CHAPTER XIV

EXTERNAL RESOURCES

I. The Role of External Resources

No economy is self-sufficient. Every country needs to import certain things from outside and it has to export in order to pay for them if it has no aid or accumulated balances abroad. Imports and exports, in their widest sense, include not only merchandise but also services, the so-called "invisible" items in internal trade, such as, transportation, banking and insurance facilities, as well as technology and know-how. Rarely does it happen that all that a country is currently importing is exactly balanced by what the country is exporting. In any given period of time, there is either a surplus on current account in a country's international payments, or a deficit. Whenever a country has a deficit, it needs external resources with which to cover it.

Most countries maintain a certain reserve, usually in the shape of gold or internationally acceptable foreign currencies, out of which temporary deficits are met and to which temporary surpluses are credited. Such reserves, by their very nature, can only help to tide over short-term fluctuations in trade, but are no answer to a situation in which a country suffers a chronic deficit year after year in its external trade. Such a country must either be able to borrow abroad, or it must take steps to curtail the excess of its imports over exports.

The need to borrow abroad or to obtain external resources can thus be said to arise when a country's exports are not sufficient to pay for its imports over the years. One must, however, go a little deeper and ask in what conditions such a situation can develop and those in which reliance on loans or capital from outside can be said to be justified. A country can well get into a chronically deficit position in its international trading by being extravagant in the sense that it consumes more than it produces, or by indulging in large unproductive expenditure on armaments. To rely on borrowing abroad in such contingencies is only to postpone the evil day. Sooner or later, the debts have to be repaid and if the economy has not gathered any strength, if it is not developing new lines of export, or industries, which will reduce its requirements of imports, then, in the end, it would be the worse off for the loans it has incurred. On the other hand, if the deficit in current trade is a reflection of increased investment in productive enterprises, investment which cannot be matched for the time being by domestic savings, then the country may well find it to its long-term advantage to borrow abroad with the confidence that as its economy develops, it can not only repay

what it has borrowed, but has secured for itself a higher level of national income in the process. Thus the richest nations today — countries like the United States — have, in the past, relied heavily on external resources, the inflow of capital from abroad, during the decades when they were developing rapidly and their own internal resources, their domestic capital formation, were inadequate.

One of the most important problems, both politically and economically, before the world today is that a large number of countries, which have after centuries of foreign domination emerged as independent nations, cannot afford anything but an intolerably low standard of living out of their own resources and need external help in order to develop. Perhaps, the most important single factor limiting development in these countries is the shortage of capital. When per capita incomes are low, only a small proportion of the national income can be saved and, therefore, a rate of investment sufficient to secure a satisfactory growth rate cannot be attained without additional resources being made available from abroad.

There is another way of looking at the same situation. The process of development requires many kinds of goods, particularly plant and machinery which are not produced in under-developed countries or, at any rate, not in any adequate quantities. As the rate of investment increases, the demand for power and transport equipment and other kinds of machinery rises so substantially that it has to be met only from a significant increase in imports. This increase is usually of such magnitude that it can be financed only if external resources are available. Indeed, even if domestic savings could be stepped up substantially to match the level of aggregate investment, the process of development may engender an imbalance in trade for the simple reason that developmental goods are not being produced in adequate quantities to meet the requirements, and new lines of exports to pay for their imports cannot be developed until the economy itself has been diversified. In other words, a developing country, which has the domestic capital for investment but not the capital goods which it needs, may also face a situation in which imports increase in the developmental phase and thus be in need of external resources. In actual fact, practically all developing countries are short both of indigenous capital and of indigenous capital goods. Their efforts to step up the level of domestic investment engender a demand not only for capital goods but also a wide variety of other things. Thus, when a factory is being set up, the employment created results in increased requirements of food, clothing and shelter on the part of labour which may in turn lead directly or indirectly to higher imports. Whichever way we look at it, there is no gainsaying the fact that when an under-developed country tries to build up its economy, it needs a great deal of additional external resources; it is only after the

process of development has reached a certain stage, when domestic savings are adequate and domestic production has been diversified, that the economy can continue to develop at a reasonable pace even without external resources.

Ways have, therefore, to be found for the transfer of resources from countries which have already attained a high standard of living and have a surplus of capital to the developing countries of the world. This transfer can take place through the initiative of private investors, who would expect a better return on their investment in an area where there is a tremendous shortage of capital than in places where it is in abundance. In actual fact, however, it is becoming increasingly clear that the scale of private investment in developing countries is not likely to meet their needs at least for quite some time to come. There are many reasons for this. The rate of growth in the developed countries themselves is pretty fast and has gathered a new momentum in recent years. Much of the private capital available for investment can, therefore, be usefully and profitably employed in the developed countries themselves without venturing farther afield into what looks like more risky terrain. Another connected problem lies in the fact that private capital must normally expect a return fairly soon. It may, however, happen that while the project in which the investment has been made is profitable, the remittance of the profits outside the country may tend to aggravate the gap in the balance of payments from which developing countries as a rule suffer, unless the production which flows from the investment directly and immediately contributes to a saving of foreign exchange. For these and various other reasons, it has come to be recognized that there is need to organize official assistance on an international or bilateral basis to provide the external resources which developing countries need.

We have now to turn from these somewhat general considerations to the specific role of external resources in the Indian economy. There has been a radical change in the basic factors affecting the situation with the conscious and deliberate effort for the planned development of the Indian economy after independence. It would, therefore, be desirable to make a review of the period before independence separately from the later and more recent developments.

India today is engaged in an effort to reach a stage of self-sustaining growth. By this is meant the achievement of a certain level of development beyond which further growth of the economy will cease to be dependent on external resources. For this, two things would seem necessary in the light of what has been explained above. First, the level of domestic savings has to be raised to sustain an adequate level of investment. It is important to realize that unless the level of investment is high enough to result in a rate of growth which will outpace the increase in population, the economy as a whole will not be moving for-

ward. Considering the state of poverty and the generally low levels of income, the prospect of domestic savings being adequate is itself dependent upon accelerating the present rate of growth with external resources. The second factor which is important is an increase in the domestic production of those things which contribute to higher rates of growth *e.g.*, plant and machinery, as well as things like fertilizers which help in increasing agricultural production.

Before considering the way in which external resources are being deployed towards the objective of what is popularly known as "economic take off", it would be useful to look at the past so as to see the problem in its historical perspective. Unfortunately, adequate and reliable data are not available. While trade statistics exist for the whole of the country — and it is unnecessary to go earlier than that — figures about invisibles are both scarce and unreliable.

The lack of consistent and authentic statistics is naturally more pronounced before the First World War. However, on the basis of such information as is available, it is clear that there was consistently some inflow of capital into the country as reflected in the estimated current account deficits in the balance of payments. One must also consider two other things: first, that although authentic figures of foreign exchange reserves are naturally not available for the period until the Reserve Bank of India began to keep custody of reserves and to publish figures regarding them, it seems likely that there was no sizeable accretion to reserves from year to year and secondly, that in fact it is common knowledge that there was considerable foreign investment in certain sectors, such as, the railways and other utilities as well as the plantations. These factors taken together with the estimated current deficits lend support to the belief that even during the period preceding the First World War, there must have been some steady inflow of private foreign capital into the country. While the actual magnitudes of such inflow may be debatable, the broad trend is probably unmistakable.

II. External Resources Before Independence

The need for and the role of external resources in India's economy prior to independence were different from what they are now. Since planning began, the need for external resources has been steadily rising for reasons to be discussed later. In the pre-independence days, India almost always ran a surplus in her overall merchandise trade account (excluding treasure) which had averaged a little under Rs. 100 crores per year in the ten years preceding the Great Depression, but which fell to an annual average of about Rs. 70 crores during 1930-33* and further

*Actually, in the worst Depression year 1932-33, the country's trade surplus had fallen to a distressingly low level of under Rs. 6 crores.

to Rs. 30 crores during the next three years 1933-36. After that there was a gradual recovery. In any event, there was no trade deficit to be financed by external resources.

Brief Review of India's Pre-War Balance of Payments: Statistics of India's balance of payments are not available prior to the First World War. Even when the required statistics are collected, estimated and put together, the result seriously falls short of the degree of sophistication which goes into a modern presentation of the balance of payments on the pattern laid down by the International Monetary Fund.

1901-1914: An effort to estimate the balance of payments of the country in the years preceding the First World War was made by Y. S. Pandit.* According to Pandit, while India generally ran a surplus in her merchandise trade account, in the current account of her overall balance of payments, there was, however, an average deficit of about Rs. 13 crores per year.

TABLE I

India's Balance of Payments 1901-14**

(Rs. lakhs)

Year	*Merchandise Trade Net Receipts*	*Invisibles Net Payments*	*Total Current Account (Net)*
1901—02	3,486	4,823	—1,337
1902—03	3,575	4,152	—577
1903—04	4,534	4,713	—179
1904—05	3,854	5,044	—1,190
1905—06	3,283	5,780	—2,497
1906—07	2,762	3,791	—1,029
1907—08	1,176	3,844	—2,668
1908—09	1,732	3,160	—1,428
1909—10	4,220	6,685	—2,465
1910—11	5,141	5,869	—728
1911—12	5,067	5,632	—565
1912—13	4,144	4,679	—535
1913—14	3,596	5,427	—1,831

The structure of India's balance of payments until the outbreak of the First World War is quite clear from the above; there was invariably a sizeable surplus on trade account, which was more than offset by net payments on account of invisible transactions, including service transactions as well as Home Charges.*** The important point which emerges

*Y. S. Pandit — India's Balance of Indebtedness, 1898-1913, George Allen & Unwin Ltd., London, 1937.

***Op. Cit.*, P. 103.

***A minor portion of 'Home Charges' consisted of payments against purchases of Government stores in Great Britain, which should strictly form part of merchandise imports and not of the invisible account.

from the above figures, however, is that every year there was a current account deficit of about Rs. 13 croreswhich was financed by an equal inflow of foreign capital. Virtually all of this inflow of private capital was from Britain and was directed to the Railways and other utilities as well as some other sectors such as plantations, etc.

1914 to 1939: After 1913-14, there was a wide gap in our series of balance of paymentx upto 1921-22 and the picture is blurred, except for statistics of the trade balance. For the war years, the trade balance was as follows:

TABLE II

India's Balance of Trade During First World War*

(Rs. crores)

1914-15	1915-16	1916-17	1917-18	1918-19
+3.8	+6.2	+5.5	+5.4	+4.4

It should, however, be added that the war generated forces which did not exist before and the country's external accounts were substantially transformed. Briefly, what happened was that foreign demand for India's exports, especially of jute bags for trench warfare, and for her other manufactures as well increased sharply while demand for imports remained fairly stagnant until after 1917. The increasing trade surplus meant that foreign demand for Indian rupees exceeded supply and exchange equilibrium had, therefore, to be maintained only by the sale of Council Bills on London, on a large scale, by the Secretary of State for India. This together with a continuous rise in the price of silver (of which rupee coins were made) made it difficult to peg the rupee-sterling exchange rate at 1s. 4d. which was ruling when the war began. Therefore, the exchange rate was raised successively, in step with the rise in the price of silver to 1s. 4½d. in January 1917, 1s. 5d., in August 1917, 1s. 6d., in April 1918, 1s. 7d., in May 1919, 1s. 10d., in August 1919, 2s. 0d., in September 1919, 2s. 2d., in November 1919, and 2s. 4d., in December 919. By the early months of 1920, the rate reached a peak of 2s. 11d.

For the period 1919-1921, again, it is extremely difficult to strike a balance of payments for the country. Only a partial picture can be gleaned even of the trade accounts, which themselves are, by no means, the most important element in a country's balance of payments especially in disturbed periods, such as those following a war. The private merchandise balance of trade is estimated to have amounted to a surplus of

*G. B. Jathar and S. G. Beri — *Indian Economics*, Vol. II, Oxford University Press, 1952, p. 164.

Rs. 126 crores in 1919-20 and a deficit of Rs. 80 crores in the following year. However, as stated before, not much should be read in this as this does not convey any idea of the net balance on current account.

For the years beginning 1921-22, a consistent series on estimates of India's balance of payments upto 1933-39 has been compiled by A. K. Banerji. In addition, the Government of India also started compiling blanc e of payments statistics from 1923-24 onwards for the Legue of Nations. How ever, for a number of reasons, including better coverage and superior methodology the series compiled by Banerji for the period 1921-39 is to be preferred. This is reproduced below:

TABLE III

Estimates of India's Balance of Payments*

(Rs. crores)

Year	*Trade Balance*	*Invisibles (net)*	*Current Account (net)*
1921—22	—9.6	—77.9	—87.5
1922—23	46.3	—109.8	—63.5
1923—24	111.3	—119.7	—8.4
1924—25	85.6	—126.0	—40.4
1925—26	113.2	—121.1	12.1
1926—27	68.8	—59.0	9.8
1927—28	82.4	—111.5	—29.1
1928—29	89.9	—109.8	—19.9
1929—30	88.2	—84.7	3.5
1930—31	61.3	—84.3	—23.0
1931—32	109.3	—84.3	25.0
1932—33	85.1	—89.3	—4.2
1933—34	108.6	—107.9	0.7
1934—35	90.8	—95.7	—4.9
1935—36	81.7	—61.8	19.9
1936—37	111.4	—91.2	20.2
1937—38	75.2	—89.1	—13.9
1938—39	73.8	—86.2	—12.4

The most striking feature of the above Table is the extent to which the invisibles account dominated the current account of the balance of payments. The fact that the country always owed net payments to the res t of the world on this account will be commented upon and the underlying factors explained in the following paragraphs. It may be noted, however, that the net payments on account of all invisible items taken

*Arun Kumar Banerji — *India's Balance of Payments*, Asia Publishing House, 1961, p. 147.

together averaged about Rs. 95 crores per year and were entirely responsible for turning the average annual trade surplus of about Rs. 83 crores into a small average annual current account deficit of about Rs. 12 crores.

External resources were required for meeting, among other things, certain invisible payments commonly called the 'Home Charges'. These consisted of the gross sterling expenditure incurred in the United Kingdom by the Government of India mainly on account of first, recruitment of British personnel for civil and military employment in India and their furlough pay and pensions; secondly, payment of the Government of India's share of the expenditure incurred by the British Government in wars in adjoining territories such as Afghanistan and Burma; thirdly, purchase of stores; and lastly, other miscellaneous payments owed by the Government of India to the British Government. All these payments added up to a sizeable amount which went on growing steadily upto 1922-23 and then stabilized itself around a level of £30 millions per year with minor variations around that level. Of this, the amount spent on purchases of stores should properly be regarded as payment for imports on Government account and only the balance should be considered as invisible payments. However, the bulk of the gross sterling expenditure was on account of the other items. The impact of the 'Home Charges' on the country's balance of payments became acute when during the Depression years, the country's trade surplus dwindled rapidly and other means had to be found for meeting the 'Home Charges'. A series of inter-related factors including a fall in the prices of primary products as well as overvaluation of the rupee at the exchange rate of 2s : Re. 1, combined to produce gold exports as the means of financing the 'Home Charges'. Thus, from a net importer of treasure (mainly gold) of about Rs. 31 crores per year during the quinquennium 1926-31, the country turned into a net exporter of gold worth Rs. 53 crores per year in the next quinquennium 1931-36.

Apart from 'Home Charges', India had another recurring and fixed overseas liability to meet each year in the shape of the servicing charges against the sterling debt held by the Government of India. It has been estimated that the foreign-held porton of the Government of India's sterling debt was of the value of over Rs. 370 crores at the end of 1921 and had increased to about Rs. 450 crores* by 1938. The interest charges payable against these sums amounted to an annual average of Rs. 18 crores* during the period 1921-22 to 1938-39.

In addition to the sterling debt of the Government of India, there were sizeable foreign private investments in India in the public utilities, especially, railways, plantations, mines, industry, commerce, banking,

*_Ibid_, Table XXV, p. 88.

etc. Several estimates have been made by different persons of the value of total foreign investments in India at different points of time some of which are briefly summarized below:

TABLE IV

Estimates of Foreign Investments in India*

Estimated by	*Value £ m.*	*Year to which estimate relates*	*Coverage*
1. Beaumont of the London Stock Exchange	500	1909	British investments in India.
2. J. M. Keynes	360	1909	British investments in India.
3. Sir George Paish	365	1910	British investments in India and Ceylon excluding (a) re-investments, (b) investments in shipping, telegraph and insurance companies, and (c) all investments, the income from which, either wholly or in part was not remitted to Britain or evaded British Income Tax.
4. H. F. Howard	450	1910	British investments in India based on both the 'resident' and 'nationality' criteria and excluding capital employed by British shipping companies in the overseas and coastal trade of India.
5. Arun Kumar Banerji	531**	1921	Total foreign investment in India.
6. Dr. V. K. R. V. Rao	575	1926-27	Total foreign investments in India.
7. The Economist	354	1928-29	Total British investments in India and commercial capital invested in Ceylon excluding (a) investments in securities not registered with British stock exchange, (b) investments in shipping, insurance and banking companies and merchant houses operating partly in Britain and partly in India and Ceylon and (c) direct investments in farms, real estate and other property.

*Arun Kumar Banerji, *op. cit.* pp. 150-186. See also Reserve Bank of India *Census of India's Foreign Liabilities and Assets*, Bombay, 1950, Appendix I, pp. 151-159.

**Original figures in rupees converted into pounds sterling at the exchange rate of Re. 1: 1s. 6d. To the various estimates listed here may be added that by H. Feis of Longterm publicly issued British capital investments in India and Ceylon (Sri Lanka) (excluding that in shipping and all private investment without the intercession of the public 'money' market) at £ 379 m. at the end of 1913. Vide, H. Feis, *Europe: the World's Banker*, 1870-1914, Yale University Press, 1930, p. 23.

	Estimated by	*Value £ m.*	*Year to which estimate relates*	*Coverage*
8.	Finlay Shirras	526	1929	Total foreign investments in India excluding (a) investments held by resident foreigners, (b) debenture capital of foreign companies, (c) investments in India rupee companies, and (d) investments in partnerships, firms, landed properties, etc.
9.	Lord Kindersley	458 438	1930 1935	British investments in India and Ceylon excluding; (a) securities and bonds not registered with the British stock exchanges, and (b) investments in partnerships, firms and other proprietory holdings of Britishers resident in India.
10.	Arun Kumar Banerji	664**	1938	Total foreign investments in India.
11.	B. R. Shenoy	830	1939	Total foreign investments in India.

It is certain from the available evidence* that the value of the total foreign indebtedness of the country must have been around £ 500 m. (or Rs. 666 crores) in the thirties and over £ 650 m. (or Rs. 867 crores) on the eve of the Second World War. The average servicing charges against these foreign investments (including the sterling debt of the Government of India) were about Rs. 50 crores per year during the seventeen year period 1921-22 to 1938-39**.

While any precise estimate of the amount of the Government of India's debt held abroad is difficult to hazard, there is no doubt that the amount was sizeable. At the end of 1939-40, for example, out of the total Central Government debt of Rs. 1,204 crores, no less than Rs. 439 crores consisted of sterling loans, while a considerable portion of the rupee debt of Rs. 450 crores must also have been held abroad.*** However, the greater part of the sterling debt of the Government of India was repatriated, over the years 1937-48 and the value of the sterling debt thus repatriated was £ 327 m. (or Rs. 437 crores).****

*For an excellent discussion of these various estimates and their relative merits and drawbacks, see Banerji, *op. cit.*, pp. 150-186 and *Census of India's Foreign Liabilities and Assets*, *op. cit.*, pp. 14-16.

**Arun Kumar Banerji, *op. cit.*, Table XXV, p. 88.

***The balance of Rs. 315 crores consisted of small savings, Treasury Bills, Ways and Means, Advances and other interest-bearing obligations. See G. B. Jathar and S. G. Beri, *Indian Economics*, Vol. II, p. 404.

*****Ibid*, p. 407.

Private Foreign Investment Before Independence: The wide divergence between the different estimates of total foreign investment in the country prior to independence arises mainly on account of the divergence in the estimates of the portion relating to private foreign investment in the country, as figures of external public debt are less controversial.* According to Banerji's estimates, of the total foreign investments of £ 531 m. and £ 664 m. at the end of 1921 and 1938 respectively, about £ 246 m. and £ 324 m. respectively, were in the private secor including railways and other utilities as well.** This worked out to roughly 46-47 per cent of the total.

During the seventeen year period 1921-22 to 1938-39, when according to Banerji, aggregate net foreign indebtedness of the country increased by about £ 133 m., the gross inflow of capital into the country was much larger, since there always was a steady stream of repatriation as well. On an average, the total gross inflow of foreign capital into the country was placed at around Rs. 20 crores per year, while total repayments averaged about Rs. 10 crores per year. Net new foreign investment in the country was of the order of Rs. 10 crores per year.*** It may be noted here that these annual averages obscure the wide fluctuations in capital flows which occurred during this period. Thus, in the gross inflow of capital (chiefly the borrowings on the London Stock Exchange, valued at issue price) at least four different phases can be discerned: first, the period 1921-24, when the annual average of gross inflow was around Rs. 48 crores; next, the period 1924-30, when it fell to Rs. 11 crores; secondly, the period 1930-34, when it again rose to Rs. 27 crores; and finally, the period 1934-39, when the annual average of gross inflow shrank to Rs. 7 crores only.

It should, however, be added, that the greater part of the inflow during the years 1927-32 was by Government. Investment in other avenues had, more or less, completely petered out during these years. Foreign investment in Indian railways had tapered off before this period, and there was practically no new foreign investment in this segment after 1925-26. Investment in such semi-governmental bodies as Port Trusts, Corporations, Improvement Trusts, which had averaged £ 1.8 m. a year during 1921-26, virtually ceased after that. Public utilities other than railways, such as electricity, tramways, gas and telephone companies were fairly steady borrowers on the London Stock Exchange and were interrupted only during the years 1927-32. Borrowing by the plantations, which had averaged £ 0.23 m. annually in the earlier years,

*The chief point of dispute and divergence here is the estimation of the portion of the Government's rupee debt which was held by foreigners.

***op. cit.*, pp. 175 and 183

***Banerji, *op. cit.*, p. 195

tapered off almost completely by 1931-32, presumably on account of the steep fall in the prices of plantation crops during the Depression. Foreign investment in other industries was fitful and desultory and, in any event, was not on any significant scale.

While annual repatriation of foreign capital from India, including repayments of loans, did not show any serious fluctuations, there was a sharp increase in the rate from 1931-32 onwards, which was mostly due to discharge of the public debt. The latter averaged about Rs. 2.7 crores per year during 1921-31; during the next six years, the annual average increased to a little over Rs. 18 crores; after that it declined sharply again. Total repayments, which were obviously dominated by repayments of public debt, naturally followed a parallel trend. Their annual average increased from Rs. 4.3 crores during 1921-31 to about Rs. 18 crores during the next six years, before falling sharply again in 1937-39.

World War II and the Sterling Balances: No reliable estimates of the country's balance of payments during the years of the Second World War are available. However, it is not difficult to form certain qualitative judgements about the position during the years. With the rapid extension of the theatre of war, first, on the continent of Europe and then in South-East Asia, India's trade with some of her important trading partners abruptly ended in quick succession. There was a rise in shipping freight rates as well as in the freight element in prices on account of the need to revive the use of the Cape route (after Italy entered the war); insurance rates increased on account of the increased risk of loss on the high seas; in order to conserve foreign exchange for war purposes almost all countries introduced exchange and other controls on their foreign trade. All these factors tended to reduce the size of India's foreign trade.

These adverse factors were, however, more than counter-balanced by several favourable factors, which also arose directly out of the war. These included the great upsurge in the British demand for war materials as well as peace time goods of every description; the stimulation of demand for Indian goods from the markets of the Middle and Near East, where a great void had been created by the withdrawal of British, American, German and Japanese supplies from them; the emergence of India as the chief arsenal and supply centre for the Allies in the South-East Asian theatre of war and a pronounced tendency in all countries to substitute nearer supply centres for distant ones and to rely more on land trade than on sea-borne trade, owing to Germany's intense U-boat activity.

An indirect measure of what happened to the country's balance of payments in consequence of the several developments briefly mentioned here can be obtained from the phenomenal growth of India's sterling

balances. This would indicate the rough magnitude of the cumulative current account surpluses acquired by the country during the war years. In September 1939, when the war broke out, these balances amounted to £ 52 m. On August 14, 1947, the eve of independence, they had swollen to £ 1,160 m., broadly reflecting the excess of India's supplies to the United Kingdom and Allies over its payments to them for the imports of goods and services. Two agreements were concluded between India and the United Kingdom concerning the disposal of this colossal amount, of which the first one was an Interim Agreement which chiefly prescribed the mode of releases from this blocked amount for current purposes and also the amount of releases for the period upto the end of December 1947.

The final agreement, which was signed on July 9, 1948, included provisions on at least five important matters: first, it was agreed that India should pay £ 100 m. in full and final settlement of all the stores and installations taken over from the United Kingdom; secondly, India agreed to pay a sum of £ 168. m. to the U.K. for the purchase of tapering annuities to pay the sterling pensions of British personnel who had retired after Government service in India; thirdly, after striking the final account of undivided India for 1946-47, it was found that the U.K. still owed some £ 49 m. under the scheme of sharing defence expenditure between the two countries; after making certain other adjustments, the net amount payable by the U.K. was finally assessed at £ 55 m.; next, the release for current purposes (to Account No. 1) from the blocked balances (Account No. 2) was to be £ 80 m. for the period July 1, 1948 to June 30, 1951, over and above the unspent balance of £ 80 m. from previous releases, which was free to be carried over; and finally, it was agreed to release £ 15 m. as convertible currency for the first year (1948) and the position in this regard was subject to review in later years. After making all the adjustments, India's net share of the sterling balances came to £ 800 m.

The accumulation of sterling balances of the value of £800 m. (net) was an event of some considerable significance to the country's economy. For one thing, it altered its net international position from debtor to creditor. According to the Census of India's Foreign Liabilities and Assets carried out by the Reserve Bank of India as of mid 1948, India was shown to be a net creditor by Rs. 1,504.5 crores*. Several reservations and qualifications need to be taken into account in order to grasp the true significance of the international net creditor position revealed by the Reserve Bank of India's study. However, these will be discussed elsewhere in this chapter. For the present, it is sufficient to point out

*Reserve Bank of India: *Survey of India's Foreign liabilities and Assets*, Bombay, 1955

the change in the country's international creditor-debtor position. It should also be emphasized that while the subtle process of external capital formation was, no doubt, at the cost of the immense hardships and privations, suffered by the people of India during the war years in the form of rising prices and falling civilian consumption standrds, it had its own advantages too. Perhaps, the greater advantage was the fact that but for the availability of such a large cushion of foreign exchange reserves, it would have been quite difficult to think in terms of Five Year Plans involving large scale investment outlays.

To sum up the position on the eve of independence, from the external resources angle, the Indian economy had the following important characteristics:—

(i) Unlike the belligerent countries, there was no devastation and destruction of the Indian economy during the Second World War; on the contrary, a certain degree of industrialization had been achieved both under the stimulus of war demand and under the protection of exchange and import controls.

(ii) An efficient machinery for the regulation of foreign trade had been built up under the Defence of India Rules in the form of exchange controls and quantitative controls on imports and exports. Although set up for serving the ends of the war effort, it made a valuable addition to the country's somewhat limited repertoire of instruments of economic policy.

(iii) Thanks to the conjuncture of developments, such as the withdrawal of the principal industrialized countries from markets adjacent to India, increased preference for land trade rather than sea-borne trade, etc., India had developed almost by force of circumstances, rather than by conscious planning, a fairly flourishing export trade in the Middle, Near and Far East and in South-East Asia.

(iv) Again, by force of circumstances, she had achieved external capital formation on an unprecedented scale and had laid by £ 800 m. of sterling balances,which would be of crucial importance to her in subsequent years.

(v) As against these favourable factors, there were several developments which portended acute economic strain. Not the least among these was the considerable volume of pent up demand for food and consumer goods of all kinds, which had been built up. Inflation had been on the rampage during the war and early post-war years and had naturally created a serious imbalance between supply and demand. This was particularly true of civilian supplies. While the growth of money incomes had proceeded steadily over the war years, the commandeering of a large portion of the existing supplies for the war effort as well as

the war-time neglect of agriculture coupled with a succession of crop failures which had created a situation of acute food scarcity, had all contributed to a continuous spiralling upwards of the prices of all consumer goods and particularly, of food articles. Consequently, there was considerable pent up demand. The policy implication of this situation was clear. A large part of the country's external resources was likely to be taken up by imports of, at least, the essential consumer articles, if either a price explosion or a drastic deflation were to be averted.

(vi) Another factor which had to be reckoned with in assessing the likely claims against the apparently large sum of £800 m. of external resources was the heavy depreciation of the capital stock of the country which had occurred during the war and early post-war years. This depreciation was the result of abnormally intensive use of the country's capital equipment on account of the war effort; the absence of indigenous production of most kinds of capital equipment; and the inability of the main producing countries to export. Factories, mills, workshops, etc., in the country as well as the transport system, consisting of both rail tracks and rolling stock had carried on without practically any replacement for years. All these had to be replaced, even if gradually.

(vii) Superimposed on the strains inherent in these developments was the dislocation caused by the partition of the country into the Indian Union and Pakistan. There was considerable industrial dislocation, especially, in the affected border areas. Besides, large cross currents of migrating populations also introduced a new element of unsettlement, which caused a fall in production.

It would, therefore, be seen that it would have been fallacious to regard the apparently large sum of £800 m. as an unencumbered legacy available exclusively for meeting the needs of development in the early years of independence. Taking account of the requirements of external finance for development, the sum was, indeed, not too large. At the same time, it was sufficient to make a beginning in planned development of the country, which was the major economic task before the country.

III. Independence and Planned Development

The role of external resources in the Indian economy has been changing rapidly in the years after independence. The evolution of Indian policies, on the one hand, and the part played in the Indian economy by external resources, on the other, can be considered in a number of separate phases. The first phase would be the period after independence and prior to the launching of the First Plan, characterized by an attempt to tackle immediate problems while marshalling data and formulating policies for future development. The second phase can be said to consist of the first decade of planned development ending in March 1961.

And then we come to the phase we are passing through today.

The First Phase (August 1947 - March 1951): On the eve of independence, India's sterling balances, as we have seen, amounted to a total of £ 1,160 million which, as a result of various adjustments in pursuance of the Indo-U.K. Financial Agreement of 1947, came down to a net amount of about £ 800 million (Rs. 1,064 crores), as India's share. There were heavy drafts on these balances after independence to finance sizeable deficits in India's external trade which began to appear in the wake of partition.

Many of the commodities which had occupied places of importance in India's export trade before partition were the produce of areas which became parts of Pakistan. As a result of partition, not only did India cease to be a major exporter of these commodities, but, in certain instances, she became a large importer of them. Thus, for raw jute, India was a net exporter of Rs. 19 crores in 1946-47; in 1948-49, she was a net importer of Rs. 46 crores. In foodgrains, the deterioration between 1946-47 and 1948-49 was over a hundred crores of rupees, though not all of it could be attributed to the partition of the country, and in cotton around Rs. 47 crores. Ordinarily much, if not all, of this loss should have been compensated by the fact that while in the past supplies from the rest of India to areas later included in Pakistan formed a part of the internal trade of the undivided country, after independence, they should have gone to augment India's export earnings. But the flow of trade between India and Pakistan was interrupted by the application of import and export restrictions as well as customs duties. In addition, political bitterness then prevailing in the wake of partition further impeded the flow of trade.

Apart from this particular factor, there were others creating a demand for imports and a decline in exports. The population had been increasing. There had been throughout the war years a considerable increase in money supply. And there was a pent up demand for imports which had to be satisfied, not merely for consumer goods but also for the replacement of plant and machinery worn out during the war years.

In order to deal with the immediate problems arising out of the adverse turn in the country's foreign trade, the import policy was tightened up and in two concrete measures, explicit recognition was given, for the first time, to the importance of exports to the national economy; those measures were the passing of a Resolution on Industrial Policy on April 6, 1948 and the setting up in 1949 of an Export Promotion Committee. While the former emphasized the production of commodities for export for earning foreign exchange, the latter was assigned the task of recommending specific measures to augment India's export earnings.

In September 1949, sterling was devalued and the Indian rupee with it.

Shortly thereafter, hostilities broke out in Korea. The combined effect of these was to lead to an upsurge in the demand for many Indian products, particularly jute goods which were sold at unprecedented prices. The adverse trade gap was wiped out and the sterling balances which had fallen to the low level of Rs. 771 crores on September 16, 1949 went up to Rs. 884 crores by March 1951.

Even while attention was focussed on these short-term fluctuations in current trading, some forward thinking on the subject of external resources was taking place. To provide a foundation for it, the Reserve Bank of India undertook a census of India's foreign liabilities and assets as on June 30, 1948. At the same time, thought was given by Government to the role which private foreign capital should play in independent India.

Unlike the previous attempts in the field, which focussed on estimating foreign investments in India, the census carried out by the Reserve Bank of India encompassed the whole gamut of the country's assets as well as liabilities. Among other things, it revealed the transformation of the economy from a net international debtor to a net international creditor. According to the census, taking both the official and non-official sectors together, India had a net creditor position of Rs. 1,504.5 crores at the end of June 1948. This comprised of a net creditor position of Rs. 1,761.5 crores in the official sector and a net debtor position of Rs. 257 crores in the non-official sector. The official sector's total gross assets of Rs. 1,939.6 crores comprised long-term assets of Rs. 730.8 crores and short-term assets of Rs. 1,208.8 crores, which consisted almost entirely of the sterling balances. As against this, the total gross liabilities of the official sector were estimated at Rs. 178.1 crores resulting in a net creditor position of Rs. 1,761.5 crores.

The non-official sector's net debtor position of Rs. 257 crores emerged from gross assets of Rs. 69.1 crores more than offset by gross liabilities of Rs. 326.1 crores. Gross total assets were composed of Rs. 11.5 crores in short-term and Rs. 57.6 crores in long-term assets. Gross total liabilities consisted of Rs. 38.4 crores in short-term liabilities and Rs. 287.7 crores in long-term liabilities.

Out of total long-term foreign liabilities of Rs. 287.7 crores of the non-official sector, foreign non-banking business investments accounted for Rs. 264.6 crores, of which about 80 per cent was in the form of direct investment, the balance of 20 per cent being portfolio capital. On a sector-wise basis, out of the total, Rs. 70.7 crores was invested in manufacturing, Rs. 52.2 crores in plantations, Rs. 43 crores in trading activities, Rs. 31.5 crores in construction, utilities and transport, Rs. 22.3 crores in petroleum, Rs. 15.7 crores in financial services, Rs. 11.5 crore in mining and Rs. 17.7 crores in other miscellaneous activities.

In the period immediately following independence, there were man

uncertainties and doubts about the attitude which independent India would adopt towards private foreign capital. Prior to independence, Indian public opinion was far from favourable towards the inflow of private foreign capital. The Fiscal Commission of 1923, for example, drew attention to the distrust of foreign capital while recommending its guarded use for industrialization. A minority minute of dissent had urged the adoption of certain safeguards in regard to foreign capital, particularly that foreign capital invested in manufacture should be in a company incorporated and registered in India, in rupee capital with a reasonable number of Indians on the Board of Directors and offering reasonable facilities for the training of Indians. The External Capital Committee (1925) of the Government of India had emphasized that when concessions to foreign capital were being granted (e.g. in the shape of protection), no special discrimination in favour of foreign capital should be permitted. The National Planning Committee (1936) with Jawaharlal Nehru as Chairman and later the Advisory Planning Board (1946) had both generally opposed the entry of foreign capital, except under the most rigorous control.

The change in the attitude towards foreign capital which followed independence is specially interesting. This was based on a recognition of certain basic facts. First, it was evident that India would need a good deal of external resources for her future economic development and as things then stood, when governmental aid and credits from developed to developing countries were not anywhere on the horizon, private foreign capital was one of the most important sources of such external resources. Secondly, with independence and the end of political domination, there had been a radical change in the equations. In independent India, foreign capital could no longer dominate the Indian economy and it had to function within the frame-work of national policies. In the altered circumstances, the question was not so much of ensuring that there was no discrimination in favour of foreign capital, as recommended by the External Capital Committee of 1925, as of assuring foreign capital that there would be no discrimination against it.

The first articulate expression of free India's attitude towards foreign capital was embodied in the Industrial Policy Resolution of 1948 which emphasized, at once, the need for carefully regulating as well as inviting private foreign capital. It laid special stress, *inter alia*, on the need to ensure that in all cases of foreign collaboration, the majority interest was always Indian. This was followed by the Fiscal Commission of 1949-50 which recommended that foreign investment may be permitted first, in public sector projects needing imported capital goods and secondly, in new private industries where no indigenous capital or technical know-how was likely to be available.

The corner-stone of independent India's attitude towards private foreign capital was, however, laid by Prime Minister Jawaharlal Nehru in his historic statement in the Constituent Assembly on April 6, 1949, in the following words:

"In the first place, Government would expect all undertakings, Indian or foreign, to conform to the general requirements of their industrial policy. Government would also so frame their policy as to enable further foreign capital to be invested in India on terms and conditions that are mutually advantageous.

"Secondly, we do not foresee any difficulty in continuing the existing facilities for remittance of profits, and Government have no intention to place any restriction on withdrawal of foreign capital investments, but remittance facilities would naturally depend on foreign exchange considerations.

"Thirdly, if and when foreign enterprises are compulsorily acquired, compensation will be paid on a fair and equitable basis as already announced in Government's statement of policy.

"As a rule, the major interest in ownership and effective control of an undertaking should be in Indian hands. Government will not object to foreign capital having control of a concern for a limited period, if it is found to be in the national interest."

The First Two Plans: India's First Five Year Plan was launched on April 1, 1951. As pointed out earlier, the outbreak of hostilities in Korea had given a fillip to India's exports in 1950-51 and there had been a steady increase in India's sterling balances. The reserves' position on April 1, 1951 was fairly comfortable, the actual figure being Rs. 1,029 crores. Even so, the Plan recognized the need for foreign aid and assigned an important place to the inflow of foreign capital. The Plan calculations about foreign exchange suggested a balance of payments deficit of as high as Rs. 180 to Rs. 200 crores per annum, and a deficit of this magnitude was considered necessary to fulfil the investment targets on schedule. It was intended that a little more than half of the overall deficit should be met by drawing upon the sterling balances and the remainder, something like Rs. 230 crores, would be covered by foreign aid and private foreign investment. In actual fact, the draft on reserves during the First Plan was no more than Rs. 127 crores. This was due to several factors. It had been estimated that the current account deficit (excluding official donations) would be in the region of Rs. 700 crores. Actually, the gap was only a little above Rs. 150 crores. Official donations made a modest contribution of Rs. 109 crores towards closing this gap. Thus, the current account deficit, after allowing for receipts on official donations, had only a relatively small impact on the reserves position. If, in the event, reserves declined by Rs. 127 crores, in spite of

receipts of official loans of Rs. 106 crores (including the U.S. Wheat Loan), it was due to substantial outflows on account of private capital as well as unidentified transactions, in addition to a repayment of Rs. 42 crores to the International Monetary Fund.

A series of events were responsible for this outcome. Not the least of these was the fact that due to a succession of good monsoons and, therefore, of good crops, food imports were much less than was contemplated in the Plan. Again, the Korean War boom had given an extraordinary fillip to export earnings and the record earnings of Rs. 730 odd crores in the very first year of the Plan could not fail to influence the over-all payments position during the Plan period. Another important contributory factor was the shortfall in actual investment outlay as compared to planned outlay. As against a total Plan provision (maximum) for investment of Rs. 3,600 crores, the actual investment turned out to be Rs. 3,360 crores or about 93 per cent of the target. The combined result of all these developments was that the total aid utilized in the First Plan was just over Rs. 200 crores, which, excluding the U.S. Wheat Loan because of its special character, accounted for only 3.3 per cent of the total investments during the Plan.

In a sense, this turn of events in the First Plan was responsible for a degree of complacency when consideration was being given to the external resources required for the Second Plan. The favourable trend in agricultural production during the First Plan engendered the belief that it would not be necessary to have large imports in the Second Plan. It was also tacitly assumed that the ratio of the current account deficit to total planned investment (both in the public and the private sectors) would be of the same low order — 18 - 19 per cent — as in the First Plan despite the shift of accent from agriculture to industry. To accelerate the pace of industrial development, import licences were freely given for industrial plant and machinery of all kinds. In retrospect, it does not seem surprising that half-way through the Second Plan period, the country was confronted with serious difficulties on account of a shortage of external resources.

Briefly, the foreign exchange calculus of the Second Plan was something like this. Total investment envisaged in the Plan was Rs. 6,200 crores (comprising Rs. 3,800 crores in the public and Rs. 2,400 crores in the private sector). As against this, a current account deficit of Rs. 1,100 crores was visualized. Finance for this had to be found from external resources — including the use of Rs. 200 crores of foreign exchange, estimated receipts of private foreign capital (net) of Rs. 100 crores* and foreign aid to the tune of Rs. 800 crores. This was, by no means a

*Including an amount of about Rs. 22 crores which was the undisbursed balance of the World Bank's loans (authorized in the First Plan) for the private sector.

tall order; especially, the latter amount was expected to come from such diverse sources as bilateral as well as multilateral dispensers of aid, bankers' and suppliers' credits and floatation of public issues in foreign money markets. Broadly speaking, the estimated foreign aid receipts of Rs. 800 crores represented the aid requirements of the public sector and the remaining Rs. 100 crores those of the private sector. Particular mention may be made here of the credit of Rs. 63 crores arranged from the U.S.S.R. Government for the Bhilai Steel Plant and Rs. 33 crores jointly from the British Government and certain British bankers for the Durgapur Steel Plant. However, it is significant that it was not deemed necessary to arrange such credit for the third steel plant in the public sector at Rourkela.

Foreign Exchange Crisis of 1957-58: The actual turn of events in the Second Plan ran quite contrary to expectations. From Rs. 902 crores at the beginning of the Plan, foreign exchange reserves experienced a landslide decline of Rs. 587 crores in just 2½ years to Rs. 335 crores by the end of September 1958. In addition, the country had to borrow Rs. 89 crores (net) from the International Monetary Fund during the first half of the Second Plan. Comparatively, the role played by foreign aid in financing the current account deficit (excluding official donations) of Rs. 1,109 crores was of slightly lesser significance as the total utilization of aid amounted to about Rs. 519 crores, including Rs. 188 crores of imports financed under P.L. 480*. It may also be added that on account of private long-term capital there was actually a net outflow of Rs. 38 crores during this period.

The principal causes of the dramatic events which led to the serious crisis have already been indicated. In terms of actual magnitudes, it is of the greatest significance that there was a sharp rise in imports. While the annual average level of exports showed a marginal fall of Rs. 9 crores from Rs. 622 crores in the First Plan period to Rs. 613 crores in the Second, the average level of imports soared from Rs. 730 crores per year in the First Plan to Rs. 1,081 crores in the Second. The trade gap, therefore, widened from an annual average of Rs. 108 crores to Rs. 468 crores during the same period. Net earnings from the services and other invisible items, such as private donations (but excluding official donations), also showed a small decline of Rs. 3 crores from Rs. 78 crores per year in the First Plan to Rs. 75 crores in the Second. However, the

*In 1956 India signed the first P. L. 480 agreement with the U.S.A. for the supply of surplus agricultural commodities. The original Public Law 480 legislation of the U.S.A. enacted in 1954, provides for sales by the U.S.A., of agricultural commodities to developing nations on concessional terms. Agricultural commodities supplied to India under this programme have played an important role in fighting food scarcity and shortage of certain other commodities like raw cotton and oil-seeds.

excess of the country's current payments over current receipts widened from Rs. 31 crores per year in the First Plan to Rs. 378 crores per year in the Second. It is worth noting, however, in this context that the rapid increase in imports was solely the result of the sudden acceleration in the rate of investment.

Thus, already by the middle of the Plan, the loss of reserves had amounted to the astonishingly high figure of Rs. 567 crores as compared to the expected loss of Rs. 200 crores in the entire five year period. On September 30, 1958 only about Rs. 335 crores of foreign exchange was left in hand. In addition, as pointed out above, the country had run up a net outstanding liability of Rs. 95 crores to the International Monetary Fund. Over and above these difficulties, large payments which were due in the remaining half of the Plan had also cast their dark shadow.

A series of concerted measures had to be taken at once to salvage the economy from the difficult situation. The Plan was cut to the core. Import policy was drastically tightened. Imports of all consumer goods, except the most essential ones, such as, foodgrains were banned, while a moratorium was placed forthwith on imports of capital goods, unless there was specific foreign exchange cover for them, in the form of either official or private foreign credit or investment. Severe restrictions were also placed on all other foreign exchange payments, such as, those for foreign travel, private outward donations, etc. Some action was also initiated in the direction of export promotion. By far the most important measure, at any rate, from the point of view of obtaining direct and immediate results was, however, the determined effort made by the country to seek external assistance and the prompt and generous response to it from friendly foreign countries and international institutions. While India adopted a policy of approaching different countries/institutions individually, the World Bank which had already given ample proof of its friendly and active interest in the economic development of the country by investing large amounts in different projects in the country, took a significant step forward by sponsoring a meeting of India's principal suppliers of capital goods to consider India's immediate aid requirements jointly and to try to meet them in a co-ordinated manner. This meeting which was attended by the U.S.A., the U.K., West Germany, Canada and Japan, besides the World Bank who convened it, was the first meeting of what is generally referred to as the World Bank Consortium on India. At the meeting, general assurances were given of finance to cover the so-called core of the Second Plan, consisting mainly of the steel and fertilizer projects, which were under construction, and of ancillary development of coal, power and transport to sustain the increased steel production. The actual credits pledged at the meeting were supplemented by additional amounts at meetings of the Consortium in 1959 and 1960. Unfortunately, no additional pledges were

made in 1961 as the focus had by then shifted to the Third Plan and this was in part responsible for the pressure on reserves in 1960-61 and 1961-62.

The results of these concerted measures were both quick and telling. The precipitate decline in reserves was stemmed and in the remaining two and a half years of the Plan, they declined only by another Rs. 31 crores to Rs. 304 crores. Indeed, even this loss was occasioned chiefly by capital transactions, such as repayments of Rs. 35 crores to the International Monetary Fund. The overall deficit of Rs. 803 crores was fully covered by foreign aid. Taking the Second Plan as a whole, the total use of reserves amounted to Rs. 599 crores, net drawings on the International Monetary Fund to another Rs. 55 crores, and net receipts of banking capital to Rs. 3 crores. On the other hand, there was a net outflow of private capital of Rs. 27 crores during the period. The utilization of foreign aid during the Plan amounted to Rs. 1,441 crores, of which Rs. 543 crores was received in the form of commodity assistance under P.L. 480 etc. The balance of Rs. 898 crores comprised grants of Rs. 177 crores and loans and credits of Rs. 721 crores.

The stresses and strains to which the economy was subjected during the Second Plan were rewarding in many senses from a long-term point of view. The importance of external resources for the development of Indian economy came to be more explicitly recognized, not merely by economists and experts, but also by the people as a whole. Indeed, it would be no exaggeration to say that thinking in industrialized countries on the subject of aid to developing countries was greatly stimulated by observing what happened in India during the Second Plan period. The impressive increase in industrial production — it was nearly doubled over the first wo tPlans — and the demonstrable dependence of such a rate of development on external aid, created climate favourable to economic aid in many countries, most significantly in the U.S.A. In India, emphasis on export promotion, the importance of external aid and private foreign investment and the determination to plan future development in such a way as to enable the country after a certain specific period of time to develop without aid, came to be accepted as vital to the strategy of development.

At this point it seems relevant to refer to an important aspect of the evolution of India's commercial policy geared to the needs of the country's planned economic development. Bilateral trading arrangements based on rupee payments have come to be used widely with the objectives of (1) overcoming the persistent balance of payments difficulties through the avoidance of the use of gold or scarce foreign exchange resources; (2) diversifying and increasing Indian exports by opening up new markets for non-traditional exports and by reducing dependence on traditional markets; (3) obtaining capital goods and industrial raw material without

additional drafts on foreign exchange resources of convertible currency; (4) stabilizing prices of traditional exports; and (5) establishing direct trade contact with the centrally planned economies of Eastern Europe and Russia.

Bilateral trade based on non-convertible rupee financing, which is carried on mainly with East European countries and Russia, made rapid progress during the Second and Third Plans. Exports to Eastern Europe which averaged $ 10 million in the First Plan (or below 1 per cent of total exports) rose to $ 76 million and $ 238 million in the Second and Third Plans respectively or about 6 per cent and 15 per cent of India's total exports. Similarly, imports from Eastern Europe which averaged $ 12 million in the First Plan (or less than 1 per cent of the total) increased to $ 76 million in the Second Plan and further to $ 264 million in the Third or about 4 per cent and 10 per cent respectively of India's total imports.

The emergence of Eastern Europe as India's customer has thus had a great impact on India's exports and imports. Bulk of India's exports to these countries, however, continues to comprise traditional commodities, notwithstanding the diversification as reflected in the export of such non-traditional goods as ready-made garments, foot-wear, iron and steel, railway wagons, metal manufactures, etc. In contrast, and reflecting India's need for developmental imports, capital goods imports have shown a steady increase from about 45 per cent in 1960-61 to 61 per cent in 1965-66 of the total imports from these countries.

An important concomittant of the bilateral rupee payments arrangement entered into with these countries is the economic assistance (primarily credits) received by India for various development projects, which amounted to about $ 1,271 million (aid authorized) upto the end of the Third Plan. In fact, the economic assistance received from these countries is largely responsible for the rapid increase in India's trade with them, since these credits financed larger imports while repayments of credits gave rise to increased exports to these countries and thus minimized the transfer problem.

The Third Plan: The Third Plan was conceived as a launching of a decade or more of intensive development leading to a self-reliant and highly developed economy, with a perspective of progressively diminishing proportion of external aid to total investment. Although the idea of self-reliance was implicit in the long-term growth models on which the First and the Second Plans were based, the Third Plan both explicitly stated self-reliance as a major goal for the 25 years period, 1951-76, and sought to give it a precise meaning. This strategy involved for a limited period, a considerable increase in imports, especially of capital goods, requiring substantial non-commercial foreign assistance. When the

preparation of the Third Five Year Plan was taken in hand, the difficulties experienced during the Second Plan period as a result of the inadequacy of external resources, were very much in the minds of the planners. The substantial contribution made by the external resources to economic development during the Second Plan period was another element encouraging the planners in adopting the strategy of significant dependence on external assistance for the Third Plan in the context of the longer-term strategy, covering the period upto 1975, to reach the stage of self-reliant growth. It was also clear that in the absence of sizeable external assistance, the Plan would have to be of a modest size, involving a rate of growth lower than the increase in population and consequently a stagnant level of per capita incomes.

To secure a satisfactory rate of growth in national income and in productive capacity, the Third Plan envisaged a substantial step up in investment to Rs. 10,400 crores, which was Rs. 200 crores higher than the investment outlays in the First and Second Plans taken together. It was abundantly clear that the country's foreign exchange reserves at a level of Rs. 300 crores at the beginning of the Plan, could no longer be drawn down to meet the foreign exchange needs of the Plan. Two questions had, therefore, to be faced; what would be the gap in external resources for a Plan of this magnitude and whether, in fact, external assistance would be available to fill it?

The foreign exchange calculations for the Third Plan showed total import requirements over the five-year period to be Rs. 6,030 crores.* This was composed of the import component of investments assessed at Rs. 2,030 crores, general maintenance needs of Rs. 3,800 crores and Rs. 200 crores of components and intermediates required by the domestic capital goods industries. On the receipts side, earnings from exports were estimated at Rs. 3,700 crores. While the capital repayment liability in the Third Plan period was estimated at Rs. 550 crores, no surplus was expected from the invisibles account due to the mounting debt services payments. Thus, domestic capacity to finance imports was estimated at Rs. 3,150 crores as against import needs of Rs. 6,030 crores, and a gap of Rs. 2,880 crores emerged in foreign exchange resources indicating broadly the size of total aid required.

The amount of external assistance India sought for the Third Plan was Rs. 2,600 crores. Since this was Rs. 280 crores short of the estimated requirements, the direct import content of Plan projects was cut by Rs. 130 crores and the targets for maintenance of imports were reduced by another Rs. 150 crores.

Quite apart from the cuts made in import requirements in order to

*This excluded Rs. 600 crores of foodgrains to be imported from the U.S. against payment in rupees under her P.L. 480 programme.

reduce the figure of external assistance needed for the Plan, the estimates of export earnings for the Plan period were placed at as high a figure as could, on any judgement, be possibly sustained. India was anxious not to seek more aid than was absolutely necessary.

The breakdown of the requirements of aid of Rs. 2,600 crores was as follows:

	(Rs. crores)
Import payment for Plan projects	1,900
Maintenance needs of capital goods industires	200
Debt refinancing	500

It is significant that the total aid requirement was related to import of capital goods, production of capital goods and repayment of capital. This was on the theory and in the belief that external assistance should be used for capital purposes only. While this view was, in a sense, sound it also led, it would seem, to a certain amount of confusion. For the repayment of capital to be made possible by external aid, either there had to be straight forward refinancing of outstanding loans, or a financing of the normal imports of the economy thus freeing resources generated by Indian exports for debt repayment. Another point which was lost sight of in this pattern of thinking was that the total requirements of external finance could not be equated to the payments due on imports of identifiable capital goods. Many projects in the course of their construction create indirect import demands and if these are not covered by assistance from outside, the setting up of the project may eat into the country's external resources, even though superficially the project is being financed by external aid. Another feature not adequately appreciated was that many of the schemes included in the development programme of the Third Plan were not in the nature of conventional projects. Thus, the programmes for agriculture, transport, health and education did require sizeable imports, but not of what is commonly known as capital goods. Some of the difficulties which arose in the implementation of the Third Plan were attributable to the fact that these points had been initially overlooked both by India and the countries helping her.

The attitude of the countries on whom India had to rely for assistance showed considerable appreciation of Indian needs and a genuine desire to help the developmental effort on which the country was about to embark. Two of the more important and concrete expressions of this appreciation were the visits to India of a Three Wise Men's Mission* and the Hoffman Mission** while the Third Plan was still on the anvil.

*Consisting of Sir Oliver Franks (U.K.), Mr. Alan Sproul (U.S.A.) and Dr. Hermann Abs (W. Germany), top bankers from the respective countries.

**Sponsored by the World Bank.

Both these missions examined the content and strategy of the draft Third Plan and the estimated foreign aid requirements and endorsed the view that the scale of aid estimated in the draft Plan was necessary for the successful implementation of the Plan targets.

The Aid India Consortium* organized by the World Bank first met to consider India's aid requirements for the Third Plan in May-June 1961. Besides original participants, France and the International Development Association also attended the meeting and made pledges for assistance during the first year of the Third Plan. In the following year, Austria, Belgium, Italy and the Netherlands joined the Consortium. Since then, the Consortium regularly met for pledging assistance for each year of the Third Plan. The total amount pledged by the Consortium for the Third Plan as a whole aggregated to Rs. 2,606 crores.

TABLE V

Pledges of Consortium Assistance to India during the Third Plan

	(Rs. crores)**
Austria	8.6
Belgium	11.5
Canada	82.5
France	57.0
West Germany	306.9
Italy	80.8
Japan	138.2
The Netherlands	20.8
The United Kingdom	246.7
The U.S.A.	1,088.0
Total of Countries	2,041.0
International Bank for Reconstruction and Development and International Development Association	564.5
Grand Total	2,605.5

In addition to the aid from the Consortium, India also received assistance from many countries outside the Consortium, notably the U.S.S.R. and other East European Countries. In fact, even before the Third Plan commenced, the U.S.S.R. and other East European countries had pledged assistance of Rs. 294 crores specially earmarked for the Third Plan projects. Additional commitments of aid outside the Consrotium pledges were also made by a number of countries. There was also a sizeable amount of Rs. 1,285 crores of assistance authorized before the commencement of the Third Plan but not utilized by the end of the Second Plan period and was thus vailable for utilization during the Third Plan. Total authorization of external assistance during the Third Plan period amounted to Rs. 2,928.7 crores, Rs. 2,300.6 crores in

*The World Bank, the U.S.A., the U.K., Canada, West Germany and Japan were the members of the Consortium.

**At the prevailing exchange rate.

loans repayable in foreign currencies, Rs. 49.6 crores in loans repayable in rupees, grants of Rs. 127.9 crores, and P.L. 480 assistance of Rs. 450.6 crores.

Although the quantum of aid promised was fully in accord with the expectations of aid on which the Third Five Year Plan was framed, the country's foreign exchange position continued to be a constant cause of worry during the Third Plan period. The loss in the foreign exchange reserves during the first two years of the Third Plan could be held down to Rs. 8.5 crores only after a net drawing of Rs. 70 crores from the International Monetary Fund. In the third year, the position improved with a rise in reserves of Rs. 10.7 crores, even after a repurchase from the Fund of Rs. 23.8 crores. In the fourth year the reserves again suffered a loss of Rs. 56.1 crores, but this was substantially recouped in the last year of the Plan, partly with a net drawing of Rs. 29.8 crores from the International Monetary Fund. Thus, notwithstanding a net drawing of Rs. 76.3 crores from the Fund, the foreign exchange reserves showed a small decline of Rs. 5.6 crores over the Third Plan as a whole, while the Plan itself had envisaged no net drawing from the reserves.

Excluding commodity assistance under the P.L. 480, actual imports during the Third Plan averaged Rs. 1,047.5 crores a year which was below the Plan estimates of Rs. 1,150 crores. The export performance was also in line with the Plan expectations. It was estimated in the Plan that Rs. 3,700 crores would be realized from exports over the Plan period; in fact, the export earnings were Rs. 3,734 crores.

Where the Plan expectations did not materialize was mainly in the field of aid disbursements. External aid, other than commodity assistance, of Rs. 1,921 crores fell short of the Plan expectations by as much as 26 per cent. The position was worse still in the first three years of the Plan when the aid disbursements averaged about Rs. 329 crores per year. Shortfall in aid disbursements had many reasons and many consequences. It caused concern among the countries which were giving aid to India, no less than to the planners and the Government of India. The problem was analyzed on the one hand by the World Bank economists and, on the other in India by the committee set up under the Chairmanship of Prof. V. K. R. V. Rao in the Planning Commission. As a result of these studies, a number of measures were adopted, both by the Indian Government and by the Consortium countries, to expedite disbursements. The rate of utilization during the last two years of the Plan averaged sharply upwards to Rs. 468 crores per year.

External Assistance received in the Three Plans: During the fifteen years covered by the Three Plans, the total external assistance authorized amounted to $ 12,217 million, of which loans accounted for $ 8,048 million, grants $ 813 million and P.L. 480/665 and Third Country

Currency assistance $ 3,356 million. Assistance actually utilized amounted to $ 9,397 million, $ 5,752 million in loans, $ 699 million in grants and $ 2,946 million in P.L. 480/665 and Third Country Currency assistance.

The Fourth Plan: The last year of the Third Plan was one of considerable travail for the economy. Hostilities on a serious scale broke out on the country's north-western borders. Following the Chinese incursion into the Indian territory in 1962, defence expenditure on both revenue and capital account had increased by Rs. 535 crores between 1960-61 and 1963-64. In the following year, *i.e.* 1964-65, there was a marginal decline of Rs. 10 crores under this head. The hostilities with Pakistan resulted in a setback to the hopes that could be entertained about reducing outlays on this score. At the same time, the foreign assistance picture turned cloudy, with aid-givers cutting off fresh authorization of assistance altogether for a few months. Of even more serious consequence was the widespread failure of the monsoon. Although in financial terms the Third Plan targets were reached by the end of the Plan period, several of the physical targets of production and capacity were in the result not achieved. The progress in the Third Plan period thus turned out to be less than adequate and less than anticipated. The most significant shortfalls occurred in the agricultural sector.

But the year following was to be worse still; for the second year in succession, the rains failed badly. In 1966-67, therefore, the country faced unprecedented difficulties in the form of severe drought conditions over large part of the country. Stringent restrictions were placed on imports, huge funds having to be provided for commercial imports of food, while the setback in agriculture reduced availabilities for exports and contributed to the fall in export earnings. Not only did the fall in agricultural outturn lower the quantum of agricultural and agro-based export commodities available for export, but given the importance of prices of food and other agricultural commodities in the general price level, contributed to the growth of inflationary situation which militated increasingly against the competitiveness of our exports in the world markets. Measures taken in early 1966 to maximize exports, such as export incentives through import entitlements, tax credits and other forms of assistance for exports, simultaneously with further tightening of imports and raising of import duties, proved inadequate to meet the situation as it developed. Export earnings failed to register any improvement. Private imports were cut down severely to reduce the import bill. But this process adversely affected domestic production of those sectors of industry which were dependent on imports. A net drawing of Rs. 89.3 crores was made on the Fund in April 1966 to meet the pressure on reserves.

The selective export incentive measures, such as import entitlement schemes, tax credits and subsidies aimed at compensating the export industries for higher domestic costs, proved progressively inadequate as the inflationary momentum in the economy gathered strength both by the fall in agricultural output and cut in imports and they needed to be, and were, periodically revised by augmenting their range and quantum. These could only serve as *ad hoc* palliatives. It was felt that more radical measures were necessary to reduce the growing imbalances in the economy including those in its external sector, and what was needed to bring about an enduring prospect of growth was a better realignment of domestic and external prices through a change in the par value of the rupee. This was done on June 6, 1966, by devaluing the rupee by 36.5 per cent.

An exchange rate realignment has a pervasive effect throughout the economy, as against the temporary and limited influence of selective export incentive measures and administrative import controls. It can be expected to deal with the disequilibrium in the balance of payments through market forces so long as autonomous additions to domestic money incomes are avoided to hold down the price level. Trade policy was accordingly refashioned and liberal policy for imports was adopted. A revenue duty of 10 per cent *ad valorem* introduced in February 1965 was abolished. The duties on items of imports other than consumer goods were reduced. But in the event inflationary increases in domestic money incomes were not prevented. In the context of the famine conditions in large tracts of the country and the political and social imperatives directly attributable to them, efforts to eliminate deficit financing were not successful.

The beneficial results expected from devaluation were almost entirely frustrated by the failure of 1966 monsoon and the consequent setback in agricultural production in the 1966-67 season. Emphasis in the economic field had to be given to measures aimed at the short-term objectives while longer-term development and investment had to be allowed to suffer. The Fourth Plan due to start in April 1968 was not formulated and an interregnum in planning through five-year developmental plans ensued. It was clear that the need of the hour was to achieve a measure of stability in the economy before the pace of progress could be resumed or accelerated. When the rupee was devalued, sizeable external assistance was secured with a view to providing for the minimum food needs of the population and to reactivate as quickly as possible the surplus capacity in large sections of industry following a cut back in import of raw materials and components. The Aid Indian Consortium pledged non-project assistance of $ 900 million to support the import liberalization programme adopted in June 1966. Aid authorizations proportionately increased from $ 1,362 million in 1965-66 to $ 2,082 million in 1966-67.

The second successive failure of the monsoon, however, brought about a further deterioration in economic activity. Though in money terms the total investment in the economy during 1966-67 was of the same order as in the previous year, namely Rs. 2,800 crores, there was in real terms a decline in invetment, because the prices of inputs of capital formation were higher. The rate of investment as a proportion of national income declined to 12.2 per cent from 13.8 per cent in 1965-66. In the circumstances, the sizeable foreign assistance arranged did not come to be utilized as quickly as it was hoped and anticipated. The utilization of assistance dropped from $ 1,621 million in 1965-66 to $ 1,474 million in 1966-67, affected in part by the temporary pause in fresh authorization following the outbreak of hostilities with Pakistan in September 1965. There was a sharp decline in utilization of loans other than P.L. 480 loans from $ 912 million to $ 792.5 million and a fall from $ 525.4 million to $ 447.2 million in gross receipts under P.L. 480 Title I. There was, however, a modest offset to this fall in utilization by the rise in utilization of grants other than under P.L. 480 Title I from $ 72.2 million to $ 87.3 million. Imports other than those under P.L. 480 Title I were held down to $ 2,246.8 million from $ 2,278.7 million in 1965-66, but exports also declined from $ 1,641.8 million to $ 1,534.8 million, partly affected by the dislocation in the export trade immediately following the devaluation of the rupee. With gross invisible receipts down from $ 422.7 million in 1965-66, during which they were assisted by the inflow under the National Defence Remittance Scheme, to $ 355.6 million in 1966-67, the current account deficit in the balance of payments widened over the year by $ 65 million to $ 1,373.4 million. To meet the overall deficit, a net drawing from the Fund of $ 130 million had to be made, which was more than double that in 1965-66 when the amount involved was $ 62.6 million.

The Fourth Plan should ordinarily have commenced in 1966 on the expiry of the Third Plan but for these exceptional difficulties experienced by the economy during 1965-66 and 1966-67. Though the necessary preparatory work had been undertaken and a Draft outline was brought out in August 1966, the finalization of the Fourth Plan was delayed due to the severe stresses which developed in the economy and as, with the lapse of time, many of the assumptions and estimates of the Draft outline were no longer valid. A revised Draft of the Fourth Plan, 1969-74, was published in April 1969 and this was later adopted with some modifications by the National Development Council in March 1970.

In formulating the revised Fourth Plan, the successes and failures of Indian planning so far, the trends in the economy and in particular the experiences of 1965-67 played an important role. The Fourth Plan aims at development in conditions of stability and reduced uncertainties — the former being dependent upon the supplies and prices of agri-

cultural commodities particularly of food and the later through minimizing dependence on foreign aid. Recognizing the close inter relationship between the level of prices, ability of the Government to raise resources, Plan outlays, industrial activity and export growth, the Fourth Plan aims at a continuing increase in agricultural production and building of sizeable buffer stocks to even out supplies of foodgrains. As an essential pre-requisite to relative stability, the Plan emphasizes the need to mobilize internal resources in a non-inflationary manner and to relate the Plan outlays to the possibility of raising resources without giving rise to inflationary pressures. The Plan also seeks to safeguard the growth rate against uncertainties of external resources by reducing the country's dependence on foreign aid; and from this point of view, it is planned to do away with P.L. 480 imports, while foreign aid net of amortization and interest payments is proposed to be reduced by about half of the present level by the end of the Fourth Plan. As an important step towards the goal of self-reliance, the Plan aims at securing balances on international account by limiting the growth of imports to manageble proportions through increased agricultural and industrial production and by providing for an increase in exports of about 7 per cent a year.

With these policy objectives in view and in order to accelerate the pace of economic activity so as to provide productive employment and bring about significant improvement in living standards, the Plan provides for an initial outlay of Rs. 24,882 crores, of which Rs. 15,902 crores or over 60 per cent would be in the public sector. Of the total public sector outlay, as much as 24 per cent is allocated for agriculture, irrigation and flood control, 21 per cent for industry and minerals, 20 per cent for transport and communication and another 15 per cent for power.

The total requirement of external resources during the Fourth Plan is estimated at Rs. 10,050 crores comprising imports valued at Rs. 9,630 crores, net outgo of Rs. 140 crores on account of invisible transactions and a repayment of Rs. 280 crores to the International Monetary Fund. This is exclusive of total debt service payments (amortization plus interest) estimated at Rs. 2,280 crores. This order of foreign exchange requirements will have to be met out of external assistance and export earnings. In accordance with the policy objective of reducing dependence on foreign aid, the aggregate external assistance (net of loan repayments) required during the Fourth Plan is estimated at Rs. 2,614 crores, thus leaving the balance of foreign exchange requirement amounting to Rs. 7,436 crores to be met out of export earnings. This implies that export earnings will have to go up from about Rs. 1,365 crores in 1968-69 to about Rs. 1,900 crores in 1973-74 or at a compound rate of about 7 per cent per annum. According to the Plan, this order of growth rate in exports does not appear to be beyond reach if a proper reorientation is

brought about in institutional arrangements and policies for export promotion.

Aggregate external assistance until the end of March 1969 has amounted to $ 13,614 million out of the total authorization of $ 16,546 million, leaving the outstanding amount of aid at $ 2,719 million* available for use from 1969-70 onwards. Loans account for $ 11,207 million of the total assistance authorized, the share of grants being $ 1,038 million, and that of P.L. 480/665 aid and Third Country Currency assistance $ 4,301 million. Similar break up of utilization till the end of 1968-69 was $ 8,664 million of loans, $ 996 million of grants, $ 3,954 million of P.L. 480/665 and Third Country Currency assistance. The carry over consists of $ 2,524 million in loans, $ 42 million in grants, and $ 153 million in P.L. 480/665 aid and Third Country Currency assistance.

While it is impossible to form any kind of a historical view of the nature of problems and difficulties which were responsible for the very large gap which has been persisting between the commitment and disbursement of aid to India, it is possible to draw attention to some of them. India is, in a sense, a pilot project in the matter of international aid to a developing country. No doubt there had been a Marshal Plan before, under which massive aid had flown from the United States to war-devastated Europe. That kind of an approach was apparently not acceptable in the very different conditions under which aid was sought by, and being given to, India. India had first to prepare her Plan before aid could be pledged for it. By the time most of the aid giving countries had considered the Plan and were ready to make their commitments towards it, some months of the Plan period had already elapsed. Even after pledges were made at the Consortium meeting, it took a good deal of time for bilateral agreements to be negotiated and signed under which specific projects were picked up for financing by different members of the Consortium. And it was only thereafter that the whole physical process of starting construction, ordering and installing machinery could be taken in hand. On the Indian side too, much of the preparatory work which could have been not only started but completed before external aid was actually committed for different projects, was, as the Rao Committee pointed out, delayed for one reason or another. Once the project did get to a start, the pace of disbursement of aid was linked to the deliveries of plant and equipment for which order had been placed abroad and this, in the case of major projects, meant something like 2 or 3 years.

While procedural problems did contribute to the delays in the disbursement of aid, the study of aid utilization and attendant problems,

*Adjusted for the devaluation of pound sterling and Danish Kroner in November 1967 and also for lapsed amounts in respect of P.L. 480 assistance.

which has been going on from year to year both in India and in the countries and international institutions giving aid to India, has resulted in many changes affecting some of the fundamental assumptions on which aid was being sought and given. The process is a continuing one. It is, however, possible to discern the main directions in which progress has been taking place.

First and foremost, there has been a growing recognition, both in India and outside, of the importance and value of aid which is not tied to projects. The basic consideration underlying this change is the fact that the gap in resources which external aid to fill in a developing economy is not to be measured by the cost of the direct import requirements of machinery and equipment of identifiable projects. In the last analysis, the gap is a gap between domestic savings and investment which, unless it is filled by an inflow of capital from outside, must result in inflationary pressures at home and balance of payments difficulties abroad. Other arguments have also been used to justify non-project aid, such as the indirect import costs of equipment and material delivered from domestic factories for Plan projects, the importance of getting the utmost production out of installed capacity as against creating additional capacity, the consideration that when aid is tied both to a country and to named projects, the recipient of aid usually has to pay a much higher price for what it imports, and finally, that the Plan consists not merely of projects, but of programmes in the field of agriculture, education, transport, health, etc., whose foreign exchange requirements cannot be covered by project aid. The proportion of non-project aid has, as a result, progressively increased from about 26 per cent of the aid authorized (excluding P.L. 480 assistance) during the Second Plan to 40 per cent in the Third Plan. It went up to 45 per cent in 1966-67 and to 82 per cent in each of the years 1967-68 and 1968-69.

The other favourable trend which is discernible is in regard to the terms on which aid is offered. Initially, much of the so-called aid which India received was really in the nature of commercial credits. Interest rates were commercial rates and consequently high. The repayment period was also very short. Thus in the Second Plan, the average rate of interest charged worked out, on rough basis, to 4.6 per cent. The average for the Third Plan on a similarly rough basis has come down to 4 per cent. Loans from the International Development Association, as well as from the Agency for International Development of the U.S. Government carry only nominal annual payments in the nature of service charges rather than interest proper. Credits from other sources too have been showing a definite improvement in regard to terms—both a lowering of rate of interest and spreading of repayments over longer period of time. During 1966/67-1968/69 the average, therefore, calculated on the same rough basis has declined to around 3 per cent per annum.

Welcome and helpful as these trends have been, much more clearly needs to be done over a longer period of time, given the balance of payments prospects of India. Debt servicing has been a growing burden on the Indian economy and it has been pre-empting a progressively rising share of the country's export earnings. Outlays on debt service on official loans alone have escalated from less than 3 per cent of the country's export earnings in the First Plan period to about 13 per cent in 1961-62 and nearly 25 per cent in 1966-67. This ratio was around 27 per cent in each of the two years, 1967-68 and 1968-69.

The combined effect of the various qualitative short-comings, despite quantitative adequacy, in regard to the aid which India has been receiving, was reflected in the continuance of an extremely tight foreign exchange situation in which industry continued to operate well below capacity in many sectors, adequate fertilizers could not be imported to meet the farmer's need and the rate of growth was slower than India or her friends could feel happy with.

The Role of Private Foreign Capital: The flow of aid from Government to Government discussed above is a relatively new development. Normally, the external resources which a country needs and can have at its disposal are obtained by way of inflow of foreign capital or by the country's own export effort. Historically, the inflow of private foreign capital has made a major contribution to the development of economies like those of the U.S.A. and Canada. Even today there are large movements of capital from one country to another. The view, therefore, is often expressed that if the developing countries of the world do enough to attract private foreign capital, the external resources, which they need for their development, can be found without any aid at Government level.

Such a view, though it still has its adherence among those who believe in the doctrine of *laissez-faire* and have an ideological bias against governmental action in the economic sphere, has rapidly lost ground in the last two decades, and in the light of the experience gained, it is now widely recognized that the volume of private foreign capital investment likely to go to developing countries, even if there was complete freedom on both sides in the matter, would quantitatively and qualitatively be inadequate for their needs. Investment opportunities in developing countries continue to rise. The fields in which private foreign capital seeks opportunities for external investment are limited — with mining and extractive industries in general being among the most important because such investments have to be made wherever the mineral resources exist. On the other hand, there are so many sectors of the economy in which developing countries have to invest, such as education and health, power and transport as also a variety of industries which have a high importance in national development plans which are likely to be un-

suitable or unattractive for private investment.

Quite apart from these limitations of size and scope, countries experiencing balance of payments difficulties have to take into account the cost of servicing foreign investment. Many developing countries, including India have such a heavy debt repayment burden that they are being cautioned against accepting credits on commercial terms as distinct from aid terms. Considering that equity investment must in the long run earn more, usually much more than loans, it would be difficult for a country, which shuns private foreign capital, to service foreign investment unless it imposes restrictions on remitances which inevitably lead to a drying up of fresh investment. Even though initially the remittance burden on new private foreign investment is not necessarily high because dividends can only be earned after the project begins to earn profits and upto a point profits are retained for plough back rather than remitted, over the long run retained profits increase earnings and thus the remittances.

To say this is not to suggest that private foreign capital cannot play a useful and a valuable role in helping development in a country like India. There are projects whose contribution to strengthening the country's balance of payments either by saving imports or by stimulating exports would far exceed the cost of servicing commercial debts or private foreign capital. With the tremendous shortage of capital that concerns most developing countries, the attempt must be to maximize the availability of capital and as neither domestic capital nor aid can meet the needs of development at an adequate rate, there is a good case for allowing private foreign capital on a selective basis in accord with the changing requirements of the economy. In addition, it has to be recognized that certain types of technology, ranging from the more sophisticated products of recent invention to managerial skills of a specialized nature are difficult to obtain except through some form of collaboration* with a firm which is operationally making use of them. It is this realistic approach that lies behind the policy of the Government towards foreign capital and know-how and led the Government to announce towards the end of 1968 the industries (a) where foreign investment may be permitted with or without technical collaboration; (b) where foreign technical collaboration may be permitted but not foreign investment; and (c) where foreign collaboration (financial or tecnical) is considered necessary.

That private foreign capital has an important role to play in the country's economic development has been recognized by the Government of India as is reflected in its various policy announcements made from time to time. In fact, a specific provision was made in the Third Plan

*The Survey Report on Foreign Collaboration in Indian Industry published in 1968 by the Reserve Bank of India contains comprehensive details of imports of know-how and managerial skills by the Indian Industry.

for an inflow of Rs. 300 crores of private foreign capital as part of the external resources required for the Plan. Table VI gives a broad idea of the magnitude and the trends in the private foreign capital inflow during 1956-1966

The main points that emerge from the data shown in the Table are that though the level of gross inflow during 1962-66 is somewhat higher than in 1956-61, it has shown wide fluctuations; that the gross outflow has been higher, and that as a result, net inflow representing net transfer of resources to the country has been lower and uneven.

Accent on Exports: In the final analysis, country has to pay for its imports in terms of exports. In a sense, this pattern of exchange is symptomatic of the economic maturity of a country. Indeed, there is no doubt that if there is a choice between paying for imports through current exports or through foreign loans, the former is much to be preferred, if only because foreign loans entail a large and recurring liability which has to be met over a period of years in terms of additonal exports. Since the amount that a country can currently export is a function of, among other things, the absolute size of its current production, a poor country suffers from a severe limitation on both the size and the growth of exports. India has been no exception to this rule.

In order to understand the policies which India has adopted for getting over some of the chief obstacles to increasing exports, it may be useful to indicate very briefly the main problems in the field. The limitations of the absolute size of the country's total production relative to its population has been alrady referred to. Again, while in a country where per capita real incomes are extremely low, a certain increase in consumption per head is virtually unavoidable on humanitarian grounds; and such an increase, however marginal, superimposed on a rapidly growing population involves both a rise in imports and an adverse effect on the export availabilities of many items of its output.

Further, costs in a growing economy are often high, at least initially, owing to various factors, such as sub-optimum scales of production, the high cost of capital and of technical skills, high transport costs and often, inefficiency. These costs tend to decline at higher scales of production and with the growth of factor supplies.

There are, however, some more deep-seated problems to be faced by an underdeveloped country trying to increase its exports. As a rule, each such country has a traditional export pattern made up of raw materials with which it has been endowed by nature. Tea, jute, cotton, oilseeds, mineral ores are the kind of things which India has been exporting for a very long time. Some of these items have also been processed into semi-manufacture or manufctures and been exported. The scope for expanding the exports of such traditional items suffers from many

TABLE VI

Inflow of Foreign Investment into the Private Sector

(Rs. Crores)

	1956	1957	1958	1959	1960	1961	*Total* (1956-61)	*Annual average* (1956-61)	1962	1963-64*	1964-65*	1965-66	1966-67
A. Private Sources (Net inflow)	23.8	20.8	2.5	10.2	51.7	28.1	137.1	22.8	27.5	50.6	81.8	44.2	104.6
1. Gross inflow	30.8	26.8	28.1	25.7	63.2	35.6	210.2	35.0	37.2	67.3	101.9	71.7	144.0
(i) Retained Earnings	19.2	9.5	9.1	14.6	14.1	15.8	82.3	13.7	7.8	9.8	20.4	18.8	14.9
(ii) Fresh inflow	11.6	17.2	19.0	11.1	49.2	19.8	127.9	21.3	29.3	57.5	81.5	52.9	129.1
2. Outflow	7.0	6.0	25.5**	15.5	11.5	7.5	73.0	12.2	9.7	16.7	20.1	27.5	39.4
B. Official Sources (Net inflow)	12.1	32.9	26.2	10.0	—1.4	16.8	96.5	16.1	10.7	30.6	22.6	29.6	56.1
(i) Gross inflow	12.1	32.9	26.4	12.6	5.2	25.1	114.3	19.1	21.9	41.6	39.3	47.2	88.1
(ii) Outflow	—	—	0.2	0.6	6.6	8.3	17.7	3.0	11.2	11.0	16.7	17.6	32.0
C. Gross inflow into the Private Sector	42.9	59.7	54.5	38.3	68.4	60.7	324.5	54.1	59.1	108.9	141.2	118.9	232.1
D. Gross outflow	7.0	6.0	25.7	18.1	18.1	15.8	90.7	15.1	20.9	27.7	36.8	45.1	71.4
E. Net inflow into the Private Sector	25.9	53.7	28.7	20.2	50.3	44.9	233.7	39.0	38.2	81.2	104.4	73.8	160.7

*Revised.

**Largely due to petroleum companies.

N.B. 1. Figures exclude foreign investments in banking and insurance companies.

2. The inflow has been computed, wherever possible, by eliminating valuation changes.
3. Individual figures may not add up to totals because of rounding up.
4. In view of the shift in the assessment period from calendar year to financial year it has not been possible to indicate the inflow/outflow during 1962-63.
5. Data for 1963-64 to 1966-67 include foreign private loans and suppliers' credits for which information was not available in the earlier years.
6. Changes in the branches' net position which were shown hitherto in the previous assessment upto 1962 on a gross basis are now appropriately shown on a net basis under inflow; profits of branches are deemed to have been distributed.
7. Retained earnings figures upto 1962 are inclusive of retained earnings of branches; and for the subsequent period these relate to Controlled Rupee Companies as profits of branches are deemed to have been distributed.

handicaps. As the manufacturing industries grow, the domestic demand for their product goes up and less is available for export. Countries already industrialized, which have their own industries of a similar kind, adopt protective policies to limit the volume of imports from developing countries. Last but not the least, advances in technology keep on providing new synthetic substitutes for natural raw materials. The prospect of expanding the traditional exports is, therefore, severely limited.

The attempt to diversify exports by producing new articles is equally frustrating. As a rule, new industries set up in developing countries do not have the advantages of scale of production, which industries already established in more advanced countries have. The high cost of capital and of technical skills also makes it difficult to export in competition with the industries of the more advanced countries. While a newly established industry can enjoy protection in the domestic market as an infant industry, any attempt to overcome the handicap of initial higher costs in export markets is apt to meet various obstacles. It is not surprising, therefore, that many developing countries in formulating their plans for development concentrate on industries which will help to reduce imports rather than industries which will help to increase exports.

When the Third Five Year Plan was being formulated, a determined effort was made to provide for a substantial increase in exports. As mentioned earlier, the target for the total export earnings of Rs. 3,700 crores has in fact been achieved, the actual realizations being Rs. 34 crores higher than this figure. The annual performance has been as follows:

TABLE VII

Exports of F.O.B.

Year			*U.S. $ Million*
1960—61	..	..	1,324
1961—62	..	..	1,404
1962—63	..	..	1,430
1963—64	..	..	1,684
1964—65	..	..	1,683
1965—66	..	..	1,546
1966—67	..	..	1,535
1967—68	..	..	1,673
1968—69	..	..	1,823

In contrast to the virtual stagnation in exports during the first two Plans, the export performance during the Third Plan was satisfactory. The increase in the first three years of the Third Plan was the result of a rise in quantum as well as unit values of exports, diversification of the commodity pattern of exports and penetration into new markets. The pause in exports during the last two years of the Third Plan was due to

the decline in agriculture-based items of export (*e.g.* cotton and jute textiles) in the wake of shortages of raw cotton and raw jute. In 1966-67 however, exports declined sharply owing primarily to the severe setback in agricultural output, and to some extent due to the downtrend in international prices of primary products.

The more recent trends in Indian exports bear out that the new export policy initiated in the wake of devaluation of the Indian rupee has had its impact and that the decline in exports in 1966-67, the immediate post-devaluation year, was due to factors extraneous to the new export policy. An important aspect of the export performance since 1967-68 is the basic change brought about in the commodity pattern of Indian exports by the new export policy which has for its basis the development of non-traditional export items. The improvement in the export levels of non-traditional commodities was more striking than the overall increase in exports. The main non-traditional exports, such as engineering goods, iron and steel, iron ore and chemicals which totalled $ 175 million in 1965-66 rose to $ 347 million in 1968-69. Between 1960-61 and 1965-66 these items had increased from $ 93 million to $ 175 million. Exports of engineering goods incresed from $ 37 million in 1965-66 to $ 92 million in 1968-69; iron and steel rose by $ 79 million to $ 105 million; and chemicals showed an increase of 39 per cent to $ 32 million. The earnings from iron ore rose by 33 per cent to reach a sizeable level of $ 118 million reflecting partly the enhanced role of state trading in the exports of iron ore. On the other hand, the major traditional items, such as jute manufactures, tea and cotton textiles have shown declines between 1965-66 and 1968-69 due to high raw material costs and keen external competition. Thus, the spurt in exports in 1967-68 and 1968-69 was largely due to the rapid growth of exports of non-traditional items which in turn is attributable to the new export strategy devised in 1966-67 to make the devaluation of the rupee effective. The indications are that the rising trend in exports, particularly of non-traditional items, may continue.

IV. Conclusions

Scarcity of foreign exchange has in fact been the pivotal difficulty in economic planning in India. The realization of this has progressively grown since the latter half of the Second Five Year Plan. India does not have perfect or even approximate domestic substitutes for some of the foreign products needed to carry out the investment programmes. At the same time, the secular demand for India's major commodity exports, such as jute and tea appears sluggish, that for minerals and other raw materials, volatile, while exports of such products as steel and light engineering goods can be expected to improve substantially over a very long period of time. While India must strive hard as it has been doing

to develop exports as also invisible foreign exchange earnings, clearly it will require some substantial continuing inflow of foreign assistance in the next decade or so.

Given its natural endownments and size, India has it within its capacity to achieve a viable self-sufficiency within a reasonable spectrum of time provided adequate external resources are made available in the meanwhile. The hey day of foreign aid in India was reached during the formative period of the Third Plan. Outlook for adequate foreign assistance flows, however, varies, as could be expected, from time to time. The labours of the Second United Natons' Conference on Trade and Development held in New Delhi early in 1968 do not seem to have been as successful in regard to the quantum of developmental assistance flows as the developing countries, including India, hoped for. These changes in aid outlook have, of course, to be taken in stride by the developing countries even though the lower the size of the flows the farther the prospects of achieving self-reliant growth recede in time. India would certainly strive to do so.

There are also two aspects of aid flows which merit attention irrespective of their size in case of most developing countries and certainly in case of India. First, whatever the quantum of external aid, it should be so available that it can be used in such an efficient manner that it contributes to the development of the recipient economy to the optimum level. This implies that the time taken in putting through a specific investment and bringing it up to the productive stage is reduced to the minimum from the point foreign assistance is arranged for the purpose. We have earlier referred to the considerable delay in the early part of the Third Plan in aid utilization and the subsequent measures taken to improve the position. Efficiency of foreign aid from the recipient's point of view is also affected by the aid being tied as to source. It is estimated that source tying involved a reduction in the real value of aid and, therefore, in its productive potential in relation to the quantum of assistance given, of between 12 and 13.5 per cent in case of Pakistan in 1960-63. For Tunisia, the direct cost of source tying of the United States assistance in 1965 has been put on a conservative basis at 20 per cent. Indeed, in respect of the total global assistance extended by the United States in 1965, aid tying to purchases within the United States put up the prices of aid-financed commodities 17 per cent above the world market prices. To the extent that the assistance is in the form of loans, there is a further effective deduction in the real value of aid in that the servicing payments are proportionately higher in relation to the real aid received.

The second aspect demanding immediate favourable action on the part of those who provide assistance relates to the terms on which assistance is given. India's own position in regard to debt servicing has

already been referred to. Prospects for exports from aid receiving developing countries, including India, are not too bright even on the most optimistic assumptions. The debt service burden on these countries must, therefore, be significantly reduced as soon as possible. India has fortunately already started receiving relief on this score from some of her aid givers to meet her immediate difficulties. Over the longer term, however, not only must there be substantial reduction in the interest charges and in the annual repayment instalments but the proportion of the loans in the total external resources inflow needs to be drastically reduced. It would not be improper to recall here that what was given after the World War II to the economies in Western Europe — with all their fund of sophisticated technological, entrepreneurial and other organizational skills and destruction only of their physical capital — to effect their reconstruction, was Marshall Aid. As much as 95 per cent of it was extended as grants and only 5 per cent as loans. The loans also involved very liberal terms as to interest and repayments. They had a maturity of 35 years and carried interest at 2½ per cent per annum payable annually, but without interest payments for the first 3½ years from the inauguration of the programme at the end of 1948. The amortization payments began in July 1956, *i.e.*, 4 years later still, and it was still provided that postponement or alteration or other modifications in the loan terms could be affected by mutual agreement if adverse economic conditions prevailed in any country. The total amount involved in this exercise of U.S. magnanimity after World War II was no less than $ 13.6 billion, $ 12.5 billion of which in grants and only $ 1.1 billion in loans. Annual disbursements amounted to $ 6.1 billion in 1948-49, $ 3.8 billion in 1949-50, $ 2.3 billion in 1950-51, $ 1.4 billion in 1951-52, at which levels they worked out to 2.3 per cent, 0.4 per cent, 0.8 per cent and 0.4 per cent of the gross national product of the U.S. in the respective years. Before the inauguration of the Marshall Aid programme, the U.S. and Canada agreed in 1945 to lend as much as nearly $ 5 billion to the U.K. repayable in 50 equal annual instalments with a grace period of 5 years and interest charge of only 2 per cent per annum, with the additional proviso of an automatic waiver of interest payments in any year in which the U.K. found itself suffering from the balance of payments difficulties. If advanced countries require such massive flows with such overwhelming grant element to recoup losses caused by war largely to their physical capital alone, surely India and other developing countries need and should be given even more liberal treatment in the matter of external assistance if they are to provide socially tolerable levels of growth for their very poor populations.

The current trends in aid, however, are not encouraging. In the closing years of the first development decade, the volume of foreign official aid has been stagnant as is borne out by the fact that the quantum of aid

has not kept pace with the growth of national product in the rich nations. The doubt has now arisen whether the developed nations will continue to provide assistance to developing countries at all. There seems to prevail in the rich countries a spirit of disenchantment with aid; with the result that the very purpose and feasibility of aid seem to be in question. This is partly due to the misconceptions and unrealistic expectations on the part of developed countries in regard to the duration of the development process; and partly due to the feeling that developing countries have not been making proper use of aid. There has also been a lessening of support for genuine development aid due to the increasing complexity and urgency of domestic problems in the aid giving countries.

There has been a similar feeling of disenchantment in the developing countries as well, though for different reasons. In the developing countries, there are signs of frustration and impatience and a measure of disillusion about the very nature of aid relationship. Development was often regarded in these countries as a continuation of the political struggle and as a rsult, the elimination of foreign rule was expected to open up avenues for early and easy prosperity. The nature of obstacles in the way of development and the kind of decisions required to be taken to overcome them were not always understood. Thus, for instance, the need for export growth was underestimated while agricultural development was usually neglected.

Donors as well as recipients tended to expect too much too soon from aid as a supplement to the national development effort. Modernization and development of low income countries were viewed by both the donors and recipients as an attempt to repeat the Industrial Revolution with the result that too much attention was focussed on individual investment projects rather than on the causes and results of slow progress. It also became clear that while aid givers were particularly interested in whether recipients made efficient use of resources placed at their disposal, such interest often gave rise to friction, misunderstanding and mutual irritation. Viewed in this context, the present donor = recipient relation ship does not seem viable for any length of time and a more purposive attitude to foreign aid is called for. Aid for development means more than a simple transfer of funds. It means a set of new relationship which must be conceived as an exercise in co-operation and partnership.

The publication by the World Bank of the Pearson Commission's Report which is appropriately called "Partners in Development", was timely. The Commission on International Development was set up by the World Bank in August 1968, under the chairmanship of Lester B. Pearson to review the impact of external assistance on the development of poorer nations over the past two decades, to identify the reasons for its success or failure and to evolve a long-term strategy for aid with a view to enlarging the flow of development finance — bilateral and multi-

lateral. The Commission in its Report submitted to the World Bank President in September 1969, has made a series of far-reaching recommendations for increasing the flow of resources in the seventies from developed to developing countries. The more important of these recommendations are: (1) official development assistance be raised to 0.7 per cent of each donor country's Gross National Product by 1975 and in no case later than 1980; (ii) aid funds should be made available for periods of at least 3 years to ensure continuity in the flow of aid; (iii) reduction in the interest rate, lengthening of the maturity periods and progressive untying of aid; (iv) liberal use of long-term debt rescheduling and refinancing; (v) World Bank lending should be made available at subsidized interest rate to the developing countries suffering from growing debt burden; and (vi) substantial increase in the resources of the International Development Association. The extent to which these recommendations will be implemented depends largely on the developed nations — their attitude to development aid, their approach to the general problem of economic development and the spirit of co-operation and partnership they are inclined to display in this great endeavour.