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THE ROLE OF GOVERNMENT IN INDIA'S THIRD PLAN

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The key decisions in Indian planning concern the area of direct governmental operations. How large will investment in the public sector be in the Third Plan? How will it be allocated? What major new lines of policy will government adopt? When the Planning Commission gives some indication, however preliminary, of the answers here, the "tone" for the development effort for 1961-66 will have been set.

Inevitably, government deprecates any "pause for consolidation" in its march forward to economic expansion. The investment program must continue to expand; given the goal of a "democratic and socialist society," the role of government must also expand. Within these broad and understandable requirements however, there is considerable scope for major differences in the specific decisions as to how much, where, and what. This brief note is written far from New Delhi and remote from the various pressures and considerations which bear directly upon the official answers. Nonetheless, it points up some past experiences in India which are directly relevant to these momentous decisions.

I. How Large the Public Sector, 1961-66?

Plans. In the First Plan, development outlays in the public sector were eventually scheduled aggregate to Rs. 2,378 crores; the investment component of these outlays was about Rs. 1,850 crores. For 1956-61 both these magnitudes were given explicitly: Rs. 4,800 crores and 3,800 crores respectively. An aggregate investment program in the public and private sectors of the order of Rs. 3,500-3,600 crores was considered possible for 1951-56; for the Second Plan

*The gist of section I of this paper has appeared in the Tenth Annual Issue of The Economic Weekly, (February , 1959, pp.).

years, this was taken at Rs. 6,200 Crores. The ratio of public to total investment increased from an estimated 50 per cent in the pre-planning years (1950/51) to 52 per cent over the First Plan and 61 per cent over the Second.

The striking characteristic of this large increase in the Second Plan was its dependence upon borrowing, domestic and foreign, as distinct from surpluses on current account of regular governmental operations and of various public enterprises. Indeed, given the fact that noninvestment development outlay is actually a current account item, revenue surpluses from the various government activities were to provide but 5 per cent of all public investment; 63 per cent was to be borrowed domestically (but half of this through 'deficit financing'), 21 per cent was "to be raised externally" through loans and grants, while the uncovered gap (11 per cent) might be covered by additional measures (unspecified) to raise resources domestically.

Relevant here are facts as to the basic savings-investment habits and patterns of the Indian economy. A nation of entrepreneurs--and most of India's work force is self-employed--has a high propensity to invest directly any surpluses arising in the individual enterprise. Self-financing is of great importance in large enterprise--and in small. Most Indian enterprise thus tends to have this direct-investment attribute. It is true that banks, insurance companies, stock exchanges, cooperative societies, and the like, do facilitate the flow of private savings from individuals into public investment, and perhaps into a few of the larger industrial enterprises. In 1950/51, this transfer to government may have involved about one-fourth of total monetized savings; the transfer to big enterprise about half this amount.¹ Before the Plans, at any rate, no less than 50 per cent, and at times as much as 60 per cent of all investment was made directly by the private saver. With respect to the private sector alone, as much as 75 per cent may have been directly invested.

¹See for example, the rough estimates presented by the Planning Commission, First Five Year Plan, pp. 107-108.

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While the First Plan did not really involve any significant interference with the traditional savings pattern, the Second Plan envisaged a marked break with past performance: thus the planned expansion of the public sector implied that no less than 73 per cent of the anticipated growth in (monetized) savings during 1956-61 were to become available to the public sector (see Table I).¹

TABLE I

Characteristics of Monetized Savings and Investment (Rs. Crores):

	<u>Pre-Plan</u> (1950/51)Actual	<u>First Plan</u>		<u>Second Plan</u>	
		Plan	Actual	Plan	Projection
<u>Net Domestic Investment</u>					
Total:	380	3,550	3,100	6,200	6,000
Public Sector:	190	1,850	1,500	3,800	3,300
Ratio:	(50%)	(52%)	(48.5%)	(61.3%)	(55%)
<u>Net Imports</u>					
Total:	-39 ^a	800	125 ^b	1,100	2,100
Public Sector:	-18.5	700	250	1,000	2,000
<u>Domestic Savings</u>					
Total:	420	2,750	2,975	5,100	3,900
Used in Public Sector: ^c	210	1,150	1,250	2,800	1,300
Ratio:					
Average:	(50%)	(42%)	(42%)	(55%)	(33%)
Marginal:	-----	(17%)	(23%)	(73.5%)	(5.4%)

Note: All data but those projected are from official sources.

a: India was a net investor abroad on both public and private account in 1950/51.

b: On private account there was net investment abroad over the First Plan years. (Both groups of figures exaggerate transactions on private account due to errors and omission.)

c: Note: This is not saved by public sector, it is saved, or borrowed, etc., by government from domestic sources.

I: This observation--as indeed the present paper--is addressed to the distribution of any volume of savings between public and private investment.

Finally, the First Plan tended to retain the same general pattern of allocation within the public sector as prevailed in recent pre-Plan years. The Second Plan called for significant reductions in agriculture and for significant increases (all on a relative basis) in modern industry, mining and power. Thus, it was the Second Plan which was to bring the marked changes in the scale of investment effort, in the methods for financing it, in its allocation between public and private sectors and indeed among major industrial categories.

Performance. According to the Planning Commission, public investment during the First Plan accounted for 48.5 per cent of the total of Rs. 3,100 crores actually achieved. Actually, the scale and investment pattern for this Plan were in line with performance in 1950/51. The public sector had expected to invest some 50 per cent of total investment; it planned to mobilize for its purposes about 40 - 45 per cent of all domestic savings--all consistent with traditional savings flows.

Detailed records for the Second Plan years are not yet available. However, such information as there is suggests the persistence over the first two years of a ratio of public investment closer to 50 per cent, as in preceding periods, than any approximation to the 61 per cent specified in the Plan.

(con'd) We are not specifically concerned here with the more familiar question of the distribution of additional income between savings and consumption--the marginal propensities to save and to consume. In the First Plan, the saving propensity was assumed at 20 per cent; it actually worked out to be significantly higher, perhaps 30 per cent. The Second Plan was less explicit on this point, but it can be calculated that a marginal ratio of about 30 per cent was implicit in the estimates. On the basis of the savings figures of Table I and rough projections of national income, it is conceivable that this ratio be attained. (These calculated propensities are approximate, since only rough adjustments were made for price changes over the period. Also, they apply only to monetized transactions.)

Public investment in two years did not reach 30 per cent of the five year target of Rs. 3,800 crores, while the economy as a whole was investing at about as high a rate as had been anticipated.

Actually, governmental operations did not yield a surplus during those first two years after taking account of the noninvestment outlays called for in the Plan. Loans and small savings fell well below the target levels: only 27 per cent of the five year goals was achieved. Indeed, it was external assistance and deficit financing which provided the resources for 85 per cent of the actual public investment in those two years. The private sector preferred to invest directly rather than through government. Without a much more extensive and aggressive system of taxation and other fiscal and monetary controls, and perhaps a broad extension of pricing and distribution power to government, the Second Plan's expectations for change in savings patterns were simply unrealistic. At any rate, this has been patently evident in the actual record to date.

Second Plan Outlook. Government is now making greater efforts to step up its investment performance--with a consequent slowing down in the private sector (and with a smaller expansion in national product during 1956-61 than might have been, as we will indicate below). It is conceivable that actual investment in the public sector over the Second Plan (without adjustment for the lower domestic purchasing power of the rupee accompanying price increases) can reach Rs. 3,300 crores, corresponding to development outlays of some Rs. 4,200 crores.¹ For the economy as a whole, net investment might well be of the order of Rs. 6,000 crores --a result consistent with some overperformance in the private sector

¹While this projection is "conceivable", a public sector of Rs. 3,200 crores (still an impressive 100 per cent and more above the First Plan level) is more probable.

(12 per cent) accompanying underperformance in the public (15 per cent).

There would then be a 55 per cent ratio for public investment, the financial resources for which were supplied in very important measure from external sources. The net import surplus may well reach Rs. 2,000 crores over the Plan years, when account is taken of the use of some Rs. 600 crores of India's foreign balances. This means that government will have used only Rs. 1,300 crores of domestic monetized savings over the Second Plan years, less than half the level anticipated in the Plan.¹ This projection appears in Table I alongside of comparable data from plans and performance in earlier periods.

Over the years 1956-61, a total of Rs. 3,900 crores of investment in monetized form will have been made as a result of domestic savings. This last, as Table I implies, also assumes that there will occur a net inflow on private investment account of Rs. 100 crores; thus Rs. 2,100 crores out of the total investment will have been financed abroad. Government would then have mobilized and used 33 1/3 per cent of the nation's savings, a significantly lower ratio than prevailed in the First Plan years. In incremental terms, domestic monetized savings will have increased Rs. 925 crores above the 1951-56 total, and of these government was able to attract only Rs. 50 crores in one way or another--a marginal ratio equal to but 5.4 per cent as against the 73.5 per cent implicit in the original Second Plan formulation. Even this performance, it may be added, was influenced favorably by special factors. Thus it is questionable that such large reliance can in the future be placed on short-term borrowing through the Reserve Bank.

Third Plan Alternatives. What now about the scale of public effort in the Third Plan? Let us assume

¹ It is possible to reconcile this estimate of Rs. 1,300 crores with official published data after allowance is made for noninvestment outlays, for depreciation items, etc. In this connection, it is important to recognize that government "borrowing" of Rs. 1,200 crores through deficit financing does not represent an equivalent tapping of domestic savings. Rs. 600 crores of "domestic" expenditure by government made possible the net imports financed by reductions in foreign exchange reserves. At most therefore, only half of the deficit financing can be considered as domestic savings.

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that the total investment target becomes Rs. 9,000 crores--an amount which, given probable performance during 1956-61, may not be much out of line with the Rs. 9,900 crores projected in the Second Plan (p. 11). Forward motion for the public sector might mean raising the planned ratio for the public sector from its 61 per cent in the Second Plan to $66 \frac{2}{3}$ per cent in the Third, we'll say. Suppose now that India and the rest of the world arranged to finance as much as Rs. 3,000 crores of this (net) total from abroad, with some Rs. 300 crores of this amount from private sources. Under this set of assumptions, public authorities would need to attract 55 per cent of total monetized domestic savings, as against 33 per cent calculated above in the Second Plan projection. In marginal terms, 95 per cent of each additional crore of domestic monetized savings would need to go to the public sector!

Let us assume now that rather than the $66 \frac{2}{3}$ per cent ratio, the public sector were to content itself with the 55 per cent figure here projected for the Second Plan period. The public sector would account for Rs. 5,000 crores from the Rs. 9,000 crores total-(Alternative II). Net financing from abroad would still have to be Rs. 2,500 crores to keep the public saving ratio at the 42 per cent level actually achieved in the First Plan. If government only maintains its Second Plan performance in mobilizing domestic savings, net imports from abroad would need to total about Rs. 3,500 crores. In either event, there would still need to be a significant expansion above actual 1956-61 levels in the increment of total monetized savings which the public sector is able to use.

TABLE IISavings-Investment Calculations: The Third Plan 1961-66 (Rs. Crores):

	Alternative I	Alternative II	Pant Projection*
<u>Net Domestic Investment</u>			
Total:	9,000	9,000	10,000
Public Sector:	6,000	5,000	6,700
Ratio:	(66.7%)	(55%)	(66.7%)
<u>Net Imports</u>			
Total:	3,000	2,500	1,250
Public Sector:	2,700	2,250	1,000
<u>Domestic Savings</u>			
Total:	6,000	6,500	8,750
Used in Public Sector:	3,300	2,750	5,700
Ratio:			
Average:	(55%)	(42%)	(65%)
Marginal:	(5.2%)	(55.8%)	(90.8%)

*The Statesman, Delhi, February 5, 1959 gave most of these data in its description of a working paper submitted to India's National Development Council. This paper was prepared by Pitambar Pant, Head of the Planning Commission, *Perspective* Planning Division.

The larger the public sector, the smaller the dependence upon financing from abroad, the greater the need for intensification of governmental efforts to alter past patterns of the flow of domestic savings into investment. In this regard, the third set of figures shown in Table II is interesting, since they are working estimates very recently prepared by an official group in India.¹ Quite apart from the implications these have for the scale of total savings, they mean that government would need to quadruple and more the absolute level of its use of domestic resources as compared with our projection for the Second Plan. Over ninety per cent of this large increment in monetized savings would need to become available to the public sector. This will clearly involve major new ventures in India's economic life.

Indeed, as plans for investment in the public sector during 1961-66 expand beyond Rs. 5,000 Crores, there will need to be a new approach to taxation, especially in the rural sectors, as well as systems of prices and marketings which can step up government surpluses. A country in which government itself intends to make more than 50 per cent of all investment will encounter certain incongruities in retaining in the private sector responsibility for 90 per cent of total output. In any case, this private sector will need to anticipate increasingly more limits upon its freedom of action--and government must determine these and administer them effectively.

¹I have only added the assumption that there would be foreign investment in the private sector also. The figure of Rs. 250 Crores is simply an estimate. No mention of it is made in the account cited. Without such investment, domestic savings would need to be correspondingly higher. The marginal propensity to save would need to average closer to 45 per cent for these years, as against 40 per cent if there were such private investment from abroad. This propensity for alternatives I and II in Table II might be about 25 to 30 per cent, as in the past.

II. Sectoral Allocation of Public Investment

How government allocates the investment resources in the public sector influences not only the contribution this investment will make to future product, but also, interestingly enough, the ability of the public sector to mobilize domestic private savings, and indeed to stimulate domestic private investment. In other words, the problem of allocation of public investment in India is an integral part of our earlier problem of attracting private savings into public investment as well as a key element in creating income flows. Two major considerations are relevant here. First is the degree of interdependence between public and private investment in different sectors. The second concerns the degree of mobility of investible resources in different parts of the economy. Both these permit some elaboration, although in the present state of knowledge of savings-investment behavior in India, even the occasional insights provided by past data are hypotheses more than facts.

Interdependence between public and private investment. Whatever the scale of public investment in India's mixed enterprise economy today, income flows originate predominantly in the private sector. For an expansion in the output flows the relationship among the component parts of public investment --how much in agriculture as against transportation for example--will generally be less relevant than either the public-private balance within each sector or the relationship among components of total investment, public and private. Thus, the erection of large multi-purpose dams will provide more irrigation only if the necessary facilities for carrying the water to the fields already exist or are to be constructed along with the dam. Expanded

transport facilities (public or private) will contribute additional agricultural, mineral, or industrial product only if transport has been a bottleneck, or is anticipated to become one by prospective investors, who are mostly in the private sector in these directly productive fields in India.

In addition to these essentially technical interdependences, the motivational problem is also relevant: What prompts the private entrepreneur to greater investment? It is usual--and generally appropriate--to assume that the creation of external economies will open new vistas to the businessman and induce private, complementary investment. In India today, and without doubt in other more or less comparable countries, this role of public investment can be exaggerated. For the existing social overhead facilities are themselves generally underutilized. Government's most important tasks may thus lie in the creation both of a general atmosphere conducive to future progress and, more immediately, of sufficient purchasing power to expand current demand. The very scale of the public investment effort may thus be important to the private investor. For example, one explanation for the presently depressed position of such basic Indian industries in the private sector as cement and textiles is simply the shortage of both current and perhaps even--at least in the view of the private businessman--in prospective demand.¹ The gradual paring down of India's total investment effort over the Second Plan years and particularly that of government itself, does contribute to reduced drive on the part of the private entrepreneur.

This is a result which is not related to any direct public competition in areas of productive activity; it can arise even when government confines itself essentially to the more traditional overhead sectors. When there is

¹ This also provides some explanation of the current easiness in the supply of private savings. These may be moving into public investment because of some pessimism about economic prospects for the private sector.

important competition with private enterprise--as there must be in many cases (fertilizer and steel in India, for example) --it becomes even more essential that the totality of public operations be large enough to assure adequate levels of over-all demand. In these circumstances however, there may also emerge some ideological biases on the part of private enterprise which can deter productive investment and expansion of output. Altogether, these technical and economic relationships (even apart from the ideological) have a basic bearing upon the "best" allocation of public investment in a mixed enterprise economy. If the goal is a large volume of investment, private as well as public, and a large resultant flow of additional income, government needs to have a deliberate, informed concern about the implications of public investment allocations upon private investment.

Nonmonetization and immobile investment resources. In many economically underdeveloped countries, a very large part of national output simply does not go to market. It is utilized near where it is produced, and frequently by the producer's family. In India in recent years, perhaps 40 to 50 per cent of all rural product was utilized in this way. Inevitably, a large part of the savings which arise in the non-market-oriented sector is itself non-monetized. Thus, National Sample Survey results for 1950/51 indicate that some 25 per cent of gross investment in India was essentially in this category. (These comprehensive statistical results have been corroborated by occasional survey materials for later years.)

Yet, official savings and investment estimates (and hence those in the earlier section of this paper) simply omit this large volume of transactions from explicit consideration.¹ Plan statements also suggest a gradual diminution of these nonmonetized transactions as the economy progresses. However, no attempt has been made to measure this change, nor to devise programs for using these resources while they exist.

¹"...nonmonetized investment has not been included in the calculations of capital inputs...there is considerable investment of this kind...(and) this has deliberately to be fostered." Government of India, Planning Commission, Second Five Year Plan, New Delhi, 1956, p. 11.

This category of savings takes the form of goods produced and initially added to inventories. These may then be used in various ways--for greater-than-anticipated consumption at a later time, for disposition through the regular market and for direct use (generally as payment in kind) for capital creation. What are (or what were at the time of production considered to be) surpluses above needs for consumption may later be applied to expanded consumption, or to investment, either in a mobile or a very immobile form. The important point is that developments--subsequent to some allocation of these "surplus" products to savings--may direct them to a range of alternative uses which are very different from an economic viewpoint. Presumably, the producer's economic outlook, including his reaction to governmental policies and programs, will be of great importance in determining ^{to} just which use these surpluses will be allocated.

The general tendency for savings to be invested where they are generated is thus strongly bulwarked by these varied possibilities which pertain to an important part of rural savings. Year to year variations in the absolute and relative size of the nonmonetized savings component may show increases as well as declines--and these at the expense of consumption or of savings through local banks, small savings schemes, etc., which are part of the monetized flow in the economy. Government must therefore not only be interested in private investment performance; it must also devise methods by which nonmonetized investment can be observed--and indeed, its patterns influenced. It is true that statistics for such savings and investment are not readily at hand. But this applies to most of the private rural investment in a country like India. Government plans do make references to some figures for the monetized component of direct rural savings-investment. This component

is neither analytically nor statistically separable from the nonmonetized flow. There is need for better measurement and for tools which can influence the flow (and perhaps the form) of these investments. For this, government's investment responsibilities will therefore require some kind of direct involvement at local levels--perhaps through community development organizations.

Public control over investment allocation. The varied interrelationships between public and private investment in a mixed economy, and the nature of the savings-investment flows, especially on the part of entrepreneurs in agriculture and the small-scale sectors generally, thus give great power to India's private sector in over-all investment decisions. For the action taken in this sector has fundamental influence both on the size of the flow of real savings to public investment and on the government's ability to determine the pattern of investment in the economy as a whole. Recent experience in India may illustrate how important can be these limitations upon government investment activity.

It will be remembered that total investment during the First Plan was officially projected at some Rs. 3,550 crores. On the average this was almost 85 per cent above comparable actual investment in 1950/51. For the Second Plan, the total of Rs. 6,200 crores was to achieve an average some 75 per cent above that planned for 1951-56. For public investment alone, the expansion was even more pronounced. Table III indicates some allocations of this investment. The data are on a percentage basis, and include estimates for nonmonetized as well as monetized investment.¹

¹ Investment statistics by sectors are not officially available, not even for the public sector. However, there is considerable working material which provides a reasonable basis for the estimates. See for example my East and West in India's Development, National Planning Association, Washington, D. C., April 1959, pp.

TABLE III
Investment in Basic Sectors
 (total for each column = 100)

	Public Sector (Actual)	Total Economy (Actual)	Public Sector (Plan)	Total Economy (Actual)	Public Sector (Plan 1956-61)	Total Economy (Actual 1956-58)
Agriculture, irrigation and community development:	32	32	33	33	21	29
Modern industry (and min- ing):	5	19	6	18	19	25
Transportation and com- munication:	24	14	29	17	35	16

Relationships among these important sectors over the First Plan years show only minor deviations from those of the pre-Plan year. (This provides additional testimony for the earlier observation that this Plan did not place great strains upon the total economy.) Thus, private activity in agriculture maintained the over-all importance which government gave this sector. The predominant role of the private sector in capital formation in modern industry was not impaired--at least on a relative basis--by the small part which the government took directly in this sector. Only in transport and communication, where government has long been the dominant investor, has stepped-up public investment changed significantly the relative importance of this sector in total investment. For the Second Plan, the shifts in investment emphasis

were to be much more marked, as Plan allocations in Table III make clear. However--on the basis of such evidence as the first two years of actual experience provides--the over-all investment pattern bids fair to change much less significantly than the Plan indicated. Indeed, if one examines the rough calculations given in the Plan for the investment level and pattern officially anticipated for the private sector during 1956-61, one would rule out any expectation that an investment pattern like that in Table III could emerge for the total economy in those years.¹ Private investment--its volume and allocation--simply does not correspond with Plan estimates. For better or worse, the anticipated results do not emerge.

The percentages of Table III actually understate the role which the private sector seems to have played in the total investment picture of the past few years. We have noted earlier the important shortfalls in planned public investment arising from the difficulty of harnessing private savings. Study of public and private investment within key sectors--actual as against planned--reveals some shift toward restoring a technical balance between the two. Thus, government finds itself able to invest less, and the private sector more than the Plan anticipates. Both these operate in the direction of retaining technologically necessary relationships,

But it is clear that such "corrective" tendencies cannot be relied upon to solve all problems. The public investment program today, even after the adjustments forced by private action, is not bringing rapid over-all growth. The program in the agricultural sector is not achieving essential targets of output. There

¹The Second Five Year Plan, op. cit., pp. 56-57; it is clear that the volume of private investment anticipated for agriculture and small-scale industry, for example, could not outweigh that in the public sector.

still remain major imbalances between new public and private capital formation. In short, traditional savings and investment patterns may be deeply rooted, but in the soil of an economy which has not been growing. Government in India needs to be aware of the intricacies of private savings and investment behavior--not because government wants to adhere to these patterns, but because it must devise and implement programs for altering them. In a mixed economy the possibility exists for optimum over-all development achievement only if public and private investment activities are treated as two parts of one investment program.

III. The Role of Government, 1961-66.

In a mixed enterprise economy which is expanding, growth for the public sector must be thought of in two dimensions. The first is extensive and focuses on **scale**: the absolute expansion of investment by public authorities and its growth relative to total investment. The second is intensive: the shifts of the allocation of public investment, to such sectors and through the use of such methods, as to assure a maximum income flow as well as maximum total investment over the period of development. Public authorities like to make decisions to increase the scale of investment, and particularly so in a society which wants to place community above individual interest. Intensive steps are intrinsically difficult as well as generally unattractive. They place a great premium upon knowledge about the flows of savings, the behavior of investment, and the factors of production. In contrast to a dramatic increase in the ratio of public investment, there is something anti-climactic in making private investment more effective, and especially for a newly independent nation. It is not surprising therefore, to see more action

in the direction of simple growth in the scale of public activity.

The experience of India however suggests that effective progress in scale soon runs into the same problems as are encountered in intensification. In order to attract significantly more than 40 or 50 per cent of private domestic savings to the public sector *in order to* cut deeply into the tendency for savers to invest directly, programs to mobilize domestic resources for investment by government must be built upon an intimate knowledge of savings and investment behavior in the society. Government needs to extend in many ways its influence upon economic activity as a whole. Apart from a larger role in marketing (and pricing) and a larger area of direct productive activity by the government itself, central authorities will need to concern themselves intimately with operations in the small scale sector, whether or not these are monetized. This clearly involves incurring the costs of intensification; there is every reason therefore, to seek the gains from close cooperation with the private sector. Only then--through an effort in which government participates closely with private enterprise in rural programs, however financed, through providing new vistas for big industry--can the government sector fill the growing demands which an expanding development effort places upon it.