

Up for Debate: Scientific Planning: India's Experience

P. Chidambaram

The Legacy of Soviet Central Planning

INTERVIEWER: How important was Soviet-style central planning to the old Indian economy?

P. CHIDAMBARAM: The government of the day was greatly influenced by Soviet central planning. It appeared to be an alternative model. We were fascinated by the idea that everybody can share in the prosperity and wealth, and that poverty would be abolished, and that the state can provide virtually everything to all the people. This was an idea that seemed to have fascinated that generation.

INTERVIEWER: And you're implying that it failed?

P. CHIDAMBARAM: Obviously. It failed miserably in India. For the first 30 years the average growth rate of our GDP was barely 3.5 percent, and if you account for a population rise of about 2.3 percent or so, the per capita growth rate was barely 1.2 percent, and that is why there was such massive poverty in India.

Corruption and Self-Defeat Under the Permit Raj

INTERVIEWER: Would it be fair to say that the inevitable consequence of central planning was the Permit Raj?

P. CHIDAMBARAM: Yes. Once it was decided that the government will allocate resources, or at least control allocation of resources, the license Permit Raj was inevitable, because capacities had to be limited, growth had to be limited, and a system of rationing had to be adopted in terms of both bank funds as well as permissions.

INTERVIEWER: You had direct experience in the license Permit Raj. What did you actually come across?

P. CHIDAMBARAM: When I came back to India after Harvard Business School, I started as a lawyer and as a trade union leader. Now, I had a very special advantage -- I was looking at the way government worked as a lawyer, challenging government action in courts. I was also looking at the working of Indian companies from a trade union point of view. And I found that enterprise was stifled, [there was] rampant corruption, efficiency was penalized, growth was crippled and because of this protective market, the Indian people were being given shoddy goods and services at very high prices. Only rent-seekers flourished. The system simply was not creating enough jobs. There was not a sharp rise in incomes as we thought it would have, and the most disillusioning aspect of it was the rampant corruption in government. Every license, every permit, every amendment was procured by corrupt means.

INTERVIEWER: A bribe?

P. CHIDAMBARAM: Well, bribe is the simpler word, I suppose.

INTERVIEWER: Can you give me some kind of specific examples of the way in which the Permit Raj would interfere in businesses?

P. CHIDAMBARAM: Oh, yes. If your capacity was limited, say, to producing 100,000 cycles a year and there was an excise duty on cycles, if you produced one cycle more than the capacity you [had] to pay a higher duty, because you were exceeding your capacity. And then there was a reservation for small scale, which meant that once you touched the ceiling in allowing you to grow and enjoy the economies of scale, you were obliged to set up another unit under a bogus name -- the same proprietor, the same manufacturer -- in another unit in order again to start from scratch and go up to that ceiling.

So you were not getting the economies of scale; you were simply setting up a large number of bogus and fraudulent units, and by and large the system was a self-defeating system. Yes, it did create a small entrepreneurial class in this country; one can't deny that. But by and large I think the system failed in terms of our objectives, namely abolition of poverty and creation of jobs.

INTERVIEWER: One of the phrases that people always say is that the [Permit Raj] was more interested in redistributing wealth than creating it.

P. CHIDAMBARAM: Well, at least if wealth had grown in leaps and bounds, the redistribution could have been welcomed. But as I told you, the GDP was growing at the miserable rate of 3.5 percent a year.

INTERVIEWER: So they were redistributing poverty?

P. CHIDAMBARAM: There was very, very little to redistribute.

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Up for Debate: Scientific Planning: India's Experience
Manmohan Singh

Central Planning: From Necessity to Burden

INTERVIEWER: In the end, did central planning get bogged down in itself? And what is your verdict on the concept of central planning, at least as a first phase?

MANMOHAN SINGH: Let me say that I think the economic history of the last 150 years clearly shows that if you want to industrialize a country in a short period, let us say 20 years, and you don't have a well-developed private sector, an entrepreneurial class, then central planning [can accomplish that].... In the initial stages of India's development, central planning was a positive factor for development, for promoting industrialization, for building industries which would never have [been] built, and in terms of organizing science and technology.... If not for central planning those things would never come into being.

But the real problem starts after 15 or 20 years, because the central planning system that [has] evolved [here and in] other countries lacked an effective incentive system to modernize on a progressive basis, to improve productivity, to bring new technology. And that is where the failures of the central planning economy become far too big a burden to bear.

Functionless Capitalism

MANMOHAN SINGH: The [Permit Raj] was [an] inevitable [consequence of central planning] because in an economy where resources are scarce [and] demands are too many, you need rationing, you need controls, and therefore you need permit license rights. In the initial stages, these controls were introduced in the name of introducing greater rationality into the allocation process. But after a period of time they became instruments of corruption. They became instruments of delay. They became instruments of uncertainty, and the economy simply could not get a clear sense of direction.

Also, the information system that was necessary to rationally implement these controls, that also got bogged down, so I think it became a factor that impeded progress. I think the [Permit Raj] gave rise to what I sometimes describe as functionless capitalism. Capitalism historically has been a very dynamic force, and behind that force is technical progress, innovation, new ideas, new products, new technologies, and new methods of managing teams. If you have a rigidly controlled economy, cut off from the rest of the world by infinite protection, nobody has any incentive to increase productivity and to bring new ideas. Therefore, the license Permit Raj became a great handicap in carrying forward the sustained process of sustained growth.

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Narayana Murthy

[Nehru Sells India's Youth on Socialism](#)

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NARAYANA MURTHY: All of us believed in central planning; all of us believed in socialism because we were all children of a different generation. We were all mesmerized by the charisma of Nehru. Nehru believed in central planning, Nehru believed in socialism. Nehru believed in the Soviet-influenced model of development. So it was not at all unusual for an idealistic man to be completely bowled over by these principles.

I myself was very much influenced by Nehru's idea of socialism, Nehru's idea of planning. As a youngster, we all looked up to Nehru. But then I realized, when I went to France, and when I spent quite a lot of time in Europe -- I spent about 10 full years -- that if you want to eradicate poverty, you don't do it by [redistributing] existing wealth. You have to create more wealth, and that's when I got somewhat disillusioned by the socialism as [it] is practiced in India. Socialism as it is practiced in Sweden, I think [that is] pretty good, but not as it's practiced in India.

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Yashwant Sinha

The State as Father and Mother

YASHWANT SINHA: Two things [were wrong with central planning]. One that we should have realized right at the beginning was that central planning will not hold good for the entire country, that you cannot have one uniform model either for growth or development for the country as a whole, considering that India is a very diverse country and various states were at various levels of development. Second, we in India did not take into account the merits of decentralized development, which should have been a very important part of the developmental strategy.

The [Permit Raj was not so much] the effect of centralization as it was the effect of the economic theology of the times. We deliberately accepted a model [that] wanted the state to occupy the commanding heights, and we were proud to say that we wanted the commanding heights to be occupied by the state. And therefore, whether it was the government of India or it was the state governments, they went into business in a big way, and they decided to control whatever was there in the private sector also as firmly and fiercely as they could. And that is what led to this license and Permit Raj.

In the initial years and even subsequently, it stifled the spirit of entrepreneurship in this country. It led to too much dependence on government. It led to the evolution of a system where corruption was built in. It led to [a system] where you depend on the state for everything, and that was a bad mindset to have been created in independent India. You know, the British gave us this concept. The state was the father and the mother, and we continued unfortunately with that post-independence.

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Jairam Ramesh

Production by the Masses Versus Mass Production

JAIRAM RAMESH: There's no question about it that India has industrialized and industrialized fairly rapidly in the last 50 years.... But while it's certainly true that we have industrialized, the industrialization has not been of the efficient kind. For example, we have been unduly influenced by the Soviet model, and we have built a very large and extensive base of heavy industry, whereas other countries, like in East Asia, concentrated on labor-intensive manufacturing. You know, they concentrated on textiles, on toys, on sports goods and consumer appliances.

I think part of the reason India went the heavy industrial route and, say, East Asia went the labor-intensive, manufactured-goods route goes back to the Gandhian legacy. See, Gandhi had this dichotomy between mass production and production by the masses. And he felt that mass production was not there for India, and they should go for production by the masses. So [out of] some sort of a respect for the Gandhian legacy, while we went with the Soviet model of heavy industrialization, we also adopted the Gandhian legacy of a deep distrust of mass production.

So today, for example, all over the world you find Chinese goods. You find Chinese toys. You find Chinese garments. You find Chinese electronic appliances. But you don't find made-in-India as a label. And part of the problem is that mass manufacturing is not something India has excelled in.

"Should a steel plant produce steel?"

INTERVIEWER: Now, along with Soviet heavy industrial model, they also imported the idea of Soviet central planning. How did that work, and how successful was it?

JAIRAM RAMESH: Well, don't forget that 80 percent of the [Indian] economy, which was agriculture, was outside of central planning. Agriculture [in India], unlike in the Soviet Union and China, was entirely in private hands. Agriculture in India has never been collectivized, never been cooperativized. The main focus of central planning was on industry, on infrastructure; was saying that we have a shortage of resources, therefore we must have a system to allocate the resources to the best possible use. [It said] that India can't afford... the luxury of a market economy.

So the planning part was essentially oriented towards modern industry. And it worked through a licensing system, through a sequential licensing system, first come, first served. In other words, a group of wise men in government decided that

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so many million tons of steel should be produced, and then licenses were then doled out for those X million tons of steel.

Now, central to the central planning vision was the notion of the public sector, which is where we have to thank the British for this legacy. This was the Fabian socialist model that you have a deep distrust of the private sector and you feel that these are all areas in which the public sector must occupy what came to be called the commanding heights of the economy. And that's why steel, coal, machine tools, capital goods, all the areas of heavy industry were in the public sector and not in the private sector.

INTERVIEWER: Sounds logical, but did it work?

JAIRAM RAMESH: Well, it sounded logical. It worked to the extent that it created a base. It created an infrastructure; it created human capital. It opened up backward areas. Most of our public-sector units are in the most backward and depressed regions of the country, where no private sector would have gone or will go even today. But the question then is what is the function of a steel plant? Should a steel plant run a hospital? Should a steel plant open a backward area? Should a steel plant educate people? Or should a steel plant produce steel? Unfortunately what happened was that the primary function of the public sector, which was production, got into the background, and the other social dimensions of the public sector got primacy.

In the process the public sector became less commercial, less profitable. There was a World Bank report in 1960 which said that India has the competitive advantage to produce steel, and South Korea has no business in producing steel because it has no advantage in producing steel. By 1990 one plant in South Korea was producing more steel than all of India put together, and that plant was set up by Indian engineers. But this was the irony: You had created a technological base, you had created a manpower base, but the economic environment was simply not conducive to efficiency or profitability.

[It was] only in the '80s and the '90s that the costs of this strategy became painfully evident.... First thing that [we] realized was that we were in a shortage economy. My father waited 15 years to buy a car. Today I can go and buy a car off the shelf, to give you a simple example. If you think a car is a luxury in India, think of the two-wheeler, the ubiquitous two-wheeler in India. The two-wheeler was the most prized element in the [compensation of] Indian managers, because you had to wait 20 years to get a two-wheeler. You had a black market for cement. You had a black market for every conceivable product, consumer or industrial. So we were running a shortage economy. A shortage economy meant some people were extracting rents from the economy. The monopolists became rich. Industrialists became rich, and consumers suffered.

The Uncomfortable Reality of Import Substitution

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JAIRAM RAMESH: So clearly the consumer angle in so far as industrial growth was concerned was completely missing. Right through the '60s and the '70s the government said that the people of India should wear cotton clothes. That they should wear "khadi," you know this hand-woven [fabric], but all of Indians wanted to wear polyester. Why? Because it's only the rich who can afford to wear cotton and khadi and hand-woven, because of the cost of ironing, the cost of washing, the cost of maintaining, and polyester is very cheap. But the central-planning model said polyester is bad for India, [and] cotton is good for India. But as it turned out, the people were actually consuming more polyester than they were consuming cotton.

So I think the notion that an economy as complex as India, as large as India could be masterminded by material balances, by a group of wise men deciding what is good for the rest of the economy is simply not true. It was good to launch the economy in the '50s. I mean, Japan did this, China did this; even South Korea did this. All the East Asians did this -- import substitution. I think all countries followed import substitution in the '50s and in the '60s. But I think by the '70s countries were getting out of that first phase of the strategy. East Asia got out of import substitution and went to export promotion. Japan got out of import substitution and went to export promotion. But unfortunately India became very inflexible, and it was only when we had a crisis in the '90s that we made this paradigm shift from an inward-looking economy to an outward-looking economy.

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Lord Professor Meghnad Desai

Korea's Unlimited Market

LORD PROFESSOR MEGHNAD DESAI: In 1960 India and Korea were at the same level of income, and within the next 40 years, Korea became 25 times richer than India, and not by avoiding a state role in the economy, but by having a smart state, a state [that took] its capitalist chances to make profit, but chances to make profit out of efficiency, out of exporting. India suspected capitalists, it suspected the profit motive, and it tried to nail it down, block it, and thought that all growth would come from government planning. And these contrasting models basically showed that by the late 1980s Korea was a miracle economy, and India was a stagnant, slow-trot kind of economy. And that was very telling. Here was an Asian country, not a Western country, an Asian country, recently independent, had a colonial experience, had a war experience, and even they could beat India at the game of growth. And that really was very telling for Indian intellectuals.

INTERVIEWER: You mentioned that they had a smart government, and they didn't have that mistrust of capitalism. But didn't actual trading abroad play a much bigger part in Korea's development than India's?

LORD PROFESSOR MEGHNAD DESAI: That's right. I think the crucial difference was not that some countries planned and others did not plan. They all started planning. But in the late '60s early '70s, Korea and Taiwan switched their economy to export orientation. They built up their base, and then they switched to export orientation. And they gave their capitalists money only if they were succeeding in exporting Korean products. That meant that Korea had an unlimited market, where India had a problem of creating a market within home and selling to that. And basically the bulk of the market was probably the government itself, and that was limited by government revenue. And the whole idea that there was a big market out there did not strike Indian planners. In the mid-70s India could have transformed itself like Korea into an export-oriented open economy, but there was a great suspicion of foreign trade, great suspicion of imports. And as a big country, a continental-size country, India has this delusion that it's self-sufficient, that they can live without foreigners, that they can live without the world. And that has proved to be rather damaging.

The IT Industry Becomes a Self-Generated Miracle

INTERVIEWER: It's very, very similar to the kind of dependencia theory that prevailed in South America, isn't it?

LORD PROFESSOR MEGHNAD DESAI: That's right. Indian intellectuals just were committed not to be seen to be dependent on Western technology and Western capital because that meant to them humiliation. And they couldn't see trade as equal partnership between buyer and seller.

INTERVIEWER: This leads us to globalization, doesn't it? I mean, how significant is the success of an information technology industry in India?

LORD DESAI: That is tremendously important. The IT industry is the first industry which has had global success in India without being part of the government's plans. It figured in no plan at all. No government sectors, no government plan said let us invest in the IT sector. It is entirely a self-generated miracle.... The people participating in it are younger people; many of them have been to the U.S. and experienced entrepreneurship and survived in a competitive market. They've come back, and they have, as it were, made the room. And India has an ambivalence about foreigners. They don't like foreigners; they like to be admired by foreigners. And the fact that the IT industry was admired by Americans, that was a very, very big booster to India. And once those people became a success, they also played in a very, very sophisticated manner, because they were able to lobby ministers so that the minister would not interfere too much, but would give them the supporting infrastructure, like telephone lines and power and so on. And they were willing and able to spend a lot of their political goodwill in announcing the industry, in a very collective way. And so the IT industry has behaved in a remarkable and sort of progressive way. And they've really become an inspiration of all the young people to join the IT industry. And that makes a lot of difference.

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INTERVIEWER: Imagine if Hayek or any member of the Austrian school was here today. I mean, they would be saying, well, it was the precise fact that there was no government involvement that made it successful.

LORD DESAI: Yes, the success of the IT industry is precisely because the government did not make it a national priority. The government did try to make hardware, computer hardware a priority. Rajiv Gandhi did that, and that whole experiment was extremely expensive. But where we could develop comparative advantage was in software. But there's another sector, which is the film industry, which is Bollywood, as it's called. That, too, is completely neglected by the government, and it is a global success. Lots and lots of people watch Indian films around the world. And India, unlike France, does not need cultural protection from American films because it can stand up to Hollywood in a one-to-one fashion. But that is the mark of the new India -- that it can succeed without government help.

INTERVIEWER: If you look at two industries which have been an outstanding successes for India, both with zero government involvement, what is the moral to be drawn here?

LORD DESAI: The moral to be drawn here is something that the people in 1947 did not appreciate: that India has a unique collection of very entrepreneurial, hardworking, commercially minded people. They are not strangers to trade; India has been a trading country for thousands of years. India has had a private-sector economy for thousands of years. It has had a sophisticated financial network. And it needed an independent India to bring out this talent, rather than invent a whole new machinery in its place. Now I think India has learned that you don't need a government to run the economy. You need the government not to interfere with the economy; the economy will run itself. And there are some very talented people who will work very hard and who will save and who will invest and who will get the opportunity. Yes, some of them will fail; they will go bankrupt. But bankruptcy, failure, through that they will make a success of their firms, of their industries. And I think India has now slowly learnt that lesson.