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DEVELOPMENT STRATEGY INITIATED DURING THE II[nd] FIVE YEAR PLAN : A CRITICAL REVIEW

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DEVELOPMENT STRATEGY INITIATED DURING THE SECOND FIVE YEAR PLAN: A Critical view

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1. INTRODUCTION

The last few years, especially after the initiation of economic reforms in India, have seen a lot of soul searching with respect to the development strategy that had been followed in this country over the last three and half decades. To be fair there have been misgivings in certain quarters regarding the path that India has charted out since 1991-92, as well. These misgivings and apprehensions have been shared across the ideological spectrum: the left views the importance being given to markets as an abdication of its responsibilities by the State; the right, on the other, believes that markets still continue to be shackled and the State has still not relinquished enough of its controls for the market to really deliver benefits. Alongside this introspection with respect to Indian planning there have been comparisons with the success stories in East Asia. It is well known that roost of the East Asian "Tigers" began their process of development around the same time that India did, but choosing a different strategy of growth, have forged far ahead of India. This sense of being left behind has, been coupled with anguish that had India chosen differently, it would have been among the ranks of the "Tigers". This anguish is not overcome by rationalisations such as "even though life can best be understood backwards, it has to be lived forward" i.e. in retrospect the decision taken earlier may seem inappropriate though at the time it was taken, it may have been reasonable . Consequently, there has raged a controversial debate regarding the conscious choice of India's development strategy in the mid-1950s. The plan of the paper is as follows: Section 2 deals with what I have called Mahalanobis' world view, a discussion of which, I believe, to be important for appreciating the development strategy of the Second Plan. Section 3 is concerned with examining different aspects of the Mahalanobis model such as heavy industrialisation, import-substitution, employment, etc. Section 4 briefly discusses a specific role of the State, namely; the one related to equity in society; the neglected contribution of markets in attempting to introduce social justice is pointed out. Section 5 concludes.

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2- MAHALANOBIS WORLD-VIEW

In appreciating the contribution of Mahalanobis to the Indian planning process, I believe, it is quite important to have a good idea about his view of the world situation in the late 1950s and India's position in it. This will then enable roe to compare Mahalanobis world-view with the situation as it prevailed then and point out any contradictions that might exist between the two, The importance of this comparison cannot be emphasised more since Mahalanobis' planning strategy was a direct outcome of his world-view. Should the world situation prevailing then be seen to be different from Mahalanobis' world view, then the whole planning strategy initiated in the Second Plan could be called into question. The Second Plan, in many ways, charted out the path that the Indian economy was to follow for the next three and half decades, albeit with substantial dilution of the Nehru-Mahalanobis vision, but, nonetheless, with the same emphasis *on* tine public sector and shackles on the private sector.

2-1 **Export Pessimism**

One of the basic premises of the Mahalanobis model was that India would not be able to make a breakthrough in export market development in view of the traditional character of Indian exports and their price inelasticities (Sengupta, 1996). Thus the model neither considered any analysis of comparative advantage among individual lines of production nor examined the possibility of any gains from trade. Mahalanobis sought to demonstrate with his model how India could confidently optimise allocation of investment and long run growth for a given technology scenario irrespective of developments in the rest of the world. Thus the Mahalanobis model was permeated, according to Parikh (1996) with "export pessimism that was widespread in post-World War II years". As a matter of fact this statement of Parikh is not quite accurate in that export pessimism was not explicitly stated in the Second Five Year Plan. The following quote of Bhagwati and Srinivasan (1971, p.12) is quite illuminating:

> "It is interesting that the Second Plan did not explicitly state the rationale of the shift to heavy industries in terms of foreign trade constraints, so that the later justification of this strategy by alluding to 'stagnant world demand' for exports comes close to an ex post facto rationalization"

Further, it is pointed out that the discussion in the Second Plan document about India's export earnings is so cursory that it seems implausible that the assumption of export-pessimism was seriously made. This statement may be supplemented by pointing out that export volumes in dollar terms rose almost continually over the First Plan period (see Bhagwati and Desai, 1970), Table 18.2, p.371) and that the balance of payments position over this Plan was comfortable (Bhagwati and Desai, 1970, p.369). Thus, Indian evidence around that time period does not sees support the

View that export pessimism, was widespread.

It is, possibly, not fair to single out Mahalanobis for this world view since this view was widely prevalent in India. The objective of self-reliance was a major theme in the reports of the National Planning Committee set up under the Chairmanship of Nehru in 1938 (Bose, 1996). It was felt that the industrial world of the late 1940s and 1950s was dominated by economies of scale, the world market was deeply segmented and nations were separated by protectionism (Guha, 1996). Given this international milieu what role could a densely populated poor economy like India play? Import substituting industrialisation within an autarkic economy thus became the model that came to be adopted in the Second Plan.

How realistic is this view of the world? How important was it to plan development in an autarkic framework? Was this view of the world shared by other countries who were starting off on the path of development in the 1950s? I try to answer these questions below.

2.2 **Experiences in East Asia**

The world was changing quite rapidly during the 1950s. By 1953 the Korean war had already ended; steps towards the formation of OECD were already being taken which was subsequently established in 1961; the precursor to the OECD, the Oranisation for European Economic Cooperation <OEEC) had been in existence since 1948; multinational corporations were beginning to operate and invest in Third World countries by the middle of this century (Sengupta, 1996); volume of world trade was already beginning to pick up during the 1950s; importantly the increase in the real wage rates in developed countries meant that the international division of labour was working to the advantage of developing countries. Significantly, Asian countries such as South Korea and Taiwan were ready to take advantage of the changing world situation wherein export pessimism of the immediate post World War-II years was starting to wane. At about this same time when the world was opening up and Asian countries were about to launch their export led growth, India was in the process of pulling down shutters. The world view that prevailed in India was not so much wrong as it was completely misunderstood.

The Korean experience with import substituting industrialisation (ISI) from 1954 to 1960 was a product of the peculiar historical circumstances of that country. After the colonial period ended in 1945, Korea was divided into North Korea (supported by the Soviet Union) and South Korea (backed by the U.S.A.). During the transition, in 1950, from the American Military Government to the Syngman Rhee government, the Korean war broke out and lasted till 1953. After the war ended there were significant doubts about the very survival of South Korea as a nation-state. The objectives of the Rhee government were solely short term: reconstruction of the nation and maintenance of minimum standards of consumption. Import substitution was introduced by the Rhee regime purely in the interest of maintaining minimum consumption and using scarce foreign exchange to import essential commodities. However, Korea had always been trade-dependent during colonial times* and the necessity of export promotion was recognised as early as 1951, when the export-import link scheme was introduced (Datta-Chaudhuri, 1981). The system was reinforced in 1953 and 1955 by increasing the proportion of export earnings that could be used for importing goods, The first instruments of export promotion were highly discretionary; exporters were supported with multiple ex-change rates, direct cash payments, permission to use foreign exchange for private use, etc. (World Bank, 1987). After 1955, by introducing the dollar-denominated deposit system, exporters were insured against exchange risks, as well. Thus, even though, South Korea had a phase of ISI, there was never any doubt regarding the direction in which Rhee wanted the system of State intervention to move: it was towards a regime of liberalised trade with a system of selective intervention to promote industrial growth and exports (Datta-Chaudhuri, 1981).

An important feature of import substitution as practiced in Korea was that there was a distinct slowing down of the economy: GNP growth peaked in 1957 at 7.7% and fell to 1.9% by 1960. The standard interpretation for this is growing inefficiency and exhaustion of import substitution (Haggard et al, 1990). *A* similar scenario was unfolding in Taiwan at around the same time and for the same reasons: by the late 1950s, growth was slowing down (Little, 1981).

Even in the brief episode of ISI that was witnessed in Korea, some of its unhealthy political manifestations were starting to become evident. It is possible to attribute the slowing down that was taking place in Korea during the late 1950s to excessive political manipulation of the economy by the Rhee regime for partisan ends. Rhee used instruments of economic policy, such as allocation of foreign exchange, import licenses, bank credit, to sustain and build support bases (Haggard et al, 1990). It is indeed ironical that when the perils of manipulative State intervention and the inefficiencies of ISI wore being witnessed in Korea and Taiwan, India was embarking on the same path and with much greater vehemence. The Korean and Taiwanese flirtation with ISI, it must be remembered, was with its easy or primary phase, mainly confined to manufacturing of consumer goods such as textiles, clothing and wood and leather products (Little, 1981). In the Indian case, however, import substitution was being pursued in as many sectors as possible, often causing a very thin distribution of scarce resources over too many sectors (Sengupta, 1996).

2.3 **Autarky**

India's choice of ISI was combined with- an emphasis on self-reliance or autarky. Such an isolationist policy meant that India was cut off from the rest of world: cut off from international competition as well as technological progress outside India. In the absence of either of these benefits that would have been available had India integrated with the rest of the world, production within the country was not cost-competitive from an export point of view; further, since India was always trying to catch up with technological development in the rest of the world, production quality suffered. Emphasis on self-sufficiency of the kind that India adopted was observed in a few other countries such as Korea, Taiwan, Soviet Union and China, but their circumstances were vastly different. I have already made reference to the historical circumstances in Korea, which led to its brief experiment with ISI and autarky. As far as Taiwan, which was a Japanese colony till 1945, was concerned it found its industry largely destroyed during the war. Substantial American aid helped it to overcome its macroeconomic problems, notably massive inflation, only in 1952. Primary ISI, mainly in consumer non-durables, continued hill I960, by which the familiar ills of this strategy had begun to show up (Little, 1981).

In the case of the Soviet Union and China autarky was forced on these countries by the necessity of having to live in a hostile environment. Surrounded as these countries were by the "enemies of communism", it was inevitable that self-sufficiency would be a desirable objective. In the case of India, however, autarky was a deliberate choice: India had not gone through the ravages of war as had Korea and Taiwan, nor was it surrounded by enemies which made autarky inevitable. This choice reflected a desire on the Indian government's part to distance itself from the erstwhile imperialist powers; in the west and their military alliance and to generate a new World Force, the so-called Third World (Nachane and Karnik, 1992, 1992a). The autarkic nature of India's development policy was thus a natural concomitant of the desire to play a leadership role in the Third World and remain non-aligned in a polarized world.

In a sense India's development policy was an extension of Nehru's world view, as well as, that of the Fabian Socialists who saw in Communism "the living, vivifying expression of something hitherto hidden in the consciousness of humanity" (Nachane and Karnik, 1992). The rigours of Stalinism were, mistakenly, felt to be accidental and very much tied to the personality of Stalin rather than to the nature of the communist system itself. Thus a humane approach to communism was cobbled together under the name of Fabian Socialism and India became the experiment for these recipes. The major features of this experiment were intrusive State control (as, operationailsed by a powerful bureaucracy), a public sector straddling the "commanding heights" and, what we have already discussed, autarky.

Like Nehru, Mahalanobis was also greatly influenced by the developments in the Soviet. Union: "...it appears quite plausible to argue that Mahalanobis.....was impressed with Soviet thinking on industrialisation, with its emphasis on the building up of the capital goods base, without full recognition of the fact that such a strategy pre-supposes constraints on domestic and foreign transformation that need to be empirically verified" (Bhagwati and Chakravarty, 1971, p.11). The impression that the Soviet Union had on Mahalanobis is also quite apparent from his writings; see, for example, Mahalanobis (1958, 1985, 1935a).

In the final analysis one could very well argue that development policy of the Second Plan was fashioned by a view of the world which was already changing. By the mid-1950s, Korea and Taiwan were already taking their first steps towards integration with the rest of the world and were also finding out the perils of isolation as operationalised by ISI. The geo-political conditions facing the Soviet Union and China were completely different those facing India and yet India consciously chose to isolate itself from the rest of the world. It does not appear to me, as Guha (1996> seems to suggest, that India had no choice but to choose to isolate itself from the rest of the world. It seems more the case that due to reasons of ideology as well as due to an out-of-date and misunderstood view of the world, the Second Plan deliberately chose a development strategy that would set India on a path that was quite at variance with that followed by the more successful Asian economies.

2.4 Vaki1-Brahmananda Critique

One should not get the impression that the inappropriateness of the Soviet experience for India is being recognised here only with hindsight. In fact, there were scholar, especially at the Bombay School of Economics, who had warned against emulating the Soviet strategy of heavy industrializing but unfortunately, these warnings were not heeded. I refer to the works of Vakil and Brahmananda. Their major work (Brahmananda and Vakil, 1956) was, probably, the only rival to the Mahalanobis approach to planning (Bhagwati and Chakravarty, 1971). But here I would like to draw attention to an earlier contribution, namely. Vakil and Brahmananda (1955):

> "....it may be pointed out that the system for an expansion of heavy industries is based on the experience of the Soviet Union which concentrated in the first few years on the development of heavy industries and later on the development of consumer goods industries including that of agricultural production. It would be dangerous to argue on the basis of the experience of a country which had had a different economic background to face in planning. May we point out that the problem in the case of the Soviet Union was more one of deficiency of marketable surplus rather than of overall production, whereas in the case of India, we have both problem of relatively lower production as well as a lower proportion of marketable surplus .....(In this connection), it may also be pointed out that the international climate under which the Soviet industrialisation process was carried

out was not favourable for the imports of capital equipment into that country. Fortunately, the conditions in the case of India are somewhat better. The above reasons are sufficient to prove the doubtful validity of the Soviet experience under conditions facing India" **(pp.115-116)**

The **extensive** quote above is sufficient to establish that there were scholars at that time who had a different and, possibly, a more accurate view of the world, as compared to the world-view that informed the formulation of the Second Plan. Vakil and Brahmananda (1955, p.118) went even further and argued in favour of emulating the Japanese approach as opposed to the Soviet one. In fact, towards the end of the 1955 paper, Vakil and Brahmananda argue for a strategy for India which anticipates the Korean export promotion drive of a few years later: "(The Second Plan) should concentrate on expanding industries which have built up export markets and at the same time explore the potentialities of those industries which can build up export markets anew" (p.119).

3. CHARACTERISTICS OF THE MAHALANOBIS MODEL

3.1 Heavy Industrialisation

The strategy developed for the Second Plan was based on the framework of Mahalanobis which stressed industrialisation with an emphasis *on* the development of heavy industry or production of capital goods (Rangarajan, 1996). In a deviation from the Harrod-Domar growth model which focused on shortage of savings, Mahalanonis focused on the bottle-neck that might be created by shortage of capital goods. The novel feature of the Mahalanobis model (195 3) was the extension of the Harrod-Domar model to an optimising framework. The two sector model divided the economy into a consumer goods industry (C) and the investment goods industry (I). Total investment, 1(0), was fixed forming the datum for the model. The target variable was the rate of growth of national income (Y). The instruments were 0I and 0c, the relative shares of investment in the two sectors (0I + 0c = 1); while the structural parameters, βI and βc, were the reciprocals of the ICORs in the two sectors. Assuming full capacity utilisation and a single period lag between investment and output, yielded the Mahalanobis income growth equation (see Rao and Karnik, 1994 for details):

$$Y(t) = Y(0)\{1+\alpha\{\{(\theta_I\beta_I + \theta_C\beta_C)/(\theta_I\beta_I)\}\{(1+\theta_I\beta_I)^t - 1\}\}\}$$

This equation makes it clear that high values of 6j would be associated with lower rates of growth in the initial stages but with the passage of time higher values of 8j would imply a higher rate of growth of income in the future (Rao and Karnik, 1994, p.204). Thus the policy prescription to emerge from the growth equation was that priority was to be given to the development of the capital goods or investment goods sector if the rate of growth of consumption was to be higher in the long run and that this strategy was to be pursued even though the consumption goods industry had a higher output-capital ratio.

The two sector model of Mahalanobis was concerned with inter temporal allocation of investment, while the four sector model (Mahalanobis, 1955) was related to the intersectoral a location of investment. The four sectors considered were investment goods *(I)* , factory production of consumer goods (C1), Household production of consumer goods (C2) and services (C3). In spite of this detailing, however, 8j, the investment share of the capital goods sector remained the key policy parameter as in the two sector model.

Both of these models of Mahalanobis formed the philosophical basis of the Second Plan and provided the rationale for a shift in industrial investment towards building up a capital goods base. The Second Plan rather surprisingly assumed that India had a comparative advantage in heavy and basic industry and that an emphasis on them was justified (Parikh, 1996), So far as I can see, Mahalanobis* bias towards heavy industrialisation and against agriculture stems from his view of the world and the power play between the Western nations (notably, U.S.A.), the Soviet bloc and the underdeveloped nations. This is especially apparent in Mahalanobis (1985a) where it is pointed out that experience has shown that it is not possible to improve the level of living beyond a certain limit on the basis of agricultural production alone. Further, in underdeveloped agricultural economies a very small group of families have the largest share of wealth, income and political and economic influence and it is very easy for a foreign power to exert influence on a small group of powerful persons. Relations between foreign powers and underdeveloped countries, Mahalanobis argues, are thus unstable. The process of industrialisation would broaden the base of social and political decisions; consequently, the external relations between foreign powers and the now industrialised (formerly developing) countries would be more stable and contribute to decreasing tensions between East and West. Thus, for Mahalanobis, the industrialisation of underdeveloped countries, especially India, was an indispensable condition for world stability and peace.

The difficulties that a nation such as India would have in 1950s to pursue a programme of heavy industrialisation were scarcely recognised. Thus, Mahalanobis (1985a, p.189) notes:

> "In India it would be economical (emphasis added) to establish a heavy machine building industry which would manufacture heavy machines and equipment required for the installation of factories for the production of steel, fertilizers, aluminum etc ....It would be also economical (emphasis added) gradually to establish large scale industries for the manufacture of synthetic raw materials

of many kinds....It follows that a big country would require a comparatively small amount of outside capital".

Much before the contradictions of this drive towards heavy industrialisation became apparent, a virtual plea was put out by Vakil and Brahmananda (1955) to abjure the strategy that the Second Plan eventually adopted. Their strategy called for development of heavy industries which were ancillary to Agriculture; a continuous state of excess capacity in these industries would enable India to have continuously increasing supply of marketable surplus of food. Especially because Vakil and Brahmananda believed that India's food position, at the beginning of the Second Plan, was not completely secure that they suggested that India should not embark on a type of industrialisation which would neglect cultivation over a fairly long period of time.

It is pertinent to point out here that even Korea, which had Achieved much success during the 1960s, had little sectoral bias in its development strategy prior to the 1970s. Its shift from general export promotion to heavy and chemical industries (the so-called HCI drive) did not happen till 1973. This change represented a major change in policy in favour of specific industrial targets and a wide-ranging commitment by Government to using trade and financial policies to steer resources to the HCI sector (World Bank, 1987). In spite of introducing the HCI drive late in its development process and with substantial intervention from the Korean government including a secondary import substition sub-phase of transition, it is widely accepted that the HCI drive was over ambitious and resulted in serious misallocation of resources (Park, 1981; World Bank, 1987).

3.2 Import-Substitution

The emphasis, in the Second Plan, on investment in capital goods industry went hand in hand with Mahalanobis' world view which inevitably had to assume a closed economy and hence self-reliance. Industrialisation combined with self-reliance necessarily led to import substitution (Sengupta, 1996). Sengupta makes the important point that ISI need not have, necessarily, excluded growth of export industries in which India had a relative cost advantage because of favourable factor endowments. However, continuous technical progress in the rest of the world meant that successive rounds of import substitution became more and more difficult. Thus, compared to the rest of the world, costs of production remained very high in India and Indian exports suffered on the score of cost-competitiveness. Consequently, ISI also concomitantly meant the negation of export promotion.

Although the Mahalanobis model assumed a closed economy, subsequent to the Second Plan, growth of imports became inevitable for the economic development of India. This was especially so in the case of imports of foodgrains and this could be seen as a tragic outcome of the neglect of agriculture in the Second Plan, bat more on this slightly later. Apart from food grain, Imports of basic industrial products such as petroleum, fertilisers, chemicals, steel, non-ferous metals and machinery became necessary Such imports placed major demands on availability of foreign exchange. In setting targets for the Second Plan the government had assumed a much higher level of foreign assistance as compared to the First Plan and estimated a level of exports just below that of the earlier quinquennium; as is turned out this was over -optimistic and foreign exchange, constraint came to have a powerful impact on the implementation of: the Second Plan (Tomlinson, 1993) Inevitably, the government had to resort to rationing of scarce foreign exchange by means of quantitative restrictions on imports. The Reserve Bank of India Report on Currency and Finance (1957-58) Report points out:

> "During 1957-58, despite efforts to conserve foreign exchange, import payments reached an all time high of Rs. 1175 crores.....Sector wise, the entire increase was under government imports which rose by as much as Rs. 201 crores; private import payments dropped sharply...." (p.70)

The Report also points out that the heavy imports were on account of the Government's expanded developmental activity; on the other hand, imports on private account were held down means of vigorous control measures. The above comments of the 1957-58 Report, come on top of similar comments of the Reserve Bank of India Report on Currency and Finance (1956-57):

> "Throughout the greater part of the First Plan there had been recurring current account surplus in the balance of payments; this was sharply reversed during 1956-57 with the emergence of an overall current account deficit of Rs. 292.5 crores.....This was mainly due to the large increase in imports, particularly of capital goods...." (p.72)

Guha (1996) points out that the contradictions of the ISI regime introduced during the Second Plan soon became apparent and imposed a substantial cost on the Indian economy, a part of which we have pointed out in the context of the balance of payments crisis. Guha further points out that combination of the ISI regime with the Industries Act, 1951 and the Industrial Policy Resolution, 1956 gave the Indian state all the standard Olsonian characteristics« The Indian Industries Act, 1951 was designed to implement (see Bhagwati and Desai, 1970):

1• the development and regulation of industrial investments and production according to Plan priorities and targets;
2, the protection and encouragement of small industries;
3, the prevention of concentration of ownership of industries;
4, balanced economic development of the different regions of the

country.

The Industrial Policy Resolution of 1956 was even more emphatic about the importance of the public sector than the Industrial Policy resolution of 1948. Seventeen industries (heavy electrical plant, iron and steel etc) were grouped into one category where the State would have total monopoly or have exclusive right to establish new industries. Twelve other industries (machine tools, ferro-alloys, fertilisers, etc.) were specified as the sector where the State would progressively establish new units. The remaining industries were left to the private sector, though the State had the option of entering these as well. This Industrial Policy resolution significantly did not reiterate the 10 year guarantee against nationalisation that was mentioned in the earlier Resolution and thus was more closely attuned towards the goal of a socialistic pattern of development (Bhagwati and Srinivasan, 1976).

The import arid export policy followed over the period 1956-66 and which had as its major objective operationalising ISI aimed at comprehensive direct control over foreign exchange utilization. Thus administrative decisions had to be made over the allocations of foreign exchange for practically all uses in the economy. Further, reliance on the direct allocative mechanism was almost complete during this period. Bhagwati and Srinivasan (1976) have listed out in detail the adverse effects of this import export policy regime. It led to a wasteful allocation of investible resources among alternative industries and also accentuated the under-utilisation of investments within these industries; the regime also reduced the degree of competition that firms in these industries had to face; apart from this, there were other problems such as delays, lack of co-ordination among different agencies, anticipatory and automatic protection afforded to industries regardless of costs and discrimination against exports (Bhagwati and Srinivasan, 1976, chapters 2 , 12 and 13). The emphasis on import-substitution also led to social inequality: The negation of import substitution i.e., "Trade liberalisation .... tilts economic activity towards the production of exportable commodities, which tend to be labour-intensive, and this can be expected to have, often enough, an inequality reducing influence" (Dreze and Sen, 1996, p. 97). On<i hardly needs reminding that this was precisely the policy that Korea started following from the mid-1950s onwards and this was also the approach that Vakil and Brahmananda (1955) had advocated.

Aa Guha (1996) points out the combination of ISI and the Industrial policy resolutions paved the way for stagnation in the Indian economy due to the following:

1. neglect of static comparative advantage in an ISI regime
2. exclusion of domestic and foreign competition
3. manipulation of industrial location
4. appointments on non-merit considerations
5. diversion of resources into rent-seeking

6- delays in decision waking
7. elimination, on account of labour laws, of the threat of dismissal as a worker disciplining device
8. belief that employment alone and not productivity is socially valuable.

3•3 Employment

As far as labour was concerned, Mahalanobis assumed, in the manner of Arthur Lewis, unlimited supplies of it (Guha, 1.996). Since labour was in excess supply, the Mahalanobis model, called for a higher allocation of resources for capital goods, which would raise the rate of growth of production, employment and consumption of the economy in the long run (Sengupta, 1996). In a sense this was a trickle down strategy spread over a long period: employment and consumption, both essential for poverty alleviation, would benefit from an increase in the rate of growth of the economy. This, of course, meant that alternative measures would have to be put in place to increase employment in the short run. Mahalanobis emphasised the role of cottage and small scale industries in supplying mass consumption goods and providing employment in the short and medium term. However, cottage and small scale industry find no mention in Mahalanobis[1] formal model and is, in a sense, an appendage to his strategy. Even Mahalanobis writing point to the subsidiary role that cottage and small scale industry would play in the overall strategy of industrialisation, which was focused on heavy industries (Mahalanobis, 1985). We have already noted above that Mahalanobis was well aware that a strategy of heavy industrialisation would increase employment only in the long run. Small industry can provide employment in the short run if there is sufficient demand for its produce. Mahalanobis[1] way of accomplishing this was to increase investment in heavy industries, which would generate income, create purchasing power and boost demand. A similar effect would result if the government increases expenditure on social services. Further, Mahalanobis felt that, the small scale industry, which is expected to play such a crucial role, should be protected from large industry: there should be no investment in factories which compete with small and household units of production. Even when factory made products compete with small and household industry, there will have to be protection afforded to the latter: since the prices of output of the small sector will be higher, suitable excise should be levied on factory made goods to maintain price parity. It is quite apparent that Mahalanobis was not particularly concerned about the consumers of these products; the point seems to have been missed that employees of small scale and large factories would themselves be consumers as well. Thus the same individual, qua consumer, would subsidies himself, qua employee.

Inspite of this importance attached to small and household industry by Mahalanobis, when it came to formal modelling, the focus of attention was heavy industry. This is definitely true if one considers the two sector model of Mahalanobis; even in the case of the four sector model investment share of the capital goods sector remain the key policy parameter, as in the two sector model (see above; also Rao and Karnik, 1994 for details) .

3.4 Agriculture

The dominant line of thinking in the First Plan advised attention to the large agricultural sector with its potential for quick yield. It was also thought that agricultural products, as also agro-based industries, would permit earning of foreign exchange through their exports and eventually lay the basis for industrialisation through the import of machines (Bose, 1996). The departure from this line of thinking came with the Second Plan: neither the two-sector nor the four sector models of Mahalanobis accorded any importance to agriculture. Vaidyanathan (1996), rather valiantly, tries to defend Mahalanobis from the criticism that he did not accord sufficient importance to' agriculture. He quotes extensively from Mahalanobis (1959, 1085b) to support his point. However, it is also true that Mahalanobis believed that only industrialisation, as opposed to an emphasis on agriculture, would enable developing countries to have stable relations with foreign powers; an agriculture dominated country would be under the undesirable influence of foreign powers (Mahalanobis, 1985b, p.185). Vaidyanathan himself admits that "(Mahalanobis') discussion of the means by which (agricultural) output required to meet anticipated demand was to be realised was admittedly thin". So, basically, what Vaidyanathan is suggesting is that there was a lot of verbalisation in Mahalanobis' writings of his concern for agriculture, but none 6f it really got incorporated into the models that formed the basis of the Second Plan. That, of course, is precisely the criticism. One could, as easily argue, a la Vaidyanathan, that there is a lot of concern, in the Planning Commission, for growth in the Ninth Plan: not because coherent policies are being recommended but, because there is a lot of verbiage about growth coming out of the Commission.

There were warnings that were issued out during the framing of the Second Plan that the optimism with regard to food security was misplaced (Vakil and Brahmananda, 1955). Vakil and Brahmananda pointed out that they were not at all certain whether the improvement in food production during the First Plan was of a permanent character and that it would be hazardous to ignore the need to step up continuously agricultural production. That agriculture was neglected is apparent from a contribution of Vaidyanathan (1982, Table 13.6) himself: the percentage share of agriculture in aggregate investment fell from 27% during the First Plan to 19% during the Second Plan. Vaidyanathan in this very contribution further states that the shortage of foodgrain that emerged during the course of the Second Plan lent credence to the criticism that the Plan had indeed neglected agriculture. Given these views of Vaidyanathan himself, ii *in* certainly very surprising that he has, in a later work (Vaidyanathan, 1996), so strongly defended Mahalanobis[1] views on agriculture.

4. EQUITY STATE AND MARKETS

By and large, it has been assumed in the context of Indian planning and discussions of the role of the State that reduction in poverty and introduction of equity or social justice lies in the domain of the State and that the market has a very limited role to play in this context. Thus Parikh (1996) states that the role of planning is to lobby for the poor in economic policy making, or that an important role of the government emerges in designing and monitoring redistributive programmes. Sengupta (1996) points out that "Since political democracy could not...afford to ignore the problem of poverty for long the development plans began to emphasise the need for a direct attack on poverty (emphasis in the original) .... . Guha (1996) makes the rather strange point that, in order to expand demand, the development policy followed by India aimed at-redistribution of income through massive expansion of government and semi-government employment to create a homogeneous middle class market for manufactures. This was necessary because the middle class in India was minuscule and this leads Guha (1996) to suggest that India had to adopt an inward looking development strategy.

I am not entirely convinced that the State alone has a major role to play in poverty alleviation and reduction of inequalities. Growth, which can come from the private sector, can also be a very significant instrument for poverty and inequality reduction. That, in fact, is the major result of Tendulkar (1996):

> "The message seems to be loud and cleat. That rapid growth has not only raised social welfare but also relieved social deprivation in a reasonably sustained fashion. In the light of this experience it is necessary to reject the premise stated in the introduction that the outcome emerging from the market forces would invariably be distributionally undesirable and that state intervention would always improve upon this outcome" (emphasis in the original).

Inegalitarian distribution of income is often seen as a market failure, in the sense that the market will not introduce distributional equity automatically. Thus distribution is seen as an essential element of government policy making or government budget formulation, along with other functions in the spheres of allocation and stabilisation. This is, of course, the familiar three way classification of the budget proposed by Musgrave (1959). It cannot, however, be the case that all the burden of introducing egalitarianism be placed on the distribution branch of the budget. To the extent that cyclical unemployment leads to poverty and increases inequality, the stabilisation function of the government budget has a role to play in the sphere of social justice. In the context of provision of "merit" goods or quasi-public goods, the government's allocation function, too, will have a role to play (see Karnik, 1997 for details). Thus, a fragmented view of government budget making, in terms of three separate functions, may not be the moat ideal way of tackling distributional problems. A more holistic view that promotes efficient allocation of resources in all sectors of the economy, maintains the economy at high levels of activity coupled with price stability, along with directly tackling income and other inequalities provides a superior approach to state intervention in pursuit of social justice. Such an approach clearly brings to the fore the importance of the market in the search for egalitarianism. Specifically, what this approach emphasises is the importance of growth and price stability in the pursuit of distributive justice. The experience of the East Asian countries seems to clearly indicate that inequalities were reduced, not by shunning growth, but by actively pursuing it; not by supplanting the market by State intervention, but by supplementing the market with quality State intervention. In fact, the East Asian experience can be seen as a good example of the synergistic relationship between growth and equality (Birdsall et al, 1995, Stiglitz, 1996).

Inappropriate State intervention, which interferes with market transactions, often tends to have effects contrary to what was intended. However, strong arguments have been made for interfering with the market in some cases, eg. establishing some minimum wage rates, affirmative action in employments policies, usurious money lending, environmental protection. Even in these cases it may often happen that, even though the initial intervention may have a strong equity component, it is possible for perversions to set in. Thus minimum wage legislation or affirmative action for employment may curtail employment as a whole; curtailment of money lending might imply complete non-availability of credit if formal credit markets are under-developed. Such unintended result arise since "it must be recognised that interference with the market exchange may have severe limitations as a re-distributive device" (Dreze and Sen, 1996, p.94).

The roots of economic inequality in market economies do not lie in market exchange per se, but in market exchange based on unequal ownership. Therefore, interventions, which leave unaltered the distribution of resources, can be ineffective and counterproductive. Such measures often have efficiency costs, which may be borne by the intended beneficiaries of the intervention. Further, even the redistributive effects of such interventions may be pointing. Thus excess wage demands, benchmarked on the legislated minimum wage may distort capital-labour ratios. Finally, from a public choice point of view, bureaucratic controls which impede the market, not only involve excessive efficiency costs, but may them selves be a major source of inequality (Dreze and Sen..., 1996, p. 94)

Any pursuit of social justice, which strongly discriminates against the market or seeks to aggressively correct market failures, has to guard against the Leviathan State, with all its attendant dangers. Further, the existence of a Leviathan State may not ensure reduction in inequalities. The evidence from the former USSR, Poland, Hungary and Czechoslovakia seems to point to an overwhelming similarity with capitalist countries with respect to inequalities, in spite of the awowed "socialistic egalitarian" objectives <Haynes, 1996). This is true whether the basis of comparison is earnings distribution of full time workers or distribution of household consumption, Even adding in non-money social benefits does not make the comparison any favourable to eastern Europe- On the other hand the: rich ,and the powerful in, both, east and west, had access to privilege;, which increased inequalities at the top. Thus, for all the propaganda rhetoric, there were serious inequalities in the socialist States, combined with severe poverty. In general, the past emphasis on accumulation in the Soviet Onion meant that consumption was-suppressed among the mass of population but the relative burden fell heavily on the poor. The poverty ratio of 14% in the Soviet Union in 1989 masked the fact that it was as low as 2% in Estonia while it was as high as 51% in Tajakistan.

The above discussion has served to demonstrate that the State need not necessarily be the best institution for poverty reduction or for inequality reduction. Rapid growth can play a significant role in attaining this objective; evidence from Tendulkar's paper is quite compelling in H»»a respect. The State will have a role playing but this role should not be played but at the cost of growth.

6. CONCLUDING REMARKS

This paper was concerned, firstly, with an examination of the contributions of Mahalanobis to the formulation of the Second Plan and, secondly, with Indian planning in general. Numerous issues have been discussed above, but one thought keeps recurring. Would India's current economic situation have been any different, had India followed some alternative development strategy, say the strategy then advocated by Vakil and Brahroananda? Like all grand questions, this one too has no definitive answer. However, looking to the successes of the Asian "Tigers", one can get some inkling of what might have been, but was not. But this is an imponderable and experiences of successful economies can rarely be transplanted in an alien soil. Such rationalisation, however, does not completely banish the feeling of having been left behind in the race towards development.

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