The planning of economic policy

1 General characteristics of the economic policy

The main emphasis in development planning has so far been on the most desirable development of production, investment, consumption, employment, imports and exports, and income. Comparatively little attention has been given to the way in which this development can be implemented, although this is really the most important part of the effort that is to be expected from both the public and the private sectors. The probable reason why so little is to be found in most plans about how they should actually be carried out — although this situation is in fact gradually changing - is that these plans were, to begin with at least, strongly influenced by communist development policy. Communist policies were often seen, perhaps in rather too simple terms, simply as directives to those who had a part to play in their execution. Soviet development policy has certainly become more subtle with the passage of time, but the idea that planning implies a policy of directives is still very widespread.

There is nowadays a general tendency to regard development policy as distinct from planning itself, and to see this policy as characterised by a number of means that are employed to accomplish the aims formulated in planning. These means consist partly of direct action in the public sphere and partly of indirect action in the private sphere. These indirect means may be either numerous or less numerous, and the private sector may be smaller or greater, with the result that it is possible for the relative importance of the direct and the indirect means to vary considerably. Both means, however, exist everywhere, and in countries like the Soviet Union a great deal of thought has been given to the question of the indirect influence on consumers and peasants, to name only two very large groups. In the sections that follow, I shall discuss how the most important means of economic policy can be chosen and I shall be particularly concerned with the extent to which these means can be used to achieve the aims of the plan.

2 Public investment

Public investment forms an important part of the development policy in every country. It takes place in the government controlled sectors, which are in any case important parts of the so-called infrastructure or, in the terminology used in this book, the national sectors. In some countries – especially the communist countries, but also India and Turkey, for example – a number of international sectors, in other words, parts of the so-called superstructure, are publicly owned. It is hardly necessary for any further calculations to be made, after the plan has been drawn up, in connection with the scope and nature of this investment, since this will have been done in the plan. Every year, however, a number of new projects will be started in addition to those already being carried out.

3 Other public development activities

Some of the so-called current activities of the government may be regarded as forming a part of the development policy. These are to be found especially in the sphere of education and information. The latter may be of a general kind, such as the publication of the plan itself, for use by many industries, for example, in market analysis. It may, however, take a more specific form, such as information for farmers about seeds and food-stuffs or about market developments. Another example of more specific information is that given in industrial estates in which small industries can rent space and use the estate's supplies of energy and water. In such cases, technical information about the particular smaller industries themselves is also frequently provided. Other kinds of information include, for example, that supplied by the statistical office and that dealing with the conditions under which foreign industries can become established in the country.

The extent to which education is to be developed is usually shown in broad outline in the plan itself, but this has to be worked out in greater detail according to regions or places and types of

education, which in turn involves the making of a very great number of decisions. This is an example of the detailed specification of means which are applied in a more or less decentralised manner

The extent to which information will have to be provided will depend partly on the demand for it. It will, however, be kept within certain limits by the budget items that are set aside for it. These will in turn be based on past experience, but will also be adapted to new circumstances.

Legislation must also be included among the current activities of the government. New legislation will, however, generally be introduced for each subject as it occurs, and it may in fact be concerned with fundamental reforms. There is considerable divergence of opinion here between different politicians and political scientists and also between various experts. My own view about these fundamental reforms has been given in chapter 5.

4 Taxes and subsidies

Fiscal means are among the most important of the indirect means available to development policy. Taxes on the one hand and subsidies on the other can have a powerful influence on the decisions of private consumers and firms. To begin with, taxes, taken as a whole, limit the purchasing power of private individuals and firms, and may thereby keep the total demand for consumer goods at the level chosen by the government in the plan. It is well known that the money needed for the large investment made by the communist countries is obtained by high indirect taxation of consumer goods in these countries. The ratios between different taxes may also contribute to the limitation of the demand for certain products, such as alcoholic drinks, more than for others, such as milk, which may perhaps be subsidised, both in the interests of public health. Taxation and subsidies can also be used to achieve temporary aims, for example, the provision of more opportunities of employment. The products of the great textile factories are taxed and those of handloom weaving are subsidised in India partly

for this purpose. The determination of the volume of such taxes and subsidies on different products should be based on a specialised econometric study, in which an attempt is made to evaluate the elasticity of the demand for products in relation to different prices and incomes, on a basis of which the tax-rates can be determined. Examples of this kind of analysis can be found in the literature of econometrics.

Taxes and subsidies can also be applied in the case of production factors, so that the prices of these factors can be made to approximate more closely to their accounting prices. The accounting prices will then provide an indication of the level of taxation or subsidies required.^[16]

5 Market regulation

The markets of some products, especially those of agriculture and mining, are subject to considerable fluctuations. These are caused partly by irregular fluctuations in the harvests and partly by cyclical fluctuations in demand. Such swings are also influenced by the degree of elasticity in supply and demand. The prices of these commodities sometimes fluctuate so much that all kinds of undesirable social and economic repercussions are caused, such as interruptions in investment or too great variations in welfare and employment. These markets are frequently regulated by special government schemes, sometimes national, but frequently international. The aim of these schemes is to bring about quieter movements in prices by manipulating stocks or imports and exports. Very many technical problems have to be solved if this market regulation is to operate smoothly. These problems can usually be dealt with in a decentralised manner by the ministries concerned, in co-operation with international bodies such as the FAO, and in consultation with the interested groups. The extent of the measures introduced can be planned partly on a basis of market analyses – either econometric analyses or rather more pedestrian analyses – and partly on a basis of a number of technical and legal data. A full

discussion of this problem and its solution would, however, clearly lead us too far from our main theme.

6 The regulation of foreign trade and the building industry

In addition, the government often needs to take steps to regulate the foreign exchange market and the building market. Foreign currency is often scarce, and care must be taken that the best possible use is made of such scarce factors. Estimates of the most desirable volume of imports of a number of categories of products are usually given in the plan, and the measures to be taken can be directly linked to these estimates. They must, however, be subjected to further detailed study. They must also be divided into the categories and qualities of the products concerned and into the firms considered for import, according to certain more detailed regulations.

Exports will normally be less subject to regulations than imports, except insofar as export products are involved in market regulation. Exports can also be encouraged by classifying export products according to quality and by fixing certain differences in price for these different qualities. The smooth flow of exports can also be promoted by packing and despatch and by holding stocks, all of which can help to improve the position of the product on the world market.

The building industry is similarly regulated in many countries, because of its strategic importance in the process of investment. If permits are required for building, it is possible to survey the whole process of investment and thus keep a check on the carrying out of the plan. It is also possible to prevent building capacity from being employed for less useful aims. There is a very common tendency in developing countries to build luxurious houses. This can yield a fairly certain income that is protected against changes in the value of money. It has, however, caused overcapacity in the more expensive sections of the housing market in many countries.

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Since the small, prosperous upper class in these countries favours the most modern forms of domestic comfort, the somewhat older houses tend to remain empty. This means that investment made in the fairly recent past will prove to have been misplaced, although this will scarcely impede the progress of new investment. Restrictive measures may, however, be needed. The nature and scope of these measures will to some extent have to be based on arbitrary decisions. Too little is known about the effects of the various factors which come into play here for any precise assessment to be made.

7 Wages and prices policy

It may be necessary for the government of a country where there is an important and growing number of employees to conduct a separate policy of wages and prices, with the aim of preventing inflationary developments. Such measures are almost inevitable in countries with a weak system of public finance, where inflation has assumed considerable proportions. In general, however, they simply cure the symptoms – the causes of the disease are usually traceable to the management of public finance.

A wages and prices policy will attempt to prevent a too rapid rise in the level of wages and prices, usually by forbidding increases in price, unless it can be established that it is the costs of production that have risen. What is frequently done, contrary to sound management, is to keep the prices of the products of at least the state industries low.

8 Financial and monetary policy

Certain important elements of financial policy have already been discussed in the preceding sections of this chapter (see especially sections 2, 3, 4). These elements should be seen in their inter-relationship, the most important aspects of the problem being that the total demand for goods and services should be kept in line with the

planned value of their production and that the demand for consumer goods should be kept in line with the domestic savings necessary for development. The figures will be known from the plans. The real difficulty is usually to keep to the proposed returns from taxation in practice. No country in the world likes paying taxes, and many parliaments put the government of a country in a difficult position by demanding that more and more should be spent on all kinds of aims, but refusing to vote for the taxes that will be needed if these aims are to be carried out.

In addition to the government's financial policy, its monetary policy (that is, its regulation of the volume of liquidity available to the economy), is also important. If the national income rises, the amount of money, in its various forms, is also permitted to increase and a part of the national expenditure, both public and private, can therefore be financed by the creation of credit, without any risk of an increase in prices. This may result either in an increase in the number of banknotes issued by the central bank or an increase in the deposits of the commercial banks. No bank notes, however, are issued unless other values are received for them, and no deposits can increase unless other values are surrendered. This means that the future accounts both of the central bank and of the commercial banks will have to be analysed if the government is to formulate its most desirable monetary policy. The remainder of the economy must also be taken into consideration if all the figures are to form a connected whole, and a distinction is usually made here between the public sector, the private sector and abroad. The planner will therefore have to concern himself with the 'financial flows' that take place between these five sectors as a result of the carrying out of the plan. A number of items in these accounts will not necessarily be fixed, and these few 'degrees of freedom' which still remain can be used to devise the best possible monetary policy. It depends, of course, on the country itself and on the legal provisions or the customs that are in force as to whether these degrees of freedom are limited or not, but generally speaking there will be a sufficient number still available, so long as the financial policy under review

is correct. Among the means available to the government or the central bank for increasing liquidity without creating undesirable consequences is a change in the 'reserve ratios' that are required, by law or custom, by the commercial banks. This reserve ratio is the ratio between the deposits of these banks with the central bank and their own outstanding deposits.

9 Incidental instruments

In addition to the instruments already mentioned – these are the best known and the most universally applied – there are many others which are less commonly employed, but which can be useful in certain circumstances. They may consist of contracts with individual enterprises, leading, for example, to a new enterprise being set up in a certain region, or to a course of training being organised for certain groups of persons. They may, on the other hand, take the form of the free provision of goods and services, of the arrangement of courses of study at an institute of higher education, of checks on quality or of consultations between private industrialists with a view to the joint manufacture of a new product. Together with the countless executive measures and their interpretation in particular cases, these incidental measures form part of the vast microcosm of economic policy with which intelligent planning is not normally concerned. I shall therefore not discuss them in any greater detail here.