich will show an increase".) It is of course right and proper that, if cuts in consumption are to be imposed on any section of the population to secure the resources needed for development, they should fall on these three deciles at the top than on those below. But the question remains whether, given the existing structure of social and political power in the country, cuts of the order needed will in fact be allowed to be made. The Commission has pointed out that "within certain limits, a decision on the rate of growth is in the final analysis a political one". It should have added that a decision on the "preferred" pattern of growth is in greater degree a political one, and that the limits within which one variant can be preferred over another on technical grounds are in fact extremely narrow.

These political questions apart, there are several other issues on which the assumptions made by the Commission in opting for the second variant are not altogether clear. For instance, since the phasing of the proposed investment in the Plan period has not been indicated, one does not know whether there will be a hump (or bunching of investment) in the earlier years so that the increases in output realizable from such investment are secured at least by the terminal year of the Plan. Year-wise breakdowns cannot of course be given till the technical requirements and compulsions of the projects are worked out, but some indication of the kind of phasing the Commission has in mind is necessary even at this stage because (a) on this will depend the marginal rates of saving and net foreign aid required in the earlier years of the Plan period (which, in principle, could be higher or lower than the annual average for the period as a whole) and therefore to some extent the feasibility of the whole approach; and (b) to the extent that technical considerations permit flexibility in phasing, those who are called upon to prepare projects for the Plan can take the relevant economic considerations into account if appropriate guidelines in this respect are laid down.

There are however some estimates given of the required rates of domestic saving at the beginning and end of the Plan period (12.9 per cent of the gross national product in 1973-74 and 16.6 per cent of it in 1978-79); it is also postulated that no net foreign aid will be needed by the end of the period. The expected average rate of growth of the gross national product during the Plan period taken as a whole (5.5 per cent per annum), the feasible rate of increase of public consumption (7 per cent per annum), the required marginal rate of saving during the Plan (27.9 per cent per annum), and the gross domestic investment over the period as a whole (Rs.45166 crores at 1971-72 prices) have also been indicated. From some assumptions about the rate of growth of output and prices in the last two years of the Fourth Plan period, and on the further simplifying assumptions that (a) the gross national product and public consumption grow steadily during the Fifth Plan at the percentage rates postulated for the period as a whole, and (b) the marginal rate of saving is constant over the Plan period, it is possible to work out very roughly the relevant magnitudes for each year and identify at least some of the implications of this kind of phasing.

Gross National Product and its Allocation during the Fifth Plan
(in Rs.crores)

	1974-75	1975-76	1976-77	1977-78	1978-79	Fifth Plan period (1974-79)
Gross national product at the market price of 1971-72	51674	54516	57514	60678	64015	
Net factor income from abroad	-320	-340	-360	-380	-400	
Gross domestic product at the market prices of 1971-72	51994	54856	57874	61058	64415	
Net foreign saving (based on a "guesstimate" of the phasing of the assumed net aid of Rs.1200 crores for the Plan)[2]	450	350	250	150	-	
Gross domestic expenditure at the market prices of 1971-72	52444	55206	58124	61208	64415	
Allocation of this expenditure:						
Gross domestic saving	7070	7863	8699	9582	10526	
plus Net foreign aid	450	350	250	150	-	
Gross domestic investment	7520	8213	8949	9732	10626	45040
Public consumption	5354	5729	6130	6559	7018	
Private Consumption	39570	41264	43045	44917	46771	

The main conclusion that emerges from this exercise is that, given the low initial rate of domestic saving, the net foreign aid required in the early years of the Plan period may have to be fairly high if an investment programme of the order visualized is to be implemented. Should the gross national product reach higher levels in these initial years than indicated by the above estimates the picture could be somewhat different; but on the present outlook the chances of its being lower appear to be greater.

Dependence on foreign aid in the initial years of the Plan period can perhaps be reduced if much fuller utilization of the capacity already installed could be achieved or if investment currently being undertaken matures adequately by then in industries which make possible import-substitution on a large scale. The Commission does in fact point out the existence of such under-utilization and emphasize the need for "institution building, policy making and adoption of procedures to create and utilize capacities" in these fields.

But this kind of hope and exhortation has been expressed in earlier documents without leading to any significant results. Those who are familiar with the factors responsible for the under-utilization of installed capacity in the plants managed by the Hindustan Steel Limited, the Heavy Machine Building Plant at Ranchi, etc. know how unrealistic are the assumptions made by those who set targets in this regard without caring to study the problems involved in each case. Moreover, some of the decisions taken by the concerned Ministries — as in respect of the steel plant at Salem — run wholly contrary to the full utilization of capacity in key industries for saving foreign exchange (and indeed contrary to several other declared objectives of the Fifth Plan). It is therefore difficult to avoid maintaining a degree of scepticism in this matter, until there are signs of a more concrete, disaggregated, and consistent approach to questions of capacity utilization.

While the existence of under-utilization of capacity in key industries is in general a factor that could make the implementation of the "preferred variant" easier, there are some other very hard realities of economic performance that have to be contended with. One of these, extremely relevant to the achievement of the production and export targets, is the rate of growth of output of crops other than foodgrain in the last few years. Until the middle 'sixties the output of these crops had grown faster than of foodgrains (at 3.6 per cent per annum in the preceding 15 years compared to 3 per cent per annum in the case of foodgrains).[3] Not only has it been much lower since then but the total increase in their output over the entire period, 1964-65 to 1970-71, has been less than 5 per cent. Not surprisingly, the output of agro-based industries has grown during this period at a rate of less than 1½ per cent per annum (compared to 6 per cent per annum in the case of the other industries covered by the index of industrial production); and the foreign exchange earnings from agro-based exports seem to have been about one-sixth lower in 1970-71 than in 1964-65.

It is true that the required growth rate for agriculture, corresponding to the preferred variant for the Fifth Plan period, is "somewhat below the 5 per cent rate which is generally mentioned as the required rate". If the estimates of the Commission are correct it would be enough if the rate of growth of output of foodgrains is about 4 per cent per annum, and of other field crops about 4.9 per cent per annum, during this period. But these are higher than the rates realized between 1964-65 and 1970-71, and strikingly so in the case of crops other than foodgrains.

Indeed one of the serious gaps in the otherwise clear and cogent exposition of the main considerations relevant to the formulation of the Fifth Plan is the lack of a diagnostic analysis of the performance of the Indian economy in the Fourth Plan period. The Commission had made a very good beginning in this respect in its Mid-Term Appraisal of the Fourth Plan published a little over a year ago, but no attempt has been made to follow up the implications systematically in either the first formulation of the approach to the Fifth Plan ("Towards the Approach") published last summer or in the latest document.

All this is not to suggest that the targets indicated in the Approach paper are totally unrealistic and cannot possibly be achieved. In terms of realism, the latest document shows some improvement over the earlier one in certain respects. For instance, it had been categorically asserted in the "Towards the Approach" paper that "the total outlay in the Fifth Plan period would have to be around twice the size of the Fourth Plan"; since the planned outlay in the Fourth Plan was about Rs.25,000 crores at 1967-68 prices, this would have required a total outlay of around Rs.50,000 crores in the Fifth Plan at this level of prices. The total estimated outlay in the Fifth Plan is still placed at a little over Rs.51,000 crores according to the latest document. However, not only is it at 1971-72 prices but the document makes it clear that all the estimates relate to <u>gross</u> investment (unlike in the earlier Plan).[4] Anyone familiar with the relevant concepts and data can see that in real terms the proposed investment outlay in the Fifth Plan cannot be much more than about 50 per cent over the Fourth Plan period; it could be even less.

Actually most of the targets indicated in the Approach paper appear reasonably realistic, except those implicit in the presumed redistribution of consumption on the scale contemplated in the "preferred variant". It is true that very much more purposive and concerted efforts will be needed to improve on past performance in almost all sectors of the economy, but unless the possibility of this kind of improvement can be postulated there is not much point in even attempting to accelerate progress through planned development.

The lack of realism in regard to the presumed redistribution of consumption is basically due to the political dimensions of a programme of the sort outlined in the "preferred variant". One cannot wholly blame the Commission for this, as it has only responded to the political directive given to it and tried to show that, if the objectives laid down at the political level are to be realized, it <u>can</u> be done given the necessary political understanding, will and discipline. If a perceptible dent is to be made into the phenomenon of mass poverty, and this is to be achieved along with the attainment of self-reliance by the end of the Fifth Plan period, it is in fact difficult to think of any other way of doing it. The ball is therefore now in the side of the court where it should be.

In the process of placing it there, and more specifically by the way in which it has done it, the Commission has made an extremely useful contribution. It has questioned the kind of facile reasoning that used to be made till now between development, rates of growth, and foreign aid and thereby given a new direction which, if translated concretely into political and economic measures, could make a significant impact on the economy as well as on the processes of social and economic change in the country in the future. One only wishes that the precise policy implications of the "preferred variant" had been spelt out more explicitly than they have been, so that the political leadership cannot later blame the Commission for not having made more clear — in ordinary layman's language of the kind they can understand — some of the very important assumptions underlying this approach.

On the contrary, the Commission has indicated an all-too-obvious escape route to the political leadership which the shrewder among them could not have overlooked when accepting the "preferred variant" with apparently unquestionning enthusiasm. For, in operational terms, the most significant observation in the Approach paper is contained in the following inference the Commission has drawn from its quantitative exercise:

> "An important point emerging from the exercise was that the inter-sectoral patterns of growth in the two variants were broadly similar at the level of aggregation reflected in a

66 x 66 table. In most cases, the differences in the rates of growth of individual sectors were marginal.......Only in five of the above sectors the difference in the rate of growth exceeded one percentage point.......It follows that even if the reduction of inequality that may be actually achieved during the Fifth Plan period is much less than postulated in the second variant, while it will substantially slow down progress towards removal of poverty, the broad pattern of growth emerging from the preferred variant will not require major modification".

From the technical angle one could question, precisely for this reason, the value of a quantitative exercise at the level of aggregation implicit in the 66 x 66 table; one could also be curious as to how the problems of estimation of the import requirements corresponding to each of the two variants referred to in the paper were in fact overcome when the level of aggregation is such that the otherwise important differences in the patterns of growth implicit in these variants get so thoroughly concealed. It is obvious however that, from the political point of view, the result could not have been regarded as anything but a blessing; both those who are willing to accept the implications of the "preferred variant" and those who are not can accept the Plan as outlined in the Approach paper, leaving it to later actions and non-actions to decide the eventual outcome.

January 30, 1973. K.N.Raj

FOOTNOTES

1 *Financial Express*, December 6 to 12, 1972.

2 "Besides the net inflow of funds corresponding to the deficit on current account, there is another element of draft on the rest of the world, namely, the accrual back from interest payments in rupees on P.L.480 debts and deposits". In the estimate of the total saving available to the economy for the Fifth Plan period by the orginating sectors the figure given for "rest of the world" is therefore Rs.1203 crores. *Approach to the Fifth Plan*, 1974-79, p.33.

3 The effect that diversion of area to more remunerative crops like wheat, maize and bajra has had on the output of important crops other than foodgrain (such as cotton and groundnuts) has been drawn pointed attention to by Dr. Dharm Narain, Chairman of the Agricultural Prices Commission, in an address to the Indian Society of Agricultural Statistics in March 1972 on "Growth and Imbalances in Indian Agriculture".

4 For a fuller discussion of this point, see K.N.Raj, P.G.K. Panikar and T.N.Krishnan, *Some Perspectives on Planning and Development with Particular Reference to Kerala: A Preliminary Paper on the Approach to the Fifth Five Year Plan* (Centre for Development Studies, Trivandrum, September 1972).