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Planning in an Open Economy

By Dr Bela Balassa, New Haven

The word "planning" has been used to denote a wide range of activities from the central management of the economy in the Communist countries to government-sponsored forecasts by private groups in Sweden. In a more restricted sense, we speak of planning if the allocation of resources among individual industries is directed—or substantially influenced—by the government whose actions are based on a comprehensive blueprint relating to a period of several years. This definition includes within its scope planning in Soviet-type economies and in several of the developing countries, as well as planning on the industry level in developed market economies.

It is suggested here that planning, as understood in a narrower sense, is inward-looking in character: it can best be applied in countries whose economy is more or less closed to foreign influences and it provides an inducement for reducing reliance on international trade. To begin with, the uncertainty of plans and forecasts increases with the degree of openness of the national economy. While information on interindustry relationships can be utilised to derive a feasible pattern of production associated with a growth target in a closed economy, disappointed expectations in regard to exports and unforeseen changes in imports will give rise to discrepancies between plans and realisation if the foreign trade sector is of importance. Correspondingly, the chances for plan fulfilment can be increased by limiting dependence on international exchange.

In this paper, I will consider the implications of the "openness" of developed market economies for planning on the industry level. In this connection, first I will examine the experience of certain European countries in planning the level of foreign trade, its composition, and the balance of trade. Next, we will examine the limitations of planning in open economies and the implications of Common Market's establishment for French planning. The paper will close with a discussion of the prospects for planning on the EEC level.

European Experiences

A consideration of the plans of various countries suggests a tendency to underestimate the level of foreign trade. While demand for primary products can be estimated as a function of national income or the production of various branches of manufacturing, international exchange in manufactured goods involves intra-industry specialisation, when the uncertain-

ties relating to the latter may, in part, explain the observed underestimation of the level of trade.

The French Third Plan

The French Third Plan can serve as an example; in this case, exports to countries outside the franc area had been estimated at 17.5 billion francs and imports at 16.3 billion francs for the terminal year of the plan 1961, while actual exports were 22.4 billion and imports 20.6 billion. And although one may argue that during the period of execution of the Third Plan the planners faced a special situation by reason of the two devaluations and entry into the Common Market, the volume of trade has again been underestimated in the Fourth Plan: between 1961 and 1964 imports rose by 49.2% instead of the projected rate of increase of 16.7%, while the relevant figures for exports are 21.5 and 14.8%.

At the same time, changes in total exports and imports often cover large interindustry differences. Thus, even if exports and imports are correctly estimated for the economy as a whole, production and investment plans in individual industries will be disappointed if export demand exceeds expectations in some industries while others have to contend with smaller exports or larger imports. Deviations from projected trade values will affect domestic production directly, as well as indirectly, through input-output and multiplier-type relationships. An indication of the direct effect can be provided by comparing actual production and trade figures with the estimates contained in the plan. In the case of the French Third Plan, the deviations went in the same direction in six out of nine manufacturing industries, and in three cases—automobiles, naval construction and aircraft, and construction materials—unplanned changes in the trade balance had a considerable effect on production (Table 1).

Its poor trade performance accounted for the entire shortfall of production in the automobile industry; actual production fell behind the planned figure by 433 million francs, while the discrepancy in the trade balance was 564 million francs. Similar results are indicated for a number of other commodities, too, if the data are appropriately disaggregated. Besides the well-known case of refrigerator imports from Italy, we may mention the experience of the organic chemical industry where the expansion of imports restrained the rise of domestic production. It may be added that the production figures show the influence of domestic and foreign uses and, in cases where the

two moved in opposite directions, the data do not reveal the direct impact of trade on production.

Table 1
**Differences between Forecasts and Realisation in
Manufacturing Industries during the period of the
French Third Plan (1958—61)**
(million francs in 1956 prices)

Manufacturing Industry	Production a	Trade Balance b
Food manufacturing	—1336	—297
Construction materials and glass	+ 195	+120
Production and transformation of metals	—1150	+121
Electrical and nonelectrical equipment	+ 738	—199
Automobiles, motorcycles and bicycles	— 433	—564
Naval construction and aircraft	+ 493	+290
Chemical products	+1934	+ 54
Textiles, clothing and leather	— 998	—196
Wood, paper and other industries	— 45	+435
All manufacturing	— 602	—236

Source: J. Benard, C. Roux, and C. Girardeau, "L'exécution du III^e Plan français: Essai de mesure et d'analyse", Bulletin du CEPREL, July, 1964, pp. 96, 103—4.

Notes: (a) at production prices; (b) excluding customs duties.

A further consideration is that the trade balance in the national plans is generally taken as a target rather than accepting the independent estimates of exports and imports. Thus, the trade balance postulated in the plans provides a constraint for the estimation of trade flows and requires the—often arbitrary—modification of the trade projections. Adjustments are usually made in regard to exports so that the global export forecast included in the plan becomes a residual as well as a target. Few efforts have been made, however, to indicate the price changes that would be necessary for reaching this target, and to ensure the consistency of the assumptions underlying the export and import forecasts.

United Kingdom, the Netherlands

In the United Kingdom, note has been taken of the lack of consistency in the assumptions made by the National Economic Development Council in regard to exports and imports, and the projections of the Cambridge Growth Project are also open to criticism. In the latter case, exports are regarded as an exogenous variable and competitive imports become a residual, inasmuch as a balance-of-payments constraint is imposed on the model and complementary imports are estimated as a function of the output of individual sectors.¹ But although the forecast of exports, as well as that of competitive imports, involves implicit assumptions regarding prospective changes in prices, price changes are not explicitly introduced in the model and the consistency of the underlying assumptions is not ensured.

By comparison, in the Netherlands it has been proposed to apply a general equilibrium model that incorporates consistent price assumptions and does not include a balance-of-payments constraint. Instead, equilibrium between potential and actual production

is assumed to be ensured by the choice of the appropriate level of autonomous expenditure (government expenditures and residential construction).

The Dutch model represents an advance in the handling of the foreign trade sector and could be further improved upon through appropriate disaggregation. But, for the purposes of projection, the model is as good as its assumptions—in the present case the assumptions relating to the future growth of the world market, the share of the country's exports in this market, the elasticity of substitution between domestic and foreign merchandise, and changes in relative prices in the world economy. The realism of the assumptions means, in the first place, that these are consistent with assumptions made in the plans of other countries. There are indications that this is not the case for industrial countries that are presently engaged in preparing long-term plans. Estimates on the expansion of the world market would agree only by chance, and the tendency to assume unchanged or increasing shares for individual countries results in a "oversubscribing" of future sales. This tendency in turn, finds its origin in the desire of the countries under considerations to improve, or at least to maintain, their balance-of-payments position. We find here the counterpart of the observation according to which by reason of the conservative ways of judging the balance-of-payments position in individual countries, on the world level a substantial deficit is shown. Correspondingly, a summation of planned trade balances would show a substantial surplus that could materialise only if aid to less developed countries was greatly stepped up.

Much has been said about the error-possibilities associated with the estimation of substitution elasticities and it does not need to be repeated here.² Uncertainties are even larger in regard to price trends, as indicated by differences in the projection of prices in France and the Netherlands: while the preliminary version of the Fifth Plan calculates with a slight fall in the export prices of manufactured goods in the 1965—70 period, in the Dutch model import prices of manufactures were assumed to rise by 5% between 1962 and 1970.

The Limitations of Planning

In the previous section, I have examined various error possibilities associated with the projection of trade in the national plans. These error possibilities augment uncertainty for individual industries and enterprises, while the lack of a common methodology and the tendency to project improvements in the trade balance of developed countries lead to inconsistencies in balance-of-payments forecasts. In turn, the relative importance of these errors for planning and business decision-making will depend on the degree of "openness" of national economies. For individual industries,

¹ Richard Stone, "British Economic Balances in 1970: A Trial Run on Rocket", Colston Papers, London, 1964, pp. 75, 77, 82.

² Cf. e.g. G. H. Orcutt, "Measurement of Price Elasticities in International Trade", Review of Economics and Statistics, May, 1950, pp. 117—32; and A. C. Harberger, "Some Evidence on the International Price Mechanism", Journal of Political Economy, December, 1957, pp. 506—21.

the openness of the national economy means that projections on future sales involve a considerable degree of error by reason of the uncertainty associated with future trends in production and consumption abroad, of which foreign trade is but a reflection. These errors are magnified in regard to investment decisions that respond to changes in production over time.

At the same time, the opening of national economies makes the activity of individual industries and enterprises more sensitive to changes in international price-relationships. On the one hand, buyers will react to relatively small changes in prices; on the other, foreign competition will restrain price increases, whereas in a closed economy oligopolistic firms could raise prices in the event of a wage inflation.

Given the uncertainty introduced by foreign trade, the planners can hardly guarantee the correctness of projections for individual industries in an open economy, and doubts arise concerning the desirability of government intervention in business decisions since ultimately the profit of the enterprises will be affected. At any rate, while in a closed economy selective measures can be used to validate the forecasts and constrain enterprises to follow the directives of the plan, under OECD and GATT regulations the scope for the application of such instruments is greatly limited. The possibilities for employing measures that discriminate among domestic industries, and between home production and imports, further diminish in the framework of the European Common Market and the European Free Trade Association.

Moreover, with the reduction of trade barriers and the movement towards integration in Western Europe, entrepreneurs increasingly take account of developments elsewhere in making their production and investment decisions. There appears to be a tendency for specialisation in narrower ranges of products and the production process itself is often subdivided between the manufacturers of different countries through the exchange of parts, components, and accessories.

These considerations indicate the limitations of planning in the private industrial sector of open economies. It appears, then, that industrial countries have to make a choice between fully participating in the world trade-network and planning in the private industrial sector. This choice is especially acute for small countries where the cost of protection and the obstacles to planning are the greatest.

It is hardly surprising, therefore, that small countries, such as the Netherlands, Norway, and Sweden, generally refrain from the application of non-neutral measures in regard to manufacturing industries.³ As

³ Cf. C. A. van der Beld and P. de Wolff, "Exercise in Medium Term Macro Forecasting for the Netherlands Economy", paper presented at the Centre International d'études des problèmes humains, in Monaco, in May, 1964, P. J. Bjerve, "Government Economic Planning in Norway", Working papers from the Central Bureau of Statistics of Norway, 1963, and Ingvar Svennilson, "Long-term Planning in Sweden", Skandinaviska Bank Quarterly Review, 1962 (3).

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Professor Svennilson expressed it, 'the philosophy of this approach is closely linked to the factor of uncertainty. Roughly 25% of Swedish production is exported and imports have a corresponding share in supplying the home market'.⁴ In Norway, the present situation has come about as a result of a "de-planning" undertaken following the early postwar period when the government had a number of instruments at its disposal for controlling production and investment. Finally, in the Netherlands planning has been confined to short-term policy-making, and long-term models have been used only for purposes of forecasting.

The Experience of France

The experience of France is also of interest. Before the acceptance of obligations in the OEEC and entry into the Common Market, the French applied fiscal and credit measures of a discriminatory character to ensure plan fulfilment and to shelter domestic industry from foreign competition. With the opening of the French economy, however, these instruments have increasingly fallen into disuse. At the same time, industrialists have come to orient their activity in a Common Market framework, and have reasserted their

⁴ Op. cit., p. 77.

independence from government intervention.⁵ To avoid a further erosion of the planners' authority, some commentators have suggested that the methods of French planning be "transplanted" and utilised on the Common Market level.⁶

But are the conditions for planning of the French variety fulfilled in the Common Market? Robert Marjolin, the Vice-President of the European Community in charge of matters of economic policy, has pointed out that "planning, including programme planning, presupposes an economy whose relations with the outside world are limited or can be restricted should the necessity arise".⁷ At the same time, the openness of the EEC, measured as the ratio of foreign trade to value added in the production of traded goods, is about 20%, comparable to that of the French economy, taken by itself. Moreover, notwithstanding the trade diversion the Common Market's establishment might have entailed, trade with non-member countries as a percentage of value added in the production of traded goods has continued to increase: this ratio was 16.5% in 1953, it rose to 19.0 in 1958 and to 19.6 in 1963.

The figures indicate that international trade is of considerably greater importance for the European Common Market, taken as a unit, than for the United States where the ratio of trade to value added in the sectors producing traded goods barely exceeds 10%. And while in 1959 the average share of exports in the output of manufacturing industries was 14.1% in the EEC, the share of exports is higher in the fastest-growing industries: machinery and transport equipment (21.2%) and chemicals (16.7%). The share of external trade in manufacturing output may increase further in connection with the observed process of intra-industry specialisation among industrial countries, and these developments would be accentuated if the tariff negotiations undertaken in the framework of the Kennedy Round were successful.

It would appear, then, that the Common Market, too, faces a choice between a liberal trade policy and planning in the private industrial sector. In this connection, a comparison with the situation existing in France before the "opening" of its economy will be of interest. In 1953 the proportion of foreign trade outside the French market area to value added in the production of traded goods was only 10.8% in France, i.e. about one-half of the ratio shown for the Common Market in 1963. Moreover, the French used quotas, subsidies, and various other discriminatory measures to shelter domestic industry from foreign competition and to favour one industry over another. Thus, the Government could effectively intervene in the private industrial sector, while the

pre-conditions of such an intervention have increasingly disappeared as the French economy has become more open.⁸

Programming in the EEC

Given the higher proportion of foreign trade in national income, the lack of application of quantitative restrictions, and its lower tariff level, a shift towards protectionism would be necessary in the Common Market to provide the same "environment" for planning that existed in France in the mid-fifties. Some observers believe that such a shift is, indeed, in the offing, and interpret the pronouncements made by officials of the Community as indicative of a tendency towards planning on the industry level—and hence towards protectionism. According to D. Swann and D. L. McLachlan, for example, programming in the EEC will develop in the direction of bringing "a direct influence to bear upon the production and investment decisions of the private sector".⁹

In support of this proposition, the authors argue that Marjolin's assurances to the contrary should not be taken at face value since "Marjolin believes in planning, and he is not the only Commissioner to hold such a view".¹⁰ They further maintain that pronouncements by the EEC Commission and Marjolin on this subject are ambiguous,¹¹ and conclude that "an even stronger argument for believing that EEC programming will tend in the direction of direct influence on private entrepreneurial decisions... is based on the fact that the progressive establishment of the customs union weakens the effectiveness of the national programmes; so much so that those responsible for national programmes regard programming at the EEC level as being indispensable".¹² In the opinion of the present writer, however, Swann and McLachlan's conclusions are based on a misreading of the evidence.

Their first argument is mind-reading, pure and simple, and can be dismissed as such. In turn, references to ambiguity in the pronouncements of EEC officials reflect a lack of understanding of developments in the thinking of the responsible authorities in Brussels. This progress finds expression in the apparent discarding of the term "planning" in favour of "programming" after the first Marjolin speech in Arcachon on May 25, 1962, and in the subsequent interpretation of programming as a growth policy. It is also suggested by a careful reading of published material. Thus, Marjolin does not speak about "the probable and desirable distribution of the increase of GNP" among individual industries as the authors imply¹³ but among the large sectors of the economy,

⁵ See, e.g., the declaration of the Conseil National du patronat français, made public on January 19, 1965.

⁶ Cf. e.g., Jean Boissonat, "A la recherche d'une planification européenne", *Economie et Humanisme*, November-December, 1961, pp. 66-82, and Jean Bénard, "Le Marché commun européen et l'avenir de la planification française", *Revue économique*, September, 1964, pp. 756-84.

⁷ Bulletin of the EEC, July, 1962, p. 12.

⁸ For a detailed discussion, see my "Whither French Planning?", *Quarterly Journal of Economics*, November, 1965.

⁹ D. Swann and D. L. McLachlan, "Programming and Competition in the European Communities", *Economic Journal*, March, 1964, p. 90.

¹⁰ Op. cit., p. 90.

¹¹ Op. cit., p. 91.

¹² Op. cit., p. 91.

¹³ Op. cit., p. 81.

such as agriculture, mining, and manufacturing.¹⁴ At the same time, a broad sectoral policy does not necessarily entail direction or intervention in the production and investment decisions of private enterprises; in fact, Marjolin disclaims any intention of "limiting in any way the freedom of the enterprises, who will rest entirely the masters of their production and investment decisions".¹⁵ This theme is further developed in the policy proposals of the Community made public on July 25, 1963. This document expressly excludes interference with decisions made by private enterprises from the scope of programming in the Common Market.¹⁶

Finally, while pressure is brought on the Commission from some quarters for introducing planning in the private industrial sector on the Common Market level, one should not forget the counter-pressure that comes from countries with a tradition of liberal economic policies, such as Germany and the Netherlands. At the same time, with the lessening of government intervention in the private sector in France, the French patronat, too, has come out for further "deplanning". One may doubt, therefore, that in the absence of a radical change in the present economic situation of the Common Market, the proponents of Community-wide planning in private industry would carry the day.

The Prospects for Planning

These considerations raise serious doubts concerning the desirability and the feasibility of planning in the private industrial sector of open economies, including the Common Market. In the face of the uncertainty associated with foreign trade and the limitations of instruments available to governments under GATT and OECD regulations, the introduction of planning in this sector would presuppose a shift towards protectionism which would not fail to have adverse consequences for the world economy.

This conclusion does not mean, however, that industrial countries should adopt a negative attitude towards all forms of planning, using the term in a more general sense. One can hardly object to preparing long-term forecasts for the industrial sector in the framework of projections for the national economy, for example, provided that no coercive measures are used to insure the implementation of the forecasts. This is planning's function as "generalised market research", the virtues of which Pierre Masse, the Commissaire général of the French Commissariat général du Plan, has often extolled.

Long-term Projections

At the same time, long-term projections would provide information on the government's economic policy and its future claims on resources. But, in the opinion of

¹⁴ "Rapport général", in *La Programmation économique dans les pays de la C.E.E.* (Rome, Consiglio Nazionale dell'Economia e del Lavoro, 1962, p. 28; p. 54 in the Italian edition.)

¹⁵ Ibid.

¹⁶ Communauté économique européenne, Commission, *Politique économique à moyen terme de la Communauté*, Brussels 1963.

the present writer, the main function of planning should be to provide a framework for coordinated and rational action on the part of the government in regard to activities where the price mechanism does not appropriately evaluate needs and objectives, and appreciable differences between private and social productivity exist. Prices do not serve as a yardstick for choosing among private and public goods, or for determining the composition of public spending. Differences in private and social profitability are also observable in the so-called semi-public sector (agriculture, transportation, and energy), in regard to regional policy, and may pertain to the choice between social and private profitability.

As regards the latter, government intervention can be considered desirable if private decisions do not lead to sufficient investments to reach a growth rate accepted as a target. Such interventions are undertaken in practically all industrial countries, usually on an ad hoc basis, and take the form of tax policy or provisions for accelerated depreciation. Similar considerations apply to basic research that is generally regarded as a par excellence case of differences between social and private profitability.

The determination of the volume and composition of public spending is a further consideration. This involves the evaluation of collective needs and the development of methods that can be utilised for effecting a choice among them. Efforts in this direction have been made, e. g. in France, although it has been noted that the plan succeeded much less in the public sector than in market-oriented activities.¹⁷ Part of the explanation may lie in the fact that while prices provide a yardstick for choice among private goods, no similar mechanism exists in regard to public goods. Little is known about the productivity of public investment in fields such as education, for example, and methods for effecting a rational choice among various forms of public consumption are yet to be developed.

Lack of Coordination

A related problem is the lack of coordination among public agencies and administrative organisations that is observed, to a lesser or greater extent, in all industrial countries. In the absence of appropriate methods for evaluating the needs and demands of the various agencies and organisations, decisions are often influenced to a considerable extent by the relative bargaining power of these organisations. The difficulties of coordination are augmented by the apparent desire for aggrandisement on the part of heads of ministries (France, Japan), autonomous agencies (Belgium), public enterprises (Italy), and conflicts are often observable in the relationships of central and local authorities, too (Norway).

Planning can also have usefulness in the case of agriculture, transportation, and energy that can be regarded as part of the semi-public sector. Govern-

¹⁷ Jean Bénard, "Le Marché commun européen et l'avenir de la planification française", *Revue économique*, September, 1964, p. 764.

ments everywhere intervene, to a lesser or a greater extent, in agriculture but these interventions often respond to demands made by pressure groups rather than reflecting a conscious long-term policy. Yet a rational policy for agriculture can hardly be formulated without considering the future demand for and supply of foodstuffs and agricultural raw materials at home and abroad, trends in productivity, and the need for transferring manpower from agriculture to industry. Similarly, transport and energy policies should be based on an evaluation of future needs as compared to availabilities.

Differences in private and social profitability may further be associated with interregional differences in economic development, and in the postwar period several of the industrial countries have undertaken policies aimed at assisting undeveloped and declining regions. These policies have often lacked coordination, however, and little attention has been paid to their cost in terms of alternatives foregone. Thus, efforts have been made to support the economy of declining regions or to develop regions with poor natural resource endowments, thereby reinforcing the rigidity in the locational structure. With regard to Sweden, it has been suggested, for example, that by reserving government assistance "primarily for localities with high unemployment, or where a relatively small proportion of the population is employed in manufacturing industry, the Committee (in charge of regional problems) has probably selected with a high degree of precision regions with especially poor natural facilities, and thus also with limited development potential".¹⁸

NORTHERN EUROPE

Approaches to Commercial Integration

By Dr Alfred Dietrich, Stockholm

On November 21, 1966, an agreement has been concluded in the Ministry of Foreign Affairs at Stockholm, that, according to the statement of the Swedish Minister of Commerce, Gunnar Lange, is a "very obvious proof" of the North European countries' co-operation and, so to speak, has to be considered the climax of endeavours to obtain a commercial integration of this group of nations—efforts lasting for decades already. On this day an agreement on joint actions of the Northern countries within the Kennedy Round of negotiations on world-wide tariff reductions within the framework of GATT was signed by Denmark, Finland, Norway and Sweden. The chief negotiator, Mr Montan of Sweden, is in charge of "conducting the negotiations of the North European delegation and after having been authorised by the Governments of the four countries will make binding

A rational policy would take account of the long-term development potential of the economy, and would aim at facilitating the process of transformation rather than hindering it. This, in turn, would require the evaluation of possible costs and benefits that can hardly take place without establishing a consistent framework for decision-making. Regional economic policy in Norway appears to be moving in this direction by favouring larger and stronger units instead of trying to help small, unviable communities as in the past, and by attempting to avoid the possibility that local authorities outbid each other in attracting industries.

It would appear, then, that the recent emphasis on planning on the industry level in developed countries has been largely misplaced. In the face of the uncertainties associated with foreign trade and the limitations of policy investments available to governments under GATT and OECD regulations, government intervention in the private industrial sector has little to commend it. On the other hand, long term planning has a useful function in the public and semi-public sectors. It would ensure the rationality and consistency of government decisions in the public sector where prices do not provide a yardstick for choosing among alternatives. Further, a conscious long-term policy would appear desirable in the semi-public sector—agriculture, transport, and energy—where ad hoc interventions, taken often in response to special interests, give rise to inefficiencies. This shift in the objectives of long-term planning cannot fail to have a beneficial effect on the economies of developed countries.

offers in Geneva, to take binding decisions and make binding arrangements."

A judgement on the importance of this historical step of the Northern countries requires a short retrospective view at the structure of the economies of Denmark, Finland, Norway and Sweden as well as a description of former and present trade policy currents and developments in Northern Europe.

Structure of the National Economies

During the last hundred years Denmark developed a production of meat and dairy produce on the basis of cheap grain imports from abroad that sets an example for the whole world and as regards cost and quality was—and practically still is—superior to that of most other countries. In former decades industry was hardly of major importance, handicrafts, however, always have had a strong position.

¹⁸ Assar Lindbeck, "Location Policy", *Skandinaviska Banken Quarterly Review*, 1964 (2), p. 46.