

# theirview

## To plan or not to plan

The extent to which India should conform to wisdom received from the developed world needs to be debated

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Does India need a Planning Commission? Should India be concerned about its fiscal deficit? Are extant fiscal and monetary policy thumb rules optimum?

These are all issues of fundamental importance to economic policy, and keenly debated among academics, policymakers and financial dailies. Unfortunately, there is also avoidable confusion surrounding them deriving mostly from the ahistorical manner in which they are viewed.

Let us consider the Planning Commission, which has been abolished altogether and replaced by a think tank. It is frequently argued that the high noon of planning is long over. The experience of the erstwhile Soviet Union, whose Gosplans initiated planning in the wake of the Russian revolution in the interwar period, is cited in evidence.

However, unlike countries of the former Soviet Union, India is still a developing country in the early stages of putting in place a modern physical and social infrastructure. Historically, public investment, directly or indirectly through tax breaks, has played a major role in infrastructure investment. Public-private partnerships (PPP) have only a marginal role to play—in projects that generate good, and equally important certain and frontloaded, cash flows. But much of public infrastructure investment will not fall in this space.

Private investment did indeed play a significant role in Western countries that were the earliest industrializers. But this was phased over multiple decades. In contrast, economic development in emerging markets in the post-war period is telescoped over a few decades, necessitating a greater role for public investment.

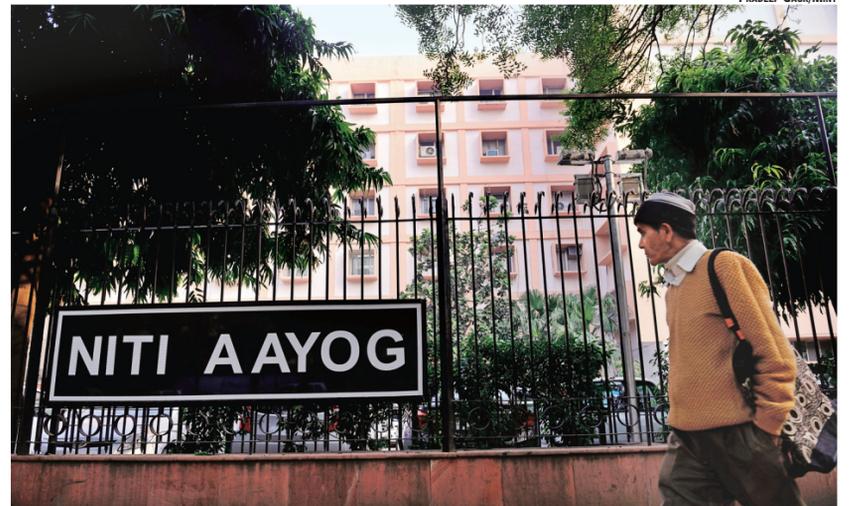
The former Soviet Union could do away quickly with its Gosplans once it broke up in the 1990s because they had achieved the job of putting modern infrastructure in place. India is

still a very long way from this. This is not to say that the Planning Commission in its present form was necessary. But we do need to plan ahead for plugging the huge infrastructure deficit piled up over the years of relative inattention. It is for this reason that South Korea recently revived planning to transit to a faster growing smart and green economy.

Let us consider the fiscal deficit next. Economic theory, indeed plain arithmetic, tells us that as long as fiscal deficits are aligned to the potential growth rate of the economy, they are eminently sustainable. Economists and policymakers in India, however, have for some reason got locked intellectually into a 3% norm for fiscal deficits that has its origins in the Maastricht Treaty of the European Union, and therefore correlated to the potential growth rate of the European Union rather than of India. Although states are allowed another 3% deficit over and above the Union deficit, the Maastricht number has got imprinted into the Indian debate, sanctified by Finance Commissions over the years. As a result, India's public debt-to-gross domestic product (GDP) ratio has shrunk despite major slippages in achieving fiscal deficit targets.

The potential growth rate of fast-growing emerging markets is much higher than that of mature economies in demographic decline. Indeed, rapid growth generates its own fiscal space for financing the infrastructure investment necessary to sustain high growth over an extended period.

China used this fiscal space to sustain high growth over three decades. India, on the other hand, has been squandering this space—first, through a conservative estimation of its fiscal space, and second by using this space for politically expedient and untargeted subsidies instead of infrastructure investment. Rather conveniently, it has shifted the bur-



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den—to the extent of 50%, which has never been achieved anywhere—onto the private sector through PPPs. Unsurprisingly, both high growth and PPP in infrastructure are groaning under the onerous burden.

Finally, let us turn to macroeconomic policies. The received wisdom, derived from the application of Keynesian macroeconomic policies in Organisation for Economic Co-operation and Development (OECD) countries, is that fiscal and monetary policies play a key role in macroeconomic stabilization through stimulative or contractionary fiscal and monetary policies, as appropriate.

Since discretionary fiscal policy came to be seen as destabilizing because of its overtly political overtones, this now mostly consists of self-limiting contra-cyclical automatic stabilizers. The pole position in macroeconomic stabilization has devolved on independent central banks through rule-based monetary policies targeting a mix of inflation and unemployment/growth, such as the widely popular Taylor rule.

It needs to be recognized however that OECD is an organization of developed economies with modern infrastructure already in place. Stabi-

lization is consequently the primary focus of macroeconomic policy. While stabilization policies have a role in emerging markets as well, the demand for large-scale infrastructure investment means that there is a major role for fiscal policy in all stages of the business cycle.

Likewise, monetary policy in emerging markets has other developmental functions over and above the stabilizing role. Since financial markets are much less developed, savings tucked away under the proverbial mattress, or in unproductive assets such as gold, need to be channelized into investment. Making financial savings more attractive may well mean tweaking the 2% constant above the target inflation rate that generates the policy rate in the Taylor rule equation.

Monetary policy in emerging markets cannot also be exclusively focused on the domestic business cycle as it needs to respond to volatile capital flows that destabilize domestic business cycles. They need to “tailor” solutions to the impossible trinity based on their own individual circumstances.

Comments are welcome at [theirview@livemint.com](mailto:theirview@livemint.com)

# otherviews



## Secular stagnation for free

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Something is definitely rotten in the state of capitalism. Despite unprecedentedly low interest rates, investment in most advanced countries is significantly below where it was in the years prior to the 2008 crisis, while employment rates remain stubbornly low.

For some reason, achieving a level of investment that will generate full employment seems to require negative real interest rates, which is another way of saying that people have to be paid to invest. But in a world of low inflation and zero nominal interest rates, getting to the required negative real rate may be a challenge. This is the ailment that Larry Summers, recalling a 1938 paper by Alvin Hansen, has dubbed “secular stagnation”.

The consequences of this state of affairs remain open to debate. For Keynesians, the answer is unconventional monetary policy, fiscal stimulus and a higher target inflation rate. But, as Summers and others point out, lax monetary policies may trigger asset bubbles, and prolonged fiscal stimulus may end in a

debt crisis. For others, the problem is lower investment demand, caused partly by the fact that machines are now much cheaper and that technological progress has slowed since 1970. Economists such as Robert Gordon and Tyler Cowen argue that the technological breakthroughs of the past, including piped water, air conditioning and commercial air travel, had a greater social impact than many of today's advances.

This assessment bothers optimists such as Joel Mokyr or Erik Brynjolfsson and Andrew McAfee, who do not believe that technological progress has slowed. Instead, they argue that the traditional concept used to measure economic output and growth, gross domestic product (GDP), understates that progress. After all, our lives have been made dramatically more productive thanks to Google, Wikipedia, Skype, Twitter, Facebook, YouTube, Waze, Yelp, Hipmunk, Pandora and many other companies. But all deliver their services for free, which means that the benefits they provide are

not counted in GDP.

The fact that so much innovation is given away for free does not only create a measurement problem for economists; it is also a real problem for those trying to find investment opportunities. In the good old days of the post-World War II boom, if you wanted an air conditioner, a car or a newspaper, you had to buy one, making it possible for producers to earn money by providing them.

Information-intensive products are different. As the cost of providing an extra copy is almost nil, it is hard to charge for them. Radio and television were the first to confront this problem, because they could not prevent those with a receiver from getting the signal. They had to develop an advertising-based model, making it possible for others to pay for the benefits received by the consumer. So we live in a world where much of the progress that new technology permits is embodied in products that must be given away for free. A somewhat haphazard subset of potential products can, with the

right business model, be profitable—say, by advertising or by selling information passively collected from users.

But many others, such as Wikipedia and public radio, have trouble making ends meet. Free products also depress the value of close substitutes. While it may require charging \$100 per ticket to recover the costs of a \$1 million theatre play, some filmmakers can make money on a \$200 million film by selling \$10 tickets to consumers unwilling to wait a few weeks until a cable TV provider offers it.

To harness the possibilities of new technology, non-market forms of payment may be needed for valuable contributions. The traditional model may have made Bill Gates rich, but his foundation now finances valuable breakthroughs in unprofitable ways. As with negative real interest rates, but in a more targeted manner, we may have to pay to make valuable investments happen.

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