

UNIT 14 NEED FOR PLANNED ECONOMIC DEVELOPMENT

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14.0 OBJECTIVES

This unit introduces you to the concepts of development planning for countries which **choose the path of economic development. Having gone through this, you would** be in a position to understand and explain the following:

Planning in Different Economic Systems

Historical Context of Planning

Planning as the Corrective for Failure of the Market Mechanism

Planning as the Means of Overcoming Under-development through State Intervention.

14.1 INTRODUCTION

In this unit we shall be concerned with the question as to (i) why the need for planned economic development arises at all; and (ii) what were the historical circumstances which favoured adoption of planning as a means for carrying out economic development.

14.2 PLANNING IN DIFFERENT ECONOMIC SYSTEMS

Economic planning as conscious design of development for any society or nation is invariably an activity or function of the state. This is because the state is sovereign and above all individuals, households, firms, corporations or associations or institutions that there are in society: By virtue of this position the state alone is supposed to have a comprehensive view of the economy and its problems of development. The role of the state in economic planning however, differs from country to country. This is because different countries have different political and economic systems.

You may be aware, for instance, that socialist countries of the world do not have a multiparty parliamentary democracy unlike many other countries. Furthermore, in the socialist countries most means of production are under public or state ownership. In such a political and economic system, the role of the state in economic planning is very comprehensive and direct. At the other extreme you have the industrially advanced capitalist countries of the West and also of Japan, whose economies are based on private enterprise. There, most means of production are privately owned, and political systems are multiparty based. The role of the state is limited to what is called 'indicative planning'. From its comprehensive overview of the economy, the state, in these countries gives signals about the health of the economy, stimulates private enterprise and indicates the direction in which it ought to move and develop. For example, in 1960 the state in Japan adopted a 10 year income doubling plan and performed precisely this type of role towards achieving the goal.

Between the above two groups of extreme cases we have the vast majority of the third world developing countries of Asia, Africa and Latin America, which have adopted the course of planned economic development. They adopted this course in the post-war years when many of these countries became free from colonial rule and came to have their own national state and government. The scope of economic planning and the planning system in this group, of course, vary from country to country. But in every one of them the state plays an active and direct role in planning the development of the national economy. Their economic system is, what is called, the mixed economy type, where public and private sectors of economic activity co-exist. Along with planning, the market also plays an important role, specially in the regulation of the private sector decisions regarding investment and production. Economic development in these countries is, therefore, both planned as well as induced and directed by the market forces.

Check Your Progress 1

- Note:** i) Use the space given below for your answer.
ii) Check your answer with that given at the end of the unit.

1) Mark True (T) or False (F) .

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| i) | Planning is comprehensive only in a socialist state. | () |
| ii) | In indicative planning, the state stimulates private investment and has an advisory role as to the direction in which to move for development. | () |
| iii) | A mixed economy has both socialist and capitalist parts | () |
| iv) | Public sector is that area of activity which is owned and controlled by the state. | () |
| v) | Market has little role in a mixed economy | () |

- 2) Write in about five sentences what are the basic differences between planning in a socialist, capitalist and a mixed economy.

14.3 HISTORICAL EXPERIENCE FAVOURING PLANNING

During the 19th century and, specially, in the years prior to the Second World War, a number of developments occurred in the Western World, the experience of which convinced the developing countries of the need to follow a course of planned economic development in the post-war years. Let us describe these for you one by one.

14.3.1 Example of the former USSR

The single most important event was the successful adoption of development planning in the Soviet Union for the first time in the world, following the socialist revolution in Russia in 1917. Private ownership of the means of production was abolished. With that went away private enterprise and the free market mechanism as vehicles for economic development. Planning and public enterprise were instituted in its place. The results were remarkable. The state mobilised high rates of public savings and investment. Capital accumulation and national income grew at unprecedented rates. By the end of the Second World War, the Soviet Union emerged as the second big power in the world. In about four decades, from a situation of under-development and backwardness, Soviet Union became a developed country. This was, thus, a very successful example of planned economic development for the countries developing later to learn from and emulate. Developing planning strategy of the third world countries was greatly influenced by the Soviet experience.

14.3.2 The Great Depression and New Deal

You may have heard about the Great Depression of 1929, also called the "World Economic Crisis". What happened was that the market system, especially in the industrial countries of the West, grinded to a halt. There was overproduction; stocks of unsold goods piled up; factories were shut down; share markets collapsed; unemployment soared up. All this meant a complete mismatch between production and market demand it had been known earlier that the free market system did not ensure smooth development of an economy based on private enterprise. But the Great Depression made it crystal clear for every-one to see. incidentally, one should also note that the Soviet economy, being a planned economy, remained unaffected by the Great Depression. How was the crisis of the Great Depression met? By state intervention. The states in the badly affected countries of the West intervened to push up market demand by undertaking public works and financing them by money creation (printing currency notes; also known as Deficit Financing). This step generated additional income and employment. Market demands for goods and services gradually picked up as a result of this policy. In course of time, normalcy was restored and development resumed. This course of state intervention is also known as the 'Keynesian solution' of the economic crisis, after the name of the famous English economist, J.M. Keynes, who had provided the economic theory on which this solution was based. In the United States this course of state intervention came to be known as the "New Deal".

The experience of the Great Depression had, apart from other things, one very major effect. The faith in a laissez faire state, a fence-sitting state not actively intervening in the economic life to control the functioning of the market, was shaken. Since then, state intervention in the market system, wherever and whenever

necessary, has become a normal feature of the capitalist countries. So far, this was occasionally practised in a war economy in emergency. Secondly, as noted earlier, the state in these countries oversees the economy and engages in indicative planning. Finally, it plans for and undertakes public works, specially in the field of social infrastructure. Such developments in the developed capitalist countries, following the Great Depression, had a lesson for the developing countries. The lesson was: economic development could not be left wholly to private enterprise based on the free market and the state had a role to play in it.

14.3.3 The War Economy

Soon after the experience of the Great Depression came the Second World War. This was a long (1939-45) and total war it necessitated not just state intervention in the capitalist and fascist countries like and production planning for meeting the war needs. This is what is known as 'Planning of the War-Time Economies'. After the war, rehabilitation and reconstruction required the active role of the state. This is the third type of historical experience favouring planning of development.

14.3.4 The Welfare State

Alongside the above developments, there arose the notion of 'welfare state' which finally came to be accepted in practice in all market economies after the war. Apart from its interventionist role, a welfare state has also to correct the negative aspects of market based development, and be concerned with the wider issue of social welfare. In the developed countries of the West, the state takes a sizeable expenditure on old-age security, unemployment benefits, health, education and such other social services. All these are called 'Social Security', or welfare measures. Provisions for all these requires planning. Lately, a major negative effect of market based development, which has come to the surface, is environmental pollution, and ecological degradation. The welfare state is required not only to protect environment and ecology, but also to conserve and plan for restoration and development of the natural resources. The free market mechanism, based on the accounting of private profit, does not provide for these. This is another historical experience justifying the necessity for planned development.

Check Your Progress 2

- Note:** i) Use the space given below for your answer.
ii) Check your answer with that given at the end of the unit.

Answer in about five sentences.

- 1) What in your opinion was the most important event influencing adoption of planned development ?

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- 2) The New Deal lifted the Western economies from the Great Depression. What was the New Deal and how did it work?

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- 3) What does the welfare state mean ?

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14.4 MARKET FAILURE

The foregoing narrates to you the historical circumstances which favoured adoption of developing planning. These experiences were there for the third world developing countries to draw upon. Now, let us go into the weaknesses and distortions from which the market-mechanism suffers and why, therefore, development cannot be left to be solely guided by it. We discuss this question keeping the third world countries in mind. The weaknesses and failures of the market mechanism may be summed up as follows:

- i) One major problem of development is optimum allocation of society's resources among socially desirable alternative uses and lines of activity so as to achieve the social goals. Economists in the neo-classical tradition have argued that, in a free market private enterprises economy, such an allocation is achieved, provided that markets are competitive. But, in point of fact, experience shows that, markets are usually non-competitive, be they markets for factors of production, or for goods and services. This being the case, market mechanism is unable to achieve socially optimum allocation of resources. For this reason, market-determined prices do not correctly reflect the real social scarcity, or value, of either factors of production, or of goods and services.
- ii) Even when market system is competitive market equilibrium, supply equating demand, may be attained at a level where society's resources are not fully employed or utilised. During the Great Depression unemployment soared up and labour remained idle. Even in normal situations, persistent labour unemployment is a common feature of the market economies. Apart from its social consequences for the unemployed individuals, this feature of the market system prevents the realization of the potential contribution to development implicit in the unutilised resources.
- iii) Free market mechanism fails to capture and put a price on 'external economies or diseconomies', also called external effects of economic activities. Such external effects are important and ought to be taken into account from the social angle. External economies are of two types: (a) technological, and (b) pecuniary. Environmental pollution arising out of industrial effluents (gases, chemicals and other wastes let out from plants) is an example of technological external diseconomy. The operating cost of irrigation tube wells in an area goes down when that area becomes a part of the command area of a canal irrigation system. This happens because, canals bring the underground water-table up. This is an example of external economy (technological). In the first case, society's health suffers, but the market mechanists fails to charge the industrialists for this. In the second case, tube wells owing farmers benefit without paying for it.

Let us now illustrate the pecuniary external economies which arise but which individual producers fail to anticipate in the market system. You are a tea producer and I am a sugar producer. Following an increase in demand for tea you increase your scale of production. Without your knowing or anticipating it, this decision of yours will have an effect on me. Since sugar demand will also go up with increase in tea demand, I will raise the scale of sugar production. My unit cost of sugar production will get reduced and I will, thus, derive a pecuniary- benefit (external economy of your decision). In the other case of demand decrease I will obviously suffer a pecuniary loss (external diseconomy). Such pecuniary external effects are widespread in an economy. But the market mechanism fails to signal the private producers in advance to help them in making their decisions.

iv) With private ownership of the means of production, income disparity, in fact, vast income differences, is a common fact of life. Free market for a particular good and service excludes altogether those income-group people in the society who cannot pay the supply price. And this can happen in respect of essential items of consumption as well, in a situation of scarcity. In this sense, the free market system operates with a bias against the lower income groups.

v) Private individuals, depending upon their own welfare considerations, allocate their current income between consumption and saving. Market system fails to guide them as to what should be their optimal rate of saving. Take the case of an exhaustible resource, let us say, petroleum, of which a country may have known, definite amounts of reserves. Market based private exploitation of petroleum, guided as it is by private profit, has no way by which to decide how much of the reserve should be saved for future in the interests of society. It would be solely guided by the current consumption demand of petroleum. Ecological degradation arises from a similar myopic vision of the market forces, endangering the conditions for future development.

vi) Finally, there are a number of important and essential areas of social life, critical for economic development, where private enterprise propelled by market forces and motivated by profit, fails to enter. A whole lot of social services-education, health, drinking water supply etc., conservation and development of natural resources can be given as examples of such failure.

The above list of market failures is not exhaustive if you think, you could add more. What about, for instance, product advertising and, through it, psychological manipulation of consumer choices'? The justification for state intervention and planning of development arises, inter alia, from market failures.

Check Your Progress 3

- Note:** i) Use the space given below for your answer.
ii) Check your answer with that given at the end of the unit.

- 1) in your own words define in three sentences what you mean by external economies and diseconomies ?
- 2) Mark True(T) or False (F):
 - i) Free markets discriminate against people with lower incomes.()
 - ii) Free markets always imply a perfectly competitive market.()
 - iii) Free markets lead to reckless exploitation of resources, which leads to harmful consequences for future development. ()
 - iv) Private enterprises, guided by profit motive can deliver all the goods and services that society requires.()

- v) The market mechanism can manipulate the market through advertising. ()

14.5 TRANSFORMING UNDER-DEVELOPMENT

Economic development is nothing but changing or transforming the situation of underdevelopment and backwardness of a country. Faster is this change, faster is economic development. The economic situation of today's developing countries was initially characterised by under-development. What the causes of this under-development were, is a wider question of history, often colonial history; we are not concerned with here. Here we discuss the chief characteristics of under-development when a country begins to move on the path of development. Of course, each country's situation is to some extent unique to itself. But the chief characteristics of under-development have been found to be common in the third world countries. Let us see what these are.

14.5.1 Structural Features of Under-development

An underdeveloped economy is predominantly agricultural. Typically, up to 80 per cent of the labour force is engaged in agriculture. Production in agriculture, based on age old technology, is largely for subsistence and carried out under feudal relations. Feudal landlords live an ostentatious life and make little or no investment in agriculture. Within the industrial sector, traditional household crafts preponderate. Modern industry, if it exists at all, is limited to a few lines for instance, jute and cotton textiles in India prior to the Second World War. Infrastructural services like transport and communications are extremely poor and limited.

14.5.2 Relative Factor Endowment

As is implicit in the structure of an underdeveloped economy, its relative factor endowment pattern is dominated by land, or by land and labour together. Relative availability of capital is extremely low. Capital goods are mainly those which are turned out by the traditional crafts. In countries like India and China marked by high population pressure, the relative factor proportion between land and labour is itself adverse, with a low landlabour ratio. Additional labour due to population growth, stays back in agriculture since little opportunity of other employment exists. As a result, a substantial proportion of labour in agriculture remains under-employed. Labour, the human capital resource, is thus poor in quality.

14.5.3 Asset Ownership and Income Distribution Pattern

Asset ownership, particularly of the most important factor of production, land, is very unequally distributed in an underdeveloped economy. It may so happen that a handful of feudal lords own most of the land and the rest of the rural population worked as tenants or landless labourers, including bonded labourers. Disparity in incomes follow from disparity in land ownership, with 50 to 70 per cent of the produce going to a small class of land owners. The rest of the population lives at subsistence level under acute poverty. Furthermore, in large countries such as India, there also exist disparity of incomes between different regions as the relative factor endowments as well as the levels of development vary from region to region.

14.5.4 Saving, investment and Capital Accumulation

Since an underdeveloped economy is characterised by stagnation in production and operates at a low level equilibrium, savings are low, and so is investment. A kind of vicious circle operates: Low income - low savings - low investment - low income. Low saving and low investment keep capital accumulation at a low rate. The vast majority of the people, living at subsistence level have no capacity to save. Landlords and renters have the capacity to save but engage in conspicuous consumption. Merchants and traders do accumulate some money capital. But they lack in enterprise and do not invest it in industry. The other reason for this failure is the large size of capital required by modern industrial units which individual holders of money capital are unable to provide.

14.5.5 Science and Technology

Under-development is also characterised by low levels of scientific and technical knowledge. Due to illiteracy and lack of education, the quality of human capital is poor. On the other hand, an underdeveloped economy dependent on the traditional means and methods of production, has little scope for technological innovation.

These are then the chief characteristics of an underdeveloped, backward economy. Development, precisely requires changing these characteristics. How can this change be effected in the shortest possible time? And this is necessary because the common urge is to develop fast, to catch up with the developed countries. Apart from the market failures noted in the preceding section, you can see from these characteristics that, in an underdeveloped economy the market system is itself underdeveloped. This is primarily because production in such an economy is motivated by subsistence and family consumption rather than for sale and exchange in the market. State initiative in the transformation of under-development, therefore, becomes necessary. State initiative takes the form of planning development and executing it through successive plans of medium-term duration.

Check Your Progress 4

- Note:** i) Use the space given below for your answer
ii) Check your answer with that given at the end of the unit.

Answer in five sentences

- 1) What are the basic characteristics of under-development?

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- 2) What is the vicious circle that operates in an underdeveloped economy ? Explain.

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14.6 PLANNING AND THE ROLE OF THE STATE

The planning process can be viewed as a sequence of formulation, implementation and performance appraisal of a development plan. The core of a plan is a statement giving the allocation of investment in various sectors of the national economy during the plan period, its division between the public and the private sectors and also between the centre and the states, in a federal political system. The allocation of investment among the sectors of the national economy like agriculture and industry is guided by three considerations: (1) goals of development, (2) the long-term strategy of development, (3) intersectoral balance or consistency. We have already learnt about the goals of development. You will learn about the strategy of Indian development in the next lesson. Here you may simply note that the strategy indicates which particular sectors should receive relatively more investment so that the economy develops faster. Inter-sectoral balance is required because output from one sector is used as input in some other sector. For instance, coal output is required as input in steel production; or for that matter agricultural output (food grains, cotton, oil seeds) is used as wage-goods or input in industry.

The planning process is naturally organised by the state. Plan formulation, as we all know, is done in India, through the executive wing of the state, the central government ministries and the state governments. The state is also helped in plan formulation by a technical body like the Planning Commission. The Draft Five Year Plan, thus prepared, is presented to the National Development Council (NDC) for its approval. After it has been approved by the NDC it is presented to Parliament, the legislative organ of the state. When finally voted by the Parliament, it becomes the National Development Plan, ready for implementation. Plan implementation is the responsibility of the bureaucracy, another organ of the state. Appraisal of the plan performance is done by the Planning Commission. The Mid-term Appraisal, as it is called, is done after the plan has been implemented over half its period. This is necessary because the work on the next plan formulation starts at this time. The final appraisal is done at the end of the plan period and is included, by way of review of development, in the next plan document.

The state's role in a mixed economy is not limited to the planning process described above. Development plan requires to be supported by a number of appropriate policies and institutional reforms. These are too many to be enumerated here. As an example of supporting policies for the plan, take the case of monetary and fiscal policies. The state designs and executes such monetary and fiscal measures as would help mobilise private savings and channelise them into investment according to plan priorities. Similarly, ceilings on land holdings and land redistribution are examples of institutional reforms that support the plan goal of agricultural growth with equity. Lastly, one must not forget that in a mixed economy of planned development, market-mechanism plays an important role in guiding the production and investment decisions in the private sector. Particularly, the plan itself creates conditions for markets to emerge and develop by building up infrastructural facilities, like transport, communication, power, etc. At the same time, it tries to overcome the failures of the market-mechanism noted earlier. The resultant outcome of development is, therefore determined both by the plan and the market in a mixed economy.

Check Your Progress 5

Note: i) Use the space given below for your answer
ii) Check your answer with that given at the end of the unit.

1) What is inter-sectoral balance ?

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2) When is the mid-term appraisal of a plan"?

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3) What are some of the appropriate policies required to support the development plan ?

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14.7 LET US SUM UP

We have seen in this unit why planning for economic development is necessary. The experience of various countries, especially the success of planned development in the former U.S.S R.. has shown how state intervention has helped in economic development.

We have also taken up instances where state intervention takes different forms. In this context, we have also seen what limitations of the market mechanism are and where it has failed.

Finally, we have seen how in the context of under-development, state intervention becomes all the more necessary, and what form it broadly takes in the Indian context. In the next unit, you will read in broader details about the strategy of Indian planning.

14.8 KEY WORDS

Feudal Relations: Where the appropriation of surplus generated in the production process takes place through extra economic coercion on the part of the landowner over the peasant producer, without the having to undertake any production obligations.

Free Market: A system where the state does not play any role in regulating the market and where private enterprise is free to produce and sell any quantity at whatever price it finds appropriate.

Indicative Planning: Where the state does not actively play a role in economic development but merely indicates the direction in which private enterprise is to move.

Laissez Faire: It literally means 'let it be'. in economic theory it is understood to be the system where the government does not intervene and gives complete freedom to private enterprise.

Mixed Economy: An economy where both public and private sectors co-exist and participate in development activities.

Rentiers: A class of people whose basic income is derived from holding assets, including such securities, stocks (shares) and bonds, which do not involve undertaking the risks and costs of enterprise.

14.9 SOME USEFUL BOOKS

Lewis, W. Arthur (1960), *Development Planning*. The Essential of Economic Policy, George Allen & Unwin; London.

Streeten, Paul and Michael Lipton (1972), *The Crisis of Indian Planning*, Oxford University Press, London.

Chakravarty Sukhamoy (1987): *Development Planning -- The Indian Experience*, Oxford, Clarendon.

14.10 ANSWERS AND/OR HINTS TO CHECK YOUR PROGRESS/EXERCISES

Check Your Progress 1

- 1) i) T
 ii) T
 iii) F
 iv) T
 v) F

- 2) See 14.2

Check Your Progress 2

- 1) Hint: Planning in former Soviet Union see Sub-section 14.3.1
- 2) See Sub-section 14.3.2
- 3) See Sub-section 14.3.4

Check Your Progress 3

- 1) See section 14.4 para (iii)
- 2) i) ii) F iii) T iv) F v) T

Check Your Progress 4

- 1) See Sub-section 14.5.1
- 2) Hint: Low income - Low savings - Low investment - Low income

Check Your Progress 5

- 1) Inter-sectoral balance implies that the output of each sector which is used as an input in the other sectors is sufficient to support the targeted level of output of goods in the economy.
- 2) Mid-term appraisal of a plan is done after the plan has been implemented over half its period and the work on the next plan formulation starts.
- 3) Appropriate monetary and fiscal policies are some of the policies required to support the development plan.