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India's Second Five Year Plan

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INDIA'S SECOND FIVE YEAR PLAN

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India's second five year plan[1/] exemplifies vividly a dilemma which confronts many underdeveloped countries today. The effort required to achieve relatively modest objectives appears to be greater than can be financed from available domestic resources without either generating a serious inflation or resorting to comprehensive direct controls over the economy including rather widespread nationalization of enterprise. At the same time, foreign capital, public and private, is generally not available in amounts sufficient to fill the gap between requirements and domestic resources so as to permit the full implementation of the plan with price stability in a relatively free private enterprise environment.

An underdeveloped country faced with this dilemma has the following alternatives open to it: (1) it may implement the plan and suffer the consequences of inflation; or (2) it may place the economy in a straightjacket of controls, including public ownership of many important enterprises, in an attempt to implement the plan without suffering inflationary price increases; or (3) it may bend every effort to attract additional foreign funds to supplement domestic resources and permit full implementation of the plan with price stability in a relatively free private enterprise environment; or (4) it may adapt the plan to the amount of resources available so as to avoid inflation and preserve a relatively free private enterprise economy; or (5) it may combine the above courses in a variety of ways.

The first course may be self-defeating to the extent that inflation results in less development from the planned outlay. The second course may lead to a growing paralysis of private initiative and, if attempts are made to offset this by making the controls ever more comprehensive and by increasing the extent of public ownership of enterprises, there is a danger that the result may be the eventual abandonment of the democratic process. The third course may fail because the additional foreign funds attracted by such measures as might reasonably be taken for this purpose by the underdeveloped countries are not likely, in most cases, to be sufficient to fill the gap between requirements and domestic resources. Moreover, it may involve abandoning or modifying national policies which prevent large

1/ Government of India Planning Commission, Second Five Year Plan, a Draft Outline, New Delhi, February 1956. A final version differing from this only in minor respects, was presented to the Indian Parliament by Prime Minister Nehru, May 15, 1956. Figures from the final version are used in this paper wherever possible.

amounts to foreign capital from being obtained and this may be unacceptable in countries which have recently achieved their political independence from a former colonial power. The fourth course conflicts with the desires of many of the underdeveloped countries to promote rapid economic development. While it would permit some development to occur, the pressure of rapidly rising population would absorb much of the resulting gain and the net improvement might be slower than required to maintain social and political stability. The fifth course, which is a compromise, involves accepting in some measure many of the undesirable consequences just listed.

As regards India, this dilemma takes on added importance because of the inevitable comparison which is bound to be drawn throughout the world and particularly in India itself with the efforts of its Chinese neighbors to develop their economy along Soviet lines and with Soviet methods. India has adopted the democratic process of government and respects the basic freedoms of the people and their human dignity. However, this position may be jeopardized unless it can make satisfactory headway on its own development efforts, for the people may not tolerate indefinitely a system which they associate with failure to achieve significant progress. The purpose of this paper is to illustrate the dilemma as it applies to India and to evaluate the Indian solution.

Targets of the plan

The plan calls for an outlay of 72 billion rupees during the five years from April 1, 1956, to March 31, 1961, nearly twice the total outlay proposed under the first five year plan which ended March 31, 1956. Public expenditures are expected to amount to 48 billion (or two thirds of the total) compared to only 60 per cent in the first plan, and private investment is expected to account for the balance. Included in the total outlay is an estimated 10 billion rupees of so-called "current expenditures on development",1/ so that the net investment called for is 62 billion rupees.

In the public sector, nearly half of the total outlay is to be allocated to public utilities (transport and communications, power, irrigation and flood control), about 20 per cent each to social services and to industry and mining, and the balance primarily to agriculture and community development. The relative share going to each of the sectors, except industry and mining, is somewhat smaller than for the

1/ The exact meaning of this concept is not entirely clear. It appears to refer to development expenditures which do not increase the value of capital assets. However, these expenditures are included in the second plan only to the extent of the increase over the level they reached at the end of the first plan.

first five year plan, while that of industry and mining is nearly tripled. In the field of public utilities, the relative share of power, irrigation, and flood control is smaller but that of transport and communications is greatly increased. The precise allocation is shown in Appendix, Table 1, together with comparable figures for the first five year plan.

In the private sector, construction is expected to account for about 42 per cent of the proposed investment, factory type industries and mining for about 24 per cent, higher inventories for about 17 per cent, village industries and agriculture for about 13 per cent (not including the probably large non-monetized investment of this sector), and plantations and private utilities for the balance. No comparable breakdown is available for the first five year plan. The precise allocation is shown in Table 1.

The overall magnitude of the planned expenditure appears to have been determined on the basis of two basic objectives which are to be aimed at in the next five years. These are (1) to raise national income by 25 per cent in this period, and (2) to provide enough new opportunities for employment to absorb all of the new additions to the labor force during this period. When viewed in isolation, the first of these two objectives may seem rather ambitious. It exceeds most rates of progress achieved by the developed economies of the West, although falling far short of the rates of progress claimed to have been achieved by Soviet type economies. Yet, when the target is viewed against the background of India's experience in the last five years, it emerges in a somewhat different light. In the five years ending March 31, 1956, India succeeded in raising its national income by about 18 per cent. Nevertheless, unemployment is understood to have increased in this period. This suggests that a more rapid rate of growth than that achieved in this period may be required to prevent any further deterioration of the employment situation. (See Appendix, Table 2).

The provision of enough new employment opportunities to absorb all new additions to the labor force, which this would call for, would seem to be a modest enough target in a country where unemployment and partial employment have long been chronic and pose a threat to the social stability of the country. The attainment of this second objective requires the creation of nearly twice as many new jobs as the Planning Commission estimates were created by the first five year plan, and it does not seem unreasonable to believe that this calls for an increase in national income such as that proposed.

Given these targets, the magnitude of the necessary over-all expenditure depends in part on the productivity of capital. At the start of the first five year plan, it was assumed that the increase in national income resulting from the proposed investment would be about one-third of the net amount invested. As events turned out, however, the increase in national income was about one-half of the net amount invested. While the plan document makes no explicit statement on this subject for the second plan period, it can be calculated from the available information that the expected increase in national income is about 43 per cent of the net amount to be invested. This means that the performance is expected to be somewhat less favorable than during the first plan.

This is reasonable inasmuch as the second plan lays greater emphasis than did the first plan on heavy and basic industries, where the immediate returns in the form of output are bound to be small in relation to the capital invested. Also, the favorable experience of the first plan is explained in part by the fact that the country had good monsoons, and therefore good agricultural production, in the last three years of the plan compared to bad monsoons in the base year, and this is hardly likely to occur in the second plan where the base year is already one of good monsoons. Indeed, it may be that the implicit ratio of 43 per cent is too favorable. However, this merely confirms the judgment that the proposed outlay of 72 billion rupees over the next five years is a modest one in terms of the targets envisaged, since, with a less favorable ratio, a larger investment would be required to bring about the desired 25 per cent increase in national income.

Financing the plan

While the proposed overall expenditure of 72 billion rupees may be relatively modest in terms of the results which it is hoped to achieve, it would seem to be ambitious in comparison with the resources available to finance it.

Foreign resources -- The Planning Commission calculates that implementation of the plan will result in a probable balance of payments deficit on current account over the next five years of about 11 billion rupees. This is about 4 times the current account deficit actually incurred during the last five years and it is doubtful whether the availability of foreign resources to finance it will increase to this extent in the next five years.

It is proposed to utilize India's official foreign exchange reserves to the extent of 2 billion rupees and a net inflow of private foreign capital estimated at 1 billion rupees is anticipated. However, the net inflow of private capital which took place between June 30, 1948, and December 31, 1953, is estimated at about 700 million rupees. This corresponds to a rate of about 635 million rupees over a five year period. If this was the rate of net private capital inflow during the first five year plan, an increase of more than 50 per cent would be required to raise the proposed 1 billion rupees anticipated from this source during the second plan. In view of the increased uncertainties as to the future of private industry in India, discussed in detail below, this would seem to be a rather unlikely development.

In addition, the foreign financial resources available must be large enough to cover not only the expected deficit of the balance of payments on current account but also the repayment of international debts previously incurred and newly created and other legitimate movements of official and bank funds. In the last five years, this consisted largely of repayments to the International Monetary Fund totaling 417 million rupees ($87.5 million).[1] In the next five years, rising repayments of IBRD loans and amortization of the 1951 United States Wheat loan of $190 million (due to begin in 1957) and of special credits currently being extended to India to expand its steel industry will have to be provided for. This may require as much as 400 or 500 million rupees ($85 to $100 million). If it is assumed that the net inflow of private foreign capital during the next five years will be about equal to the repayments of official loans and other legitimate outward movements of official and bank funds, the net contribution which private foreign capital and drawings on India's foreign exchange reserves may be able to make to the financing of the current account deficit is not likely to exceed 2 billion rupees, rather than the 3 billion rupees counted on by the Planning Commission. Assuming that the probable current account deficit during the next five years has been correctly estimated at 11 billion rupees, this would leave a balance of 9 billion rupees which would have to come from external public sources.

No estimate is given of financing which may be available from these sources, presumably in order not to appear to prejudge the decisions of foreign governments and parliaments and of the

1/ A further repayment of $12.5 million, effected April 30, 1956, following the close of the first five year plan, completes the repayment of India's drawings of $100 million from the Fund in 1948 and 1949.

International Bank for Reconstruction and Development or the International Finance Corporation concerning possible future assistance to India. However, about 2 billion rupees appears to be already assured, representing the undisbursed portion of International Bank loans already granted to India, the unexpended balance of earlier appropriations of aid from the United States, from Norway and from Canada, Australia, and other countries participating in the Colombo Plan, and the special credits made available by Great Britain, Germany, and the USSR to finance the construction of three new steel plants during the next few years (see Appendix, Table 3). If it is assumed that further aid appropriations by the United States and the Colombo Plan countries will continue to be made during the next five years and that additional International Bank loans may be negotiated, and if expenditures from these new funds reach the same amount as was spent from these sources in the last five years, this would add only about 1 billion rupees. While it is conceivable that arrangements may be made for the disposal in India of substantial quantities of surplus agricultural commodities from the United States and that additional resources may be raised through the International Finance Corporation and through export credits granted by foreign countries, it seems very unlikely that this would be enough to fill the remaining gap of 6 billion rupees ($1.26 billion).

Domestic savings -- Even if the foreign resources are available to the extent required (11 billion rupees), the bulk of the proposed 72 billion rupee outlay (61 billion rupees) will have to be financed from domestic resources. Deducting the estimated 10 billion rupees of so-called "current expenditures on development",[1] this would require net savings totaling 51 billion rupees over the five year period, an average of 10.2 billion rupees a year. Such a rate compares with net savings estimated at 6.5 billion rupees in 1955-56. Savings have been rising at a rate averaging about 7.2 per cent per year in the last five years and were about 41 per cent larger in 1955-56 than in 1950-51. The additional savings in this period amounted to about 11 per cent of the increase in national income. To reach the target, it would seem that savings would have to rise by an average of about 16 per cent per year in the next five years and to be about 115 per cent larger in 1960-61 than in 1955-56. The additional savings would have to represent about 28 per cent of the increase in national income. This would appear to imply that the annual additions to savings were rising at a rate averaging about 32 per cent a year. Although available information does not permit calculation of the rate of change of the rate of growth of savings in the last five years, it seems unlikely that such a rate has been or can be approached. Moreover, the ability to achieve the desired

1/ See above, p. 2.

increase in savings depends in large part on whether national income rises to the extent anticipated. If it does not, perhaps because the capital invested produces a lower output than has been assumed, the amount saved will be smaller, it will be more difficult to make the planned outlay, the resulting increase in national income will be smaller still, and the ability to increase savings will be further impaired. If savings continue to rise at the first-plan rate of about 7.2 per cent per year during the next five years, total net savings over the period will fall short of the target by about 10.5 billion rupees.

The inadequacy of domestic resources to finance the proposed overall outlay may be judged also from the separate points of view of the public and the private sectors of the plan. In the private sector, where an investment of 24 billion rupees is planned and an estimated 3 billion rupees in foreign resources will be required, 21 billion rupees will have to be raised from domestic sources. As much as 4 billion of this is expected to come from an expansion of bank credit over and above the probable rise in commercial bank time deposits. The Planning Commission does not estimate the extent to which commercial bank time deposits are expected to rise. On the basis of past experience, however, the guess may be made that this rise will amount to somewhere between 3 and 4 billion rupees. To this must be added the funds which will become available through investment and reinvestment of earnings and through the flotation of securities in the capital market. Only sketchy information is available on these sources of financing and the Planning Commission makes no estimate of their probable contribution during the second plan. The sketchy information available, however, suggests that this contribution is not likely to reach the target of 13-14 billion which would have to be attained in order to eliminate any deficiency in resources.

In the public sector, where an investment of 48 billion rupees is planned and an estimated 8 billion rupees in foreign resources will be required, 40 billion will have to be raised from domestic sources. Government revenues in excess of non-plan expenditures, borrowings from the public, and "deficit financing" (mainly borrowing from the Reserve Bank) are each counted on to yield 12 billion rupees. The balance of 4 billion rupees is to be financed by "additional measures to raise domestic resources". While the February draft of the plan spoke of this as the "uncovered gap" for which no source of financing was in sight, the final version of the plan, submitted to the Indian Parliament on May 15, 1956, proposes to raise this amount from profits of State owned enterprises.

There is some question whether the amounts to be raised from domestic sources for the public sector will be as large as expected. The yield of taxation has been calculated on the assumption that the proportion of national income going to taxes can be raised slightly above the present level of about 7 per cent. But the mere continuation of this level will require substantial readjustments in taxes inasmuch as the present system of taxation depends heavily on excise taxes and customs, the yield of which is not directly related to fluctuations in national income, and only to a small extent on taxes directly related to income. These readjustments do not appear to be beyond the scope of possibilities, but their very nature suggests that it may be difficult to do much more than to maintain the proportion of national income going to taxes at the present level.

The amount which it is hoped to borrow from the public (12 billion rupees) is large when compared to borrowings of recent years (see Appendix, Table 4). This is particularly true (on the Planning Commission's own admission) with respect to the amounts which are to be borrowed through the Post Office Savings Bank and through sales of small denomination Treasury obligations. The sum of 5 billion rupees expected from this source is about twice the amount obtained in the last five years. The annual yield rose from 330 million in 1950-51 to an estimated 650 million in 1955-56, and it would have nearly to double a second time in the next five years if the target is to be met. The amount (7 billion rupees) to be raised through the flotation of bonds is more than two and a half times the amount raised in this manner in the past five years. It is true that there has been a vast improvement in the response of the market to government flotations in the last two years. But to reach the expected total, the annual yield from this source would have to exceed the average yield of the last two years by about 16 per cent. As the Planning Commission points out, new government bond issues will have to compete with a rising demand for funds for investment in the private sector and, in addition, maturing bond issues of about 4.3 billion will have to be refinanced in the next five years. In the final analysis, whether the net yield of borrowings from the public will in fact reach 12 billion rupees will depend on how closely the growth of savings approaches the requirement set for it.

The proposal to raise 4 billion rupees from profits of State enterprises implies that a large scale program to set up State enterprises will be launched either through the creation of new enterprises or through nationalization of existing firms, and that these enterprises will in fact be run for profit. It is not possible to judge whether this proposal can be carried out with the desired financial result. However, it must be remembered that new enterprises generally do not yield profits during their formative period, that nationalization of existing firms is costly, and that public enterprises often are operated at less than maximum profits, whether because their efficiency is less than that of privately operated firms, or because they serve social or political objectives not consistent with profit maximization. These circumstances may combine to make it difficult to raise 4 billion rupees from profits of State enterprises in the next five years.

Even if ordinary budget revenues, borrowings from the public, and profits from State enterprises yield the amounts anticipated, it would still be necessary to borrow heavily from the Reserve Bank. The Planning Commission places a figure of 12 billion rupees on this source of financing and states that this is the maximum amount of borrowing from the Reserve Bank that can be safely undertaken. Borrowing from the Reserve Bank on such a scale, however, is expected to be accompanied by an expansion of bank credit to the private sector estimated at 4 billion rupees over and above the probable increase in commercial bank time deposits and it is planned to utilize the country's foreign exchange reserves to the extent of 2 billion rupees. On these assumptions, money supply would rise by 14 billion rupees, an increase of 14 per cent per year over the five year period. This is twice the average rate of increase per year during the last three years. Some expansion in money supply is no doubt necessary in view of the prospective increase in output, the anticipated expansion of the money sector of the economy, and the continuing propensity of the people to hoard currency. However, a rise in money supply on the scale contemplated would seem to have a serious inflationary potential.

If inflation should develop, the deficiency in resources may be greater still. The excess of government revenues over non-plan expenditures may be less than is now anticipated as the cost of the ordinary activities of Government rises. It may be more difficult for the Government and for private enterprises to borrow from the public as funds, which might otherwise be available for investment through the capital market, through postal savings, and through increases in time deposits in banks may flow to such unproductive uses as hoarding of precious metals and jewelry, inventory accumulation, or real estate speculation. The balance of payments deficit on current account may be larger than is now anticipated as exports are retarded and imports are stimulated by rising domestic demand. Finally, if the cost of development projects rises, the financing of all of the projects included in the plan may require a larger total outlay than is now proposed.

The role of tax policy and direct controls

The prospect that available resources may be insufficient to finance the proposed overall outlay of 72 billion rupees has led the Planning Commission to propose the adoption of measures intended to contribute to the fulfillment of the plan by increasing the flow of funds available for investment and channeling these funds as far as possible towards undertakings included in the plan. The Commission recognizes that monetary and credit policy can contribute to the achievement of this objective through such actions as the reorganization and promotion of rural credit at reasonable rates of interest and the improvement of the facilities through which private industry may raise the long term investment capital it will require. It recommends also increased excise taxes on essentials as well as on non-essentials and steeper income taxes to restrain consumption and divert purchasing power towards the public sector. However, it argues that the insufficiency of financial resources in relation to the proposed outlay is too large to be made good entirely by raising taxes and that the decision to depend heavily on monetary and credit expansion in implementing the plan makes it impossible to resort to traditional instruments of monetary policy to prevent inflationary price increases and secure the desired allocation of resources. In consequence, it places primary emphasis on the use of direct controls over the economy.

Price and distribution controls are envisaged to prevent inflationary price increases, in the hope of promoting the people's incentive to save and maximizing the real level of investment obtainable from a given money outlay. Rationing is implicitly suggested as a means of restraining consumption thereby releasing additional financial resources to finance essential investment. The use of import controls is explicitly anticipated to prevent any increase in imports of consumer goods and consequently ensure the maximum availability of foreign exchange for the purchase of capital goods abroad. Licensing of private businesses, allocation of foreign exchange, controls over new security flotations, fixation of profit margins, and allocation of scarce raw materials are envisaged in conjunction with fiscal and price incentives to orient the investment activities of the private sector in a direction consistent with the objectives of the plan, restrain non-essential investment, and thereby "improve upon the results that can be achieved under unregulated and uncoordinated play of private incentives and decisions."

Enlargement of the State's field of activity through nationalization and public participation in the management of enterprises is recommended (1) in fields "which are major determinants of the rate of growth of the economy", including exploitation of minerals and basic and capital goods industries, and (2) in fields where "the use of modern technology requires large scale production." In fields falling in the second category, it is thought that private enterprise would not undertake the desired investment without assistance from the Government, perhaps because of inadequate profit expectations considering the present size and potential rate of growth of the market, or, if it did, that the size of the market would tolerate only one or at best only a few producing units in the industry and that the consequences of such a monopolistic or oligopolistic situation would be socially unacceptable.

The proposed extension of State activity in the economic field and the comprehensive regulation of private enterprise in such fields as may be left to it are based on the acceptance of the view that "the basic criterion for determining the lines of advance is not private profit but social gain." The Planning Commission describes the implementation of this view as the achievement of a socialistic pattern of society. According to the Commission, this implies that "major decisions regarding production, distribution, consumption and investment -- and in fact the entire pattern of socio-economic relationships -- must be made by agencies informed by social purpose."

In such a pattern, so it would appear, private enterprise is to be encouraged to play a role within the framework of the plan. Many fields remain outside the area marked for State intervention and will continue to be developed exclusively by private initiative. In some of the fields where the activities of the State are to be extended, the State may confine itself to undertaking new developments, allowing existing enterprises to continue to operate provided they "fall in line with the emerging pattern." In general, where private enterprise is to be tolerated, the Planning Commission recommends that it be given "fullest scope" to act so long as its plans based on the profit motive are consistent with the social objectives set by the community in the overall plan for economic development.

Three such objectives are relevant here, as they very largely shape the nature and direction of the controls to be exercised. One is that the basis must be laid for rapid development in subsequent five year periods, so that a start may eventually be made toward reducing the backlog of unemployment and under-employment. Accordingly, particular emphasis is being given in this plan to the development of heavy and basic industries. The second relevant objective, one already mentioned, is that enough new employment opportunities must be created to prevent any further deterioration of the employment situation. Since the heavy industries to be given primary emphasis are essentially labor saving industries, the Planning Commission decided that, in the field of consumer goods, a special effort should be made to foster activities which would be relatively labor intensive, even if this meant a sacrifice in immediate output. This is the reason why during the second plan period, special incentives are to be offered to handicrafts and village or home industries and special obstacles are to be erected against the premature development or expansion of factories which might produce competing goods more economically but which it is thought would create a smaller number of new jobs. The measures involved may include subsidies on production of small scale and home or village industries and rebates on their sales, the reservation of certain "spheres" of production for them, and the imposition of a ceiling on the capacity of competing factories and of special excise taxes on factory produced commodities. These measures, which are described by the Planning Commission as part of a policy to set up a "common production program" for large and small scale producing units, are intended to be withdrawn when the small scale and village or home industries, having been reorganized and revitalized, are able to stand on their own feet in competition with large scale producing units.

The third relevant objective is that inequalities in income and wealth must be reduced and a more even distribution of economic power must be achieved. This explains partly why monopolistic or oligopolistic situations are unacceptable. It explains also why the Planning Commission recommends that the income tax structure be readjusted by stages so as gradually to establish a ceiling on income after taxes equal to 30 times the prevailing average per family income.1/ In this connection, the Commission mentions the possibility of imposing a small annual tax on total wealth, but it makes no recommendation on this point pending further consideration.

Pitfalls of the Planning Commission's proposals

The nature of the measures proposed by the Planning Commission to increase the extent to which the plan may be fulfilled raises serious questions from an administrative and from an economic point of view. Administratively, the controls suggested seem so far reaching that it may be asked whether the machinery needed to put them into effect can be made to run smoothly. The large number of trained bureaucrats and enforcement personnel which would appear to be called for may not be available.

The economic difficulties may be even more severe. The administrative burden which direct controls on consumption and particularly on the investment plans of private enterprise inevitably place on the economy may stifle incentives to invest in the private sector, give rise to speculative activity and distort the behavior pattern of the people in other undesirable respects. If black markets should emerge on a significant scale, serious problems of enforcement would result and the implementation of the plan would be impaired. The fixation of profit margins and the manipulation of price incentives

1/ In a speech before the Indian Parliament, May 18, 1956, Prime Minister Nehru opposed this proposal on the ground that, "although income ceilings are desirable in theory", it would be unwise to adopt them now since they would interfere with the machinery of production at a time when rapid increases in production are the country's chief need (cf. New York Times, May 19, 1956, p. 2).

would seem to be a particularly dangerous weapon because of the ease with which errors may be made, leading to undesirable investment decisions. These must later be reversed, but the time and resources involved are irretrievably lost.

The establishment of a ceiling on incomes and, even more so, of an annual tax on total wealth, may have adverse effects on the implementation of the plan. It would seem that the incentive to invest in the private sector would be adversely affected. Savings of the upper income groups may also be reduced and, if these represent a substantial portion of total savings, the result may be to hamper seriously the financing of the private sector. The danger is that these unfavorable results may more than offset any gain to the plan accruing from the transfer of financial resources to the public sector and from the reduced consumption which these tax proposals may bring about. The proposal to enlarge the field of the State's activities may also act as a deterrent to investment in the private sector, first because of uncertainty as to where the line is to be drawn between the public and the private sectors, and second because the possibility will always remain that the line, once it has been drawn, may sooner or later be pushed further into areas which, at the beginning, are reserved to the private sector.

The decision to give special incentives to handicrafts and village or home industries and to place obstacles in the way of the premature development and expansion of factories which might produce competing goods appears to be open to criticism on three counts. First, the hope that the small scale and village or home industries may eventually be able to stand on their own feet in competition with large scale producing units would seem unlikely to be realized. While it may be true that handicrafts and village or home industries can become more efficient than they now are through technical and financial assistance and increased reliance on cooperative purchasing and marketing, the factory establishments are likely to increase their efficiency at the same time as a result of the development of basic facilities (e.g. power and transport) and skills and the expansion of production of the machinery, chemical, electrical, and other supplying industries. For the small scale and village or home industries, this may be like "pursuing your own shadow". The measures designed to give "infant industry" protection to those forms of activity may have to be retained indefinitely. It is true that this "protection" may make it possible to maximize the amount of capital available to carry out the desired expansion of basic and heavy industries and that, because of a relative shortage of capital, this expansion might be retarded if the development and expansion of factories in the consumer goods field were allowed to proceed unhindered. However, to the extent that protection of small scale and home or village industries interferes with the eventual building up of secondary industries geared to absorb the output of the primary and basic industries being promoted under the second plan, the danger arises that the latter may prove uneconomic for lack of an adequate domestic market.

Second, the fear that the establishment and expansion of factories in the consumer goods field would create a smaller number of jobs than would result from the promotion of small scale and home or village industries does not appear entirely justified. If the amount of capital needed to establish and operate factories in the consumer goods field can be found without burdening these factories with unusually heavy costs, factory production may be sufficiently cheaper than home production to induce a large increase in volume of output. This in turn might involve the creation of enough new jobs to absorb many and perhaps all of the workers formerly employed in home workshops in the particular field of activity. In addition, the operation of factories would require the establishment of service industries, i.e., industries geared to sustain the economic activities of the factories and of the workers employed in factories. Such industries are not needed in an economy of village and home industries. Yet they appear capable of providing employment opportunities which may more than offset the possible direct loss in employment associated with the shift from home to factory production. A net gain in the number of jobs would appear to be indicated except in fields where the capital required to establish and operate factories could not be acquired at a sufficiently low cost to permit the reduction in the selling price necessary to induce the expansion of output which would call for the desired increase in employment.

Third, since production in home and village industries is usually less productive than factory production, the total volume of consumer goods available may not rise as fast as if factory production of such goods were encouraged. It is true that home and village industries represent a way of life which many Indians treasure for its own sake and that very severe social and political problems might result from a too rapid introduction of factory production in its place. However, it may be asked whether the need to avoid haphazard and uncontrolled application of modern technology in consumer goods industries and to promote conditions under which an orderly transition can be effected justifies the sacrifice of a significant output of consumer goods. The decision to stimulate the use of productive methods yielding less than the maximum output attainable with more efficient methods merely increases the inflationary potential already present in the plan through its financial aspects.

Finally, the proposals as a whole do not appear likely to improve the Indian investment climate for private foreign capital, to put it mildly. The prospect of expanded nationalization and of increasingly comprehensive direct controls may well be enough to reduce the net inflow of private foreign capital significantly below the levels counted on in the plan calculations.

Most of these difficulties are to some extent recognized by the Planning Commission which, however, considers the potential benefits from the use of controls, the enlargement of the State's activities, the tax proposals and the promotion of home and village industries, to be greater than the harm which may be done in the process. It is reported that Indian businessmen view the outlook for private enterprise in India with a measure of optimism, partly, it seems, in the belief that the proposed controls will be used sparingly and judiciously and that nationalization will be undertaken, not for its own sake, but for specific reasons in special cases. If such beliefs are widespread, the adverse effects of the proposals on incentives in the private sector may be lessened.

Conclusion

The above analysis brings out the difficulties faced by India in its attempts to promote the development of its economy. The relatively modest targets, particularly the employment target, appear to require an overall investment estimated at 72 billion rupees over the next five years, but available resources may fall short of this by perhaps as much as 16.5 billion rupees over this period.1/ The comprehensive controls intended to contribute to the fulfillment of the plan may in part be self-defeating. In addition, there is the everpresent danger that these controls may eventually lead to the abandonment of the democratic process which India has embraced as attempts are made to offset the growing paralysis of private initiative which may result from their use.

Pertinent though these criticisms may be, the final test of their validity must remain whether a more satisfactory alternative presents itself. A possible alternative would be for India to undertake to promote conditions under which the gap between the proposed total outlay and the estimated domestic resources available could be filled by an inflow of foreign capital. Specifically, attempts might be made to attract private foreign capital to India through deliberate measures designed to improve the climate for private investment there.

1/ The deficiency in foreign resources may be as large as 6 billion rupees (see p. 6) and that in domestic savings may be as large as 10.5 billion rupees (see p. 7). These are rather rough guesses and their total probably represents an outside limit of the overall deficiency.

This might involve softening the program for comprehensive direct controls and expanded nationalization, providing tax incentives for private investment, and eliminating certain provisions of existing business and social legislation which presently act as deterrents to the investment of foreign private capital in India. While it might be difficult to carry this program forward very far without encountering increasing political difficulties, enough of an impact might be made to attract a significantly larger amount of private foreign capital than now appears likely. Some increase in borrowings from the IBRD, and perhaps in assistance from foreign governments as well, might also be possible under these conditions. Quite aside from the climate for private investment, there may be some hope for increased U. S. assistance to India, especially if a satisfactory basis can be found for arranging the disposal in India of substantial quantities of U. S. surplus agricultural commodities. However, it seems unlikely that the additional amounts which might be forthcoming from all these sources under the most favorable conditions would add up to as much as the required 16.5 billion rupees ($3.5 billion) over the next five years.

Another alternative to the solution proposed by the Indian Planning Commission would be to reduce the proposed total outlay to the level of the estimated resources available, both foreign and domestic, or to stretch the proposed outlay over a longer period of time. However, this involves the danger that the resulting slower pace of development might prove socially and politically unacceptable to the people of India, especially when compared with the progress being made by neighboring Communist China. While this course of action has been mentioned as a possibility in recent public speeches of some Indian officials, there has also been some discussion of the need to expand the proposed outlay to cover the development of the defense establishment, including atomic energy, and increased requirements in connection with the expansion of coal production, petroleum exploration and the subsidization of the spinning wheel method of textile production.

In the end, India may be able to blend the Planning Commission's proposals with the two alternatives just discussed. There is some evidence that the Indian Government realizes the pitfalls of the solution proposed by the Planning Commission and that it will attempt to divert the people's attention away from a comparison with Chinese accomplishments and toward the concrete results of the Indian Plan. If foreign assistance can be increased under a mutually satisfactory program for the disposal in India of

U. S. surplus agricultural commodities and if the Indian Government succeeds in creating a climate of public opinion under which less than 100 per cent implementation of the plan's targets can be tolerated, it may be possible to make only moderate and sparing use of the Planning Commission's proposals for comprehensive direct controls and expanded nationalization and yet largely avoid inflationary price increases.

Appendix
TABLE 1
Indian Five Year Plans
Allocation of Outlay

	First Plan, 1951-56			Second Plan, 1956-61		
	Amount (In million rupees)	Per cent of subtotal	Per cent of over-all total	Amount (In million rupees)	Per cent of subtotal	Per cent of over-all total
Public Sector						
Power, irrigation, and flood control	6,610	28.1	17.1	9,130	19.0	12.7
Transport and communications	5,560	23.6	14.4	13,850	28.9	19.2
Total public utilities	12,170	51.7	31.5	22,980	47.9	31.9
Industries and minerals	1,790	7.6	4.6	8,900	18.5	12.4
Social services, housing, and rehabilitation	5,470	23.2	14.2	9,450	19.7	13.1
Agriculture and community development	3,720	15.8	9.7	5,680	11.8	7.9
Miscellaneous	410	1.7	1.1	990	2.1	1.4
Subtotal	23,560	100.0	61.1	48,000	100.0	66.7
Private Sector						
Organized industries and mining	n.a.	n.a.	n.a.	5,750	24.0	8.0
Plantations and private utilities	n.a.	n.a.	n.a.	1,250	5.2	1.7
Village and small industries and agriculture	n.a.	n.a.	n.a.	3,000	12.5	4.2
Construction	n.a.	n.a.	n.a.	10,000	41.7	13.9
Inventories	n.a.	n.a.	n.a.	4,000	16.6	5.5
Subtotal	15,000	100.0	38.9	24,000	100.0	33.3
Overall Total	38,560	----	100.0	72,000	----	100.0

Sources: Government of India Planning Commission, Second Five Year Plan, a Draft Outline, February 1956, pp. 22 and 24; Press Trust of India, Newsreport, May 15, 1956.

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Appendix

TABLE 2

Indian Five Year Plans

Employment, National Income, Savings, Investment, and Consumption

(Value figures at constant 1952-53 prices)

	Population	Employment	Potential labor force	National income	Net savings	Net investment	Consumption	Per Capita National income	Per Capita Consumption
	In millions			In billion rupees				In rupees	
1950-51	357	143	n.a.	91.1	4.6	5.6	85.5	255	239
1955-56	380	148	n.a.	108.0	6.5	7.7	100.3	284	264
1960-61	408	158	n.a.	134.8	14.0	16.0	118.8	330	291
Increase during first plan	+23	+5	+8	+16.9	+1.9	+2.1	+14.8	+29	+25
Increase during second plan	+28	+10	+10	+26.8	+7.5	+8.3	+18.5	+46	+27
Percentage increases:									
First plan	+6.4	+3.5	n.a.	+18.5	+41.3	+37.5	+17.3	+11.4	+10.5
Second plan	+7.4	+6.7	n.a.	+24.8	+115.4	+107.8	+18.4	+16.2	+10.2

Sources: Government of India Planning Commission, Second Five Year Plan, a Draft Outline, February 1956; Second Five Year Plan, The Framework, July 1955; and other official documents (several figures derived).

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Appendix

TABLE 3

Indian Five Year Plans

Foreign Financial Resources Involved
(In million rupees)

	Amounts utilized during first five-year plan	Amounts already assured for second five-year plan 1/	Indian estimates of further amounts available for second five-year plan
Drawings on IBRD loans	137.4	256.6	--------
U. S. wheat loan (1951)	903.1	----	--------
Other U. S. aid	775.4	642.9	--------
Colombo plan aid	254.1	223.7	--------
Norwegian aid	1.5	5.2	--------
German credit for steel industry	----	95.0	--------
British credit for steel industry	----	353.3	--------
Soviet credit for steel industry	----	434.0	--------
Total from external public sources	2,071.5	2,010.7	--------
Drawings on Indian foreign exchange reserves	1,500.0	----	2,000.0
Estimated net inflow of private foreign capital	635.0	----	1,000.0
Total	4,206.5	5,010.7	

Sources: International Bank for Reconstruction and Development, Statement of Loans, March 31, 1956; Government of India Ministry of Finance, External Assistance during the First Five Year Plan, March 1956.

1/ Undisbursed balance as of March 31, 1956, of earlier aid appropriations and of loans already granted or promised.

Appendix
TABLE 4
Indian Five Year Plans
Borrowings from the Public
(In million rupees)

	Fiscal year ending March 31, 1952	Fiscal year ending March 31, 1953	Fiscal year ending March 31, 1954	Fiscal year ending March 31, 1955	Fiscal year ending March 31, 1956	Total first five-year plan	Targets for second five year plan
Central government bonds							
Gross flotations	503.7	.7	753.0	1,586.5	1,041.8	3,885.7	n.a.
Maturing loans	845.9	9.7	1,125.1	461.5	699.0	3,141.2	3,928.7
Net flotations	-342.2	-9.0	-372.1	+1,125.0	+342.8	+744.5	n.a.
Cash balance investment account							
Add net sales	----	----	+462.1	+31.4	+137.0)	+252.1	n.a.
Deduct net purchases	-222.3	-156.0	----	----	----)		
Total central government	-564.5	-165.0	+90.0	+1,156.4	+479.8	+996.6	n.a.
State government bonds							
Gross flotations	107.5	168.0	385.0	25.0	490.5	1,176.0	n.a.
Maturing loans	.6	41.4	35.2	----	63.9	141.1	410.0
Net flotations	+106.9	+126.6	+349.8	+25.0	+426.6	+1,134.9	n.a.
Cash balance investment accounts							
Add net sales	+286.0	+254.0	----	----	+339.0)	+616.0	n.a.
Deduct net purchases	----	----	-209.0	-54.0	----)		
Total state governments	+392.9	+380.6	+140.8	-29.0	+765.6	+1,750.9	n.a.
Government bonds (per above)	-171.6	+215.6	+230.8	+1,127.4	+1,245.4	+2,747.5	+7,000.0
Small savings (net) 1/	+384.7	+401.5	+378.1	+546.1	+648.0	+2,358.4	+5,000.0
Total	+213.1	+617.1	+608.9	+1,673.5	+1,893.4	+5,105.9	+12,000.0

Sources: Government of India Ministry of Finance, Explanatory Memorandum on the Budget of The Central Government for 1956-57, pp. 255-257; Reserve Bank of India, Annual Report on Currency and Finance for 1954-55, p. 193; Reserve Bank of India Bulletin, May 1955, pp. 453-78.

1/ Borrowings through Post Office Savings Bank and small denomination Treasury obligations.

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