The Economic Crisis in India

Wilfred Malenbaum

Indian economic growth under the Second Plan, now entering its second year, is faltering. It is not likely that the economy can attain its development targets in 1960-61 unless rapid and significant actions -not now contemplated, as far as I know—are taken both by the Government of India and by financing institutions in capital-exporting areas.

The crisis is dramatized in the deteriorated foreign exchange position of the country. This is of key importance, but it is only a manifestation of the basic problems involved in India's effort at a rapid acceleration of the rate of her economic growth.

LOWERING the Plan's targets—whether by announcing a revised Plan or by a less conspicuous extension of the present-might mitigate the foreign exchange crisis. Of itself, it does not solve the underlying problems of Indian development. Moreover, such a retreat from the targets of the Plan might have international implications also. World publicity attaches to the fact that India is attempting rapid economic progress while retaining a high level of the Individual freedoms prized by a democratic society. There are clear and obvious contrasts with the development plans of Communist China. One might even point out that some of the problems India encountered arose from the deep-rooted devotion of the Government leadership to a relatively free, non-controlled economic order.

2. The solution requires action on several fronts. At least three basic factors contribute to the present Indian position. Each of them alone would have meant rough sailing for the Second Plan. Together, their effects have been marked and rapid.

(a) First is the fact that the Plan's investment estimates were low given the output targets. As steps were taken to implement specific capacity objectives in the economy, it was found that more resources were needed than were provided in the Plan. Investment expenditures were greater in both local and foreign currencies.

Note: this article is taken from a longer paper prepared at the Centre for International Studies, MIT USA. It should be noted that the information for the section on foreign trade rests primarily upon the partial data there. More recent and more complete data may, of course, alter the argument.

(b) The domestic savings and investment flows underlying the Plan appear to be unrealistic. While the Plan's domestic saving rate (an average of about 8.5 per cent of national income over the five years) is certainly a reasonable target, its achievement is made more difficult by the Plan's diversion or a heavy flow of savings, arising primarily in the private sector, into public investment. Even with strong fiscal and other measures, the result might lower savings, and perhaps lower total output. With less effective action, the private sector, and especially agriculture and big industry, would tend to continue to invest more in their own sector.

(c) The availability of the tools notwithstanding, Government has hesitated to adopt and implement the policies and actions that are necessary for, or that would facilitate the achievement of the programme. (The Government of India does not readily adopt- and implement-measures which reduce Individual freedom.) Recent budgetary measures and the sharp curtailment of foreign exchange for private imports are in themselves not likely to stanch for the immediate crisis, nor do they deal with the other two factors.

(d) In addition to these, there were of course other contributory factors—come non-recurrent, none so fundamental as those above. There was the repayment for the German steel mill during the period. Uncertainties with regard to sterling tended to aggravate India's payment position beyond what the underlying trade and service situation would justify. The Plan's gap was only partially filled in advance; this would tend to draw reserves down very heavily in the early years.

In the early years there is reason to believe that the gap was also underestimated given the Plan's provision for consumer goods imports etc.

3. Specifically, these factors point up:

(a) The fact that the Plan gives to the private sector less scope for growth than is generally realized. This is true for small scale activities, especially agriculture and other rural output; it is also true for big private Industry. If the output targets of the economy are to be achieved over the five year period, consideration must be given to restoring technologically necessary balances between public and private effort, at least in some areas.

(b) The truth that, notwithstanding the above point, at least the modern industry component of the private sector has demonstrated a vitality and a degree of entrepreneurial aggressiveness which are important assets in a poor country seeking to accelerate growth. This sector has been largely responsible for the crisis in foreign exchange, thus deterring public Investment, for the first Plan year in any case. The strong action recently taken by Government to alter this situation—annullify this private entrepreneurial drive. It will not serve to provide the required balance between private and public expansion.

4. Given the early date at which weaknesses in the development structure have emerged, provision for the crisis in foreign exchange, of resources, among other changes, can be made while still retaining broadly the targets and the rates of growth of the Plan. What seems to be required are steps such as:

(a) Some commitment (by the International Bank and the US Development Fund, for example) of a large sum, say Rs 500 crores, supplementary to any already provided or under discussion (the amount taken to be roughly the
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India and the capital-exporting nations (appointed by India and the capital-exporting nations) and charged with assuring its fulfilment. Specific releases might be made on the recommendation of an international technical staff. In brief with the problems to which study needs to be directed at once, in connection with the steps above.

A: The Foreign-Exchange Shortage

During the Plan's first year, 1906-57, India apparently used up some Rs 300-320 crores of foreign exchange reserves, 50 per cent more than was planned for the five years of the Second Plan. The official figures for March 31, 1956 and 1957 show a decline of about Rs 190 crores. This, however, understates the reduction, due to a bullion revaluation, through which India "gained" some Rs 65 crores, and the utilization of over Rs 60 crores of drawings from the I M F in early 1957. Preliminary analysis based upon official data for the first six months of 1956-57 (April-September) and upon incomplete data for the next quarter places the major emphasis for this decline upon the trading account. The annual rate of exports during this period (Rs 577 crores) was essentially at the level mentioned in the Plan, while imports (Rs 954 crores) were appreciably ahead (by some 20 per cent). The trade imbalance was partially offset by invisible earnings which were substantially ahead of the Plan's estimates.

Contrary to expectations based on the Plan, the private sector is most responsible for this expansion in imports. Thus imports on private account alone during the first six months of 1956-57 were at an annual rate Rs 783 crores at which total imports, i.e. including those on Government account were projected for the year. From the point of view of level of imports alone, this overfulfilment need not be too serious since Plan imports over the five years were phased in a very general way. Nonetheless, such a major excess of imports over the figures shown for the early years, or over the average imports forecast, should be explainable in terms of the time requirements of the Plan.

Unfortunately then- is relatively little Plan information on the specific composition of these expected imports, as between public and private, or as to their broad functional composition, capital goods, raw materials and consumer goods. It does appear, however, that imports of consumer goods and raw materials were somewhat greater than was expected. With respect to the key component, capital goods, the level of imports for the first six months (an annual rate above Rs 500 crores), Imports on private account must have exceeded by far what the Plan anticipated. It is this point which is crucial in Indian foreign exchange developments over the first year of the Plan.

Net investment in the private sector over the five years was expected to be Rs 2400 crores, of which Rs 400 crores represented increases in stocks and Rs 1300 crores more were to be for small-scale construction, especially housing, (Rs. 1000 crores) and for agriculture and small-scale industry (Rs 300 crores). Investment in all these encomasses relatively little foreign capital goods. These would instead go to the rest of the private sector, to the organized industry, mining, plantations, small electric plants, etc, which were allocated all aggregate Investment of Rs. 700 crores, including, of course, the provision for factory construction. It is probable that the private sector was expected to import over the five years some Rs 200-250 crores of capital goods for net Investment. Investment goods of this value were imported by this sector during the first six months of 1056-57 alone! If we assume that replacement involves imports equivalent to what net Investment in this sector requires, capital goods imports by the private sector for new investment during the first half of 1056-57 were running as much as five times the level anticipated on the average for the five Plan years. It is reasonable to assume that those large imports, in the first months were not simply early purchases of the requirements of the private sector for the total Plan. It therefore appears that a considerable amount of these private imports were licensed for industrial development not specifically budgeted in the Plan. Moreover, the complementary domestic investment was presumably also not budgeted in the Plan.

Several consequences follow from these developments:

(a) There has been some curtailment of resources that the public sector included in its investment budget, due to the overcommitments of the private sector for purposes for which provision had not been made in the Plan.

(b) The unexpectedly high level of private capital goods imports, even assuming that total capital goods imports were essentially at the level planned, accentuate the foreign exchange crisis. This follows from the fact that most of the provision made for Idling the foreign exchange gap applied to imports on Government account only.

(c) The heavy private composition of capital goods imports probably contributed to a larger excess Import of consumer goods and raw materials than might otherwise have occurred. This stems from the fact that this private investment as a whole is more urban-oriented than is public; it therefore contributed to expanded incomes in areas where expenditure propensities are higher. Also, private enterprise probably invested in facilities where the demand for raw materials followed much more rapidly upon Investment than would be the case for Government investment.

(d) The short-fall in Government capital imports serves as a deterrent to public investment. The high levels of private investment are not compatible with the plan for public mobilization of private savings.

A further word may be in order with respect to underlying causes for these developments. Basically, authorizations for Industrial expansion and the necessary allocation of foreign exchange for imports...
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were made with a rather open hand, and during the period when the private sector was rapidly expanding output and (in lesser degree) capacity in the fourth and fifth years of the First Plan. There is reason to believe that the general premise of the Plan, namely that the private sector could invest at a significantly higher rate than prevailed in the First Plan, was not in keeping with the resource budget of the Plan. (See below B.) Finally, neither the specific investment patterns in the private sector nor the flow of Investment resources into them had been studied sufficiently to permit effective administration of licensing for the private sector. While this is true, this technical difficulty can in no way explain authorizations for capital goods imports which were a multiple of the order of magnitude permitted by the exchange resources available.

B: Domestic Savings and Investment

On the problem of domestic savings and their flow into investment, only a few observations will be made here—to illustrate rather than to demonstrate. The Plan anticipated that the economy's savings would on the average double in 1951-56, as compared with 1950-51. The Plan envisages full utilization of these savings, but with a marked diversion from private to a sharply expanded public sector. Yet there is little evidence that the important changes in specific flows of resources implicit in the situation had been traced through and appraised. There is to be a very large expansion in public savings (attributable to the increases in revenue rather than to any reduction in Government expenditures for non-development purposes). The most extreme assumption which seems to be implied is that there will be essentially no expansion in the absolute amount of self-financing by agriculture and small enterprises. Indeed, the very rough estimates that are possible in these two areas suggest that what was an average direct flow of monetized saving to investment in excess of Rs 200 crores yearly during the First Plan was to remain below Rs 200 crores in the Second Plan.

Moreover, it is precisely in these sectors of small enterprise—agriculture and other—where the Plan's investment assumptions seem unrealistic, particularly with regard to their private-public balance. This, the nature of the Indian development programme in agriculture makes these two components complementary rather than competitive or supplementary. Government investment will in general lead to output only when it is accompanied by a necessary amount of private investment. Taking agriculture and irrigation as a whole for the six years from 1950-51 (before the First Plan) this balance was essentially on a 1 to 1 basis. For the Second Plan, public investment in these two sectors was to aggregate about Rs 800 crores while private was supposed to remain below Rs 300 crores. This shift in ratio is not even acknowledged in the Plan, which thus provides no basis at all for explaining why public investment at Rs 800 crores will not need to elicit a lower level of private. In these circumstances, the specific expectation of marshalling private resources for public investment from these sectors seems unrealistic. The tendency will be for resources available to the small scale sector to be invested in the sector rather than in public savings schemes, and the like.

A somewhat parallel argument prevails for the big industry sector. Here, moreover, the situation is complicated by the fact that the Plan speaks of a very large increase in the level of investment in this sector (from about Rs 325 crores for 1951-56 to Rs 530 crores for 1956-61). Actually, investment in large scale industry during the first Plan years was about Rs 500 crores and not the lower figure given in the Plan. The Plan's resource budget (if it may be called this) permits only the maintenance essentially of the investment rates of the previous five years (and, incidentally, of 1950-51 too).

In such circumstances a shortfall in resources for the public sector appears inevitable, either because the pattern of investment will result in a smaller expansion in income (and hence in taxes and savings) or because greater investment will in fact occur in private activities. This last may be the other side of the overperformance in the private sector observed above.

These problems, it should be noted, arise from the domestic savings-investment structure of the Plan itself. At best, the achievement of the Plan's output, savings and investment goals would have required a major effort of analysis and implementation, with the broad use of fiscal and monetary policies on the one hand, direct controls on the other. Given the fact that this would have been a formidable task, Government tended more readily to go along with the lesser degree of controls and the lesser emphasis on increased taxation that are in any case preferred.

C: The Capital-Output Ratio

The Second Five Year Plan has been formulated on the assumption that each rupee of additional income will require 2.2 rupees of new investment. For a number of reasons, including the relatively heavy Industrial emphasis of the present Plan, this capital coefficient must be considered as a very low figure. Experience to date has already suggested that the public investment programmes, calling for Rs 3800 crores according to the Plan, may well involve expenditures some 25 per cent higher, due primarily to "higher costs" (which generally refer to more than price increases). Examination of the sectoral experience of the First Plan, to say naught of comparisons with other countries, corroborates this view. A more realistic calculation is needed, sector by sector, of the capital requirements to produce the expansion in Income.

It may be appropriate to observe here that the Plan's target, an average increase of 5 per cent per annum in national income is a high goal but a goal which may be necessary for a country seeking to shift rapidly from stagnation to progress. One might well argue, given China and given the state of mind in the emerging nations of Asia and Africa, that a lower target would be inappropriate for a nation seeking to make this shift using the political tools of a democratic society.

There is also, of course, the possibility that any increase in investment requirements would need to be financed primarily from abroad. In the Indian Plan the ratio of net Imports to total investment is 15 to 20 per cent. Only further analysis of these requirements for Indian Investment, and of the mobilizable domestic savings, can provide the basis for a marked increase in this ratio.
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