
Dealing with Scarcity, 1957–63

India's external finances began to unravel from the very first year of the second plan. Imports in 1956–57 rose by more than 40 per cent to Rs 1,100 crores from Rs 775 crores the previous year, and with exports registering a small fall, the trade deficit more than tripled from about Rs 130 crores to Rs 465 crores between the two years. Despite the imposition of stringent controls and the nearly 14 per cent decline in private sector purchases abroad, total imports rose further to Rs 1,235 crores in 1957–58 and the trade deficit to Rs 565 crores. Thanks to import compression, the trade deficit fell to Rs 455 crores and Rs 300 crores during the next two years before increasing to Rs 475 crores in the concluding year of the second plan. Unlike during the second plan, the crisis in India's external sector was contained quite effectively during the early years of the third plan. But the trade deficit ballooned again to Rs 620 crores in 1964–65 and to Rs 585 crores the following year, before rising steeply to Rs 905 crores in 1966–67. With the surplus on the invisibles account showing no significant increase or dipping sharply during these years, the imbalances on the current account largely mirrored those on the trade account.

India's current account deficit peaked at around 4 per cent of national income in 1957–58 and bottomed out at 1.5 per cent in 1959–60.¹ In no other year did the deficit amount to less than 2 per cent of the national income, and the current account deficit as a proportion of national income averaged about 2.5 per cent between 1956–57 and 1967–68. With private capital flows negligible or negative during this entire period, the deficit was financed overwhelmingly by flows of official external assistance

¹ Figures for the current account deficit are from Reserve Bank of India, *India's Balance of Payments, 1948–49 to 1988–89* (Bombay, 1993); figures for the net national product at factor cost (revised series) are from Government of India, *Economic Survey: 1989–90* (Delhi, 1990).

which amounted to over 22 per cent of the second plan outlay and 28 per cent of that of the third.²

Coping with the shortfall in external resources and mobilizing foreign assistance for the development effort and to relieve balance of payments pressures became, thus, important preoccupations for India's economic policy-makers during the latter half of our period. This chapter is devoted principally to detailing India's efforts to raise external resources during 1958–63. Although efforts to gather assistance through collective forums such as the Aid India Consortium were by far more important, bilateral trade agreements with the Soviet Union and the countries of east Europe also figured among the options policy-makers explored to help sustain India's ambitious development plans. Appendix G is devoted to the latter subject.

THE CRISIS OF 1956–58

The modest first plan was widely regarded a success. Growth rates which were respectable by recent historical standards coincided with low rates of inflation, and together with a comfortable external payments position, encouraged much optimism about the longer run prospects for the Indian economy. The IMF mission led by Edward Bernstein had already declared India creditworthy in 1953 and dispelled doubts voiced by the World Bank, among others, about whether it was 'safe' to lend it money. Bernstein also recommended untying aid so that India could use it to finance the imports needed to restrain inflationary pressures exerted by large investment outlays. Since its debt service burden was still quite small, his report suggested that India could afford to borrow abroad to finance domestic investment.

Emboldened by stable economic conditions, comfortable external reserves, and the positive attitude of the international agencies, the second plan envisaged a substantial step-up in public investment. The financing of this investment was not however fully tied up. The planners expected India to run a current account deficit of Rs 1,120 crores. Of the latter, Rs 200 crores were expected to be financed out of the reserves. The second plan document argued (p. 105) that 'the extent to which development programmes can rely upon resources from abroad can hardly be determined in advance', and while making no provision for meeting the remaining gap, suggested that the latter could be financed by drawing on unutilized credits, floating public issues in foreign markets, borrowing from multilateral institutions and foreign governments,

² Second plan and third plan external assistance figures are from the *Report on Currency and Finance, 1968–69*, pp. S.114–15.

private foreign investment, grants from friendly governments, and suppliers' credits.

Officials at the Bank were sceptical about the second plan payments projections which they felt erred on the side of optimism. The Governor, B. Rama Rau, presented a less than glowing account of the draft plan to the Central Board which discussed it informally at a meeting in January 1956 about two months before the plan was set to commence, while members of the Central Board questioned the underlying plan arithmetic. They observed that the estimate of Rs 800 crores for foreign assistance was four times the assistance received during the first plan, and that foreign private investment of Rs 100 crores was unlikely to be realized.

The views of the members of the Central Board had little impact on the government. But the crisis which they and the Bank feared came sooner than anyone anticipated, in fact, in the very first year of the plan. The immediate impact of the payments deficit that year was a steep fall in the country's exchange reserves from Rs 902 crores at the end of 1955-56 to Rs 681 crores one year later. The reserve drain in the first three quarters of the inaugural year of the plan alone exceeded the total estimated draft for the entire plan period. This necessitated urgent modifications to currency cover requirements which had only recently been revised downwards, and led to the imposition of stringent exchange controls in 1957. The plunge in reserves accelerated the following year when the draft upon them amounted to Rs 260 crores, and despite the narrowing of the deficit in the remaining three years and higher aid flows, reserves continued to fall during the remaining years of the second plan. Notwithstanding the assistance India received, the actual fall in the country's external reserves was, in the event, thrice that estimated by the framers of the second plan.

The Bank's analysis of the operational reasons for the import boom of 1956-57 was published, at V.G. Pendharkar's instance, as an article by S.D. Deshmukh in its *Bulletin* in July 1957. The import boom, the article argued, was a lagged effect of liberal licensing in 1955-56, particularly of consumer goods imports. Licences were issued freely that year partly on the premise that capacity constraints in the major industrial nations would lead to imports being staggered over a fairly long period. But thanks to some easing of these constraints and a slow-down in western economic growth, there was a bunching in the execution of these orders and a flood of imports.

The 1955-56 licensing boom became a major source of controversy within the government two years later. In a letter to the Prime Minister in January 1958, the Chairman of the University Grants Commission and former Finance Minister, C.D. Deshmukh, claimed to have been kept in the dark by the other

wings of government, in particular the Commerce and Industry Ministry, about the liberal import policy. Finance Minister T.T. Krishnamachari, who was earlier in Commerce and Industry, was not amused by the *Bulletin* article nor by the fact that it led to some uncomfortable questions being raised in Parliament. He saw Deshmukh's letter as a personal attack and argued to Jawaharlal Nehru that the crisis was a result of the Planning Commission's sloppy resources arithmetic, about which the Finance Ministry was not consulted, and the former Finance Minister's failure to spot or correct it. The Prime Minister refused Deshmukh's plea for an inquiry into the origins of the crisis, while the Planning Commission for its part blamed it on adverse changes in India's external environment caused by heavy demands for defence, larger food imports, and the impact of the Suez crisis on prices and freight rates.

Exchange Control and Withdrawal of Gulf Rupees

Almost the first response of the authorities to the payments crisis of 1956–57 was to impose stringent trade and payments controls. Until then, exchange controls were imposed as part of India's obligations to the sterling area, but in 1957 the Foreign Exchange Regulation Act, 1947 (FERA) was put on a permanent footing. Controls were now necessitated by the country's own requirements and were regarded as an essential policy instrument to restrict outflows and plug foreign exchange leaks. Very soon thereafter, a comprehensive regime of restrictions was put in place covering the transfer and use of foreign exchange, the export and import of gold and foreign currency, the sale and acquisition of foreign assets abroad, emigration facilities, and licensing of exports and imports of goods. The Bank clamped down on pleasure travel in January 1957. It was already closely involved with administering controls over flows of other invisibles and foreign investment, and with the introduction of the controversial 'P' form in June 1962 to tighten travel restrictions, the Bank became the focal point of approval for business, medical, and educational travel.

The worsening payments position and the imposition of exchange controls also brought the Indian authorities face to face with the necessity of withdrawing Indian rupees circulating in the Persian Gulf. The legal tender status of Gulf rupees was a legacy of British rule, and though it was recognized as a liability whose dimensions could only be guessed at and the Bank had drawn attention to the loophole which the arrangement provided for smuggling gold into India, the government was inclined (largely for reasons of prestige) to persist with the arrangement. The external trade of the Gulf region not being licensed for transactions within the sterling area, banks there sold pounds freely against rupees. The burden of these transactions was borne eventually

by India's official reserves since balances in non-resident rupee accounts were convertible into sterling. Worse, this loophole encouraged the unauthorized export to the region of rupees from India and their conversion into sterling. Thus sterling payments against non-resident rupee accounts rose from Rs 6.8 crores in 1956 to Rs 32.6 crores in 1957 and Rs 31 crores in the following year. With currency arrangements in the Gulf threatening to undermine the effectiveness of exchange control arrangements, and convinced now of the necessity of doing something to stem the outflows, the government sought the Bank's advice on the problem. The view of the mission the Bank sent to the region and of other officials at Mint Road was that it was not immediately practicable to replace rupees by another currency. The only immediate solution lay in issuing special rupee notes in the Gulf which were distinguishable from those circulating in India. Following discussions with the Bank of England, the Bank and the government decided to adopt this course in April 1959. Special Gulf rupees however required an amendment to the Reserve Bank of India Act which was passed the same month, and new notes with a changed legend and printed in distinctive colours were put into circulation in the region in May 1959. Thanks to this, what was earlier a virtually open-ended commitment to pay sterling against rupees was limited to the amount of special Gulf rupee notes repatriated to India. The special rupees circulated in the region until the 1960s when the Gulf states began setting up their own currency arrangements.

THE SEARCH FOR FUNDS

It was always clear to the Indian authorities that an external imbalance of the magnitude necessitated by their planning exercises could not be met by short-term palliatives, and that the availability of long-term development assistance was critical to their success. The second plan, as pointed out above, envisaged a relatively modest draft on the reserves. There was no clear outlook, besides, on the phasing of imports during the plan period. Indian officials pointed out to concerned officials in London during these months that the government anticipated the initial foreign exchange costs of its investment plans to be met largely out of the reserves. But even if the drain of 1956-58 itself may not altogether have been unexpected, its extent did catch the Indian authorities by surprise and underlined the urgency of tying up external funds for the plan.

As the magnitude of reserve losses became apparent and no end appeared in sight, the Bank grew concerned about their sustainability. By the end of 1956, the Governor and his principal advisers began examining ways in which existing economic policy instruments could be used to reinforce reserves.

While imports of goods and services judged to be unnecessary for the plan effort had to be checked—and this consideration led to the imposition of exchange controls—the more fundamental solution lay in boosting reserves which, some felt even late in 1956, would fall below the reduced minimum currency cover provisions adopted only a few months earlier. The export outlook was, however, not very promising whether in the short or medium term. Although it spoke of ‘maximizing export earnings’, the second plan did not spell out a major export effort, and its investment plans could only lead to the pre-emption of exportables. The Bank too shared the prevailing sentiment of export pessimism which was reinforced during these months by the expectation that the terms of trade during the remainder of the decade would become unfavourable towards India.

Resort to the Fund: 1957

The immediate means at hand to restore reserves lay therefore in seeking assistance from the International Monetary Fund, and this was the Bank’s advice to the government. But until February 1957, the government remained quite sanguine about what it felt was a temporary hump capable of being overcome by other measures. Recourse to the Fund was not ruled out, but was to be the last resort.

This view was based on underestimating the true extent of India’s balance of payments problems and external financial needs. But it was not altogether without justification. The attention of the international institution was concentrated during these years on the developed countries and its assistance was directed chiefly towards defending the par value system by restoring confidence in the major currencies. Not only was the Fund less familiar at this time with the problems of developing countries than it was soon to become, the rupee was also under no immediate threat. But as reserves continued to fall, the decision was effectively taken out of the government’s hands, and early in 1957 it approached the Fund for a short-term drawing of \$200 million for balance of payments support.

Though the initial reaction to the Indian request in Washington was positive, negotiations were not easy. The American Executive Director at the Fund was supportive. However the same was not true of the Treasury department which first argued that India’s drawings should be related not to its total quota but to the subscribed portion of its gold quota.³ Thus while a drawing of up to \$100

³ The total Indian quota at the Fund was \$400 million. Countries were expected to subscribe a quarter of their quotas in gold and the remainder in their own currencies. But thanks to Britain’s external financial problems, India’s gold subscription at this time amounted to only \$27.53 million. Despite quota revisions in the late 1950s and

million could be made without any conditions, larger assistance, the Treasury department suggested, should be based on an assessment of balance of payments need, domestic economic conditions, and macroeconomic policies. It was clear to the Indian negotiators that the US approach was guided by political considerations and that their request for a drawing would not be approved without some hard bargaining. The government was less inclined than the Indian Executive Director (P.S. Narayan Prasad) to join negotiations, and advised the latter to defer them until the outlook became less clouded. But seeing that several countries were planning to approach the Fund, Prasad on his own initiative began talks with its management for a standby of \$200 million.

The US Treasury department held a number of general reservations about Fund drawings, one of which was that disbursements by the two Bretton Woods agencies contributed to worsening US inflation. Besides, the Treasury Secretary was not convinced that India's payments disequilibrium was temporary, and believed it was seeking development assistance in the guise of balance of payments financing. The Indian application attracted support from the IMF staff, in particular the Deputy Managing Director, Merle H. Cochran. Other influential supporters included the US director Frank Southard who is reported to have made a dozen trips to the Treasury to argue India's case with the Secretary. In the end the Treasury left the decision to the State Department, which apparently at the instance of the Secretary of State, John Foster Dulles, decided to back the request. In February 1957 the Fund agreed to India purchasing \$200 million, of which \$72.5 million were in the nature of a standby facility.

The American Treasury's misgivings about the nature of the Indian crisis were shared by representatives of some other countries, in particular the Dutch who insisted that the deficit was a planned one, was not temporary, and that India should approach the World Bank rather than the Fund. Prasad's opening remarks in the discussions anticipated this criticism and he pointed out, somewhat disingenuously, that \$200 million represented the extent of the temporary disequilibrium arising out of the rapid depletion of inventories, while an additional deficit of \$300 million arose from the development programme. He also pointed out that the Fund articles did not preclude assistance to a member country experiencing deficits because of accelerated investment so long as the former were recognized to be temporary. In the event, only Formosa (Taiwan) abstained on the resolutions. The Netherlands supported the drawing but opposed the standby arrangement.

the mid-sixties, India's lower initial gold tranche remained an enduring disability during our period.

The 1957 drawing was only the second by India since the Fund came into existence. There were five other drawings by India during the remaining years of the period covered by this volume. Some of these are discussed later in this chapter, while the drawings of the mid-sixties are covered in the next chapter in the context of the growing crisis in India's balance of payments. We may merely note here that Indian drawings or standby agreements also coincided not infrequently with large repurchases (repayments to the Fund). This feature of the assistance India availed from the Fund may tempt one to conclude that it followed a practice of rolling over the institution's credits, and of using them really as a buffer for development assistance if not directly as such assistance.

Indeed, its repeated approaches to the Fund did intensify doubts about India's intentions in the sixties, and some officials such as Per Jacobsson, Managing Director of the International Monetary Fund between 1956 and 1963, made no secret of their suspicions. Although India was not oblivious to the distinction, it was often impossible in practice to separate payments support from development financing particularly when the latter did not materialize to the extent the planners anticipated, or arrived after some delay. Besides, payments pressures could arise, as indeed they did in the 1960s, due to the import-intensity of investments financed out of foreign aid which donors had no incentive to estimate precisely, nor India the information to do so. As the crisis of financing maintenance imports worsened from the early sixties, developed countries too, began advising India to approach the Fund to raise the necessary resources. Clearly, as many contemporaries recognized, while India approached the Fund principally to meet payments difficulties, it was also at the same time testing the limits of the existing structure of institutional financial support for its development endeavours. The expansion in later years of the Fund's medium-term lending facilities reflects to some extent wider international recognition of the view India implicitly canvassed during the late fifties and early sixties, that the dividing line between the two types of needs was often a thin one.

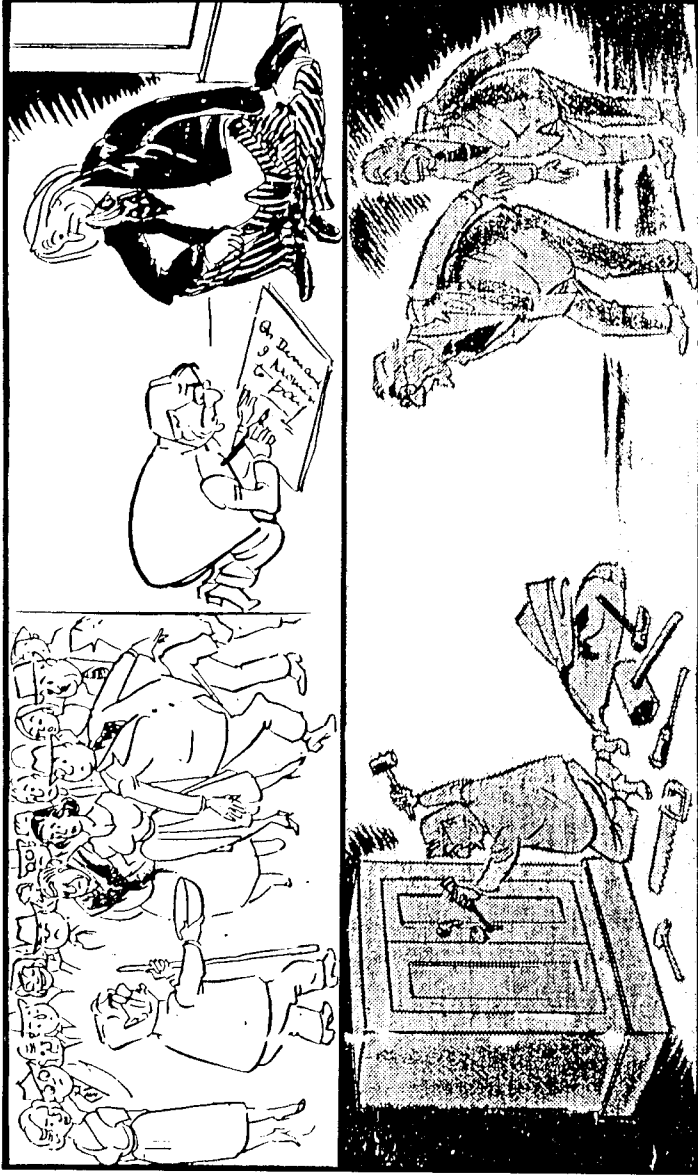
Seeking Development Assistance: Early Efforts

Even by Prasad's somewhat spurious distinction, India had to mobilize \$300 million in the form of external assistance during the second plan. This was no easy task. Apart from running reserves down by Rs 200 crores according to the Finance Ministry's estimates, India had to find \$1,400 million abroad to finance the second plan. However, until 1958 apart from specific project assistance from the World Bank and some donor countries and American wheat loans and technical credits, India had no expertise in seeking

development assistance, much less an organization capable of coordinating the effort. The planners, as pointed out above, had not cared to spell out in any detail how foreign funds would be raised, and there was inevitably a lag between the initiation of the second plan and the mobilization of external assistance to finance it. But it was longer than it need have been. Some early exercises were conducted, notably after March 1957, by the Governor, H.V.R. Iengar, and B.K. Nehru, Secretary in the Finance Ministry, to encourage the import of capital goods financed by long-term suppliers' credits. The latter were intended originally as criteria for licensing capital goods imports, and indirectly represented the first effort to source capital from abroad. But, as the Bank warned the government, not only did suppliers' credits involve 'loan tying', they also threatened to distort the plan. Besides, countries such as Britain, which faced severe external payments problems and could not afford to extend cheap or long-term suppliers' credits, objected to other European countries such as West Germany doing so, and its efforts chiefly had led by the late 1950s to an agreement between the major European industrial powers (the so called Berne Union) which restricted suppliers' credits to five years. Excessive reliance on medium-term suppliers' credit could create repayment problems in the near future. The route to solving India's external financial needs was thus seen to lie in sourcing loans and assistance rather than suppliers' credits. While untied loans or assistance best suited its needs, India was not loath to accept some tying if that was the only condition under which assistance became available.

The reserve drains of 1956-57 led to a sense of crisis, but not yet one of urgency in Delhi. The challenge of drawing the west into India's development efforts was ultimately one for the political imagination. Although P.L.480-type arrangements, technical credit missions, and tied project loans were available, large-scale transfers of development assistance were virtually unknown at the time. The problem therefore was to impress upon decision-makers in western capitals mainly, the extent of India's financial requirements without making them balk at undertaking it. Apart from financial considerations, political, strategic, and legislative factors also weighed with donor governments, and not all of these necessarily influenced events in the directions India sought. A high level of statesmanship was required, and though the country's stature and importance could not be overlooked and Jawaharlal Nehru himself commanded great international respect and goodwill, India's political relations with several western countries could sometimes be uneasy. The discourse of self-reliance too, constrained the political leadership from pursuing external assistance vigorously, while the few meetings that had taken place between Indian ministers and potential donors' representatives

Beg, Borrow, or...



Mr. T. T. Krishnamachari would explore the prospects of a loan of 500 to 600 million dollars when he visits the U.S.A. shortly.

- Shankar's Weekly, 15 Sept. 1957

failed, at best, to educate the latter about the country's aid requirements. Though the British high commissioner's conclusion—that the Indian government was 'too ready' to assume the west would 'prefer financial support to chaos' in India—was probably an exaggeration, there can be little denying the complacency which attended its early exercises to gather assistance.

Largely in order to minimize the political capital invested in aid negotiations and retain its capacity to adopt an independent posture in international affairs, India decided sometime during 1957–58 to conduct them as technical operations undertaken at official and diplomatic levels. This had the advantage, at least overtly, of de-politicizing these exercises. Some of the drawbacks of this approach would become apparent in the 1960s. An immediate one was that while India's needs were largely pressed by civil servants in the Finance Ministry and to some extent by the executives of the Reserve Bank, an impression had to be made on the political leadership of the donor nations, in particular the United States, in circumstances where public opinion in these countries did not yet favour large external financial commitments. That India's aid requirements were largely met without much controversy between 1958 and 1963 owed a great extent to the exertions of Indian officials, including to some extent Iengar and Bhattacharyya when they were Governors of the Bank, the positive role of the World Bank, in particular its President Eugene R. Black, and by 1959–60 to a distinctly favourable change in the aid climate. But for these factors, the asymmetry between India's means and its development requirements, and that between the latter and the political resources it mobilized to secure them could hardly have been redressed.

The early Indian efforts to tie up long-term external funds help illustrate the relative inexperience of its officials in this area and the optimism with which they viewed their prospects for success. Oddly, for example, central banks of the developed countries were seen (though one may add, not only in India) as a possible source of development assistance and the Bank, in general, was expected during these early months to explore the possibility of raising banking funds for the country's development needs.

The first initiative by the Reserve Bank to raise external finances for development followed the visit to Germany in October 1957 of the Finance Minister, T.T. Krishnamachari. The latter appears to have been persuaded by his hosts that while current German policy precluded a loan to the Indian government, the German central bank might be a better door to knock at. TTK thereupon asked Iengar to visit Germany and establish friendly personal contact with its central bank's President-designate, Karl Blessing, and explore with him the possibility of investments in Indian government securities.

The discussions Iengar had at the Finance Ministry before setting off on his mission led to the conclusion that accepting 'short-term' credits (defined as those repayable in five to six years) would be sheer folly, and that India should seek longer-term investment in government paper. Investments in treasury bills could be considered with a 'revolving arrangement'. The Governor was also told to offer on treasury bills, interest comparable to what India's investments earned in London, up to 5.5 per cent on long-term securities, and dollar exchange guarantees.

Armed with these elaborate instructions, Iengar embarked on a visit to Germany, Britain, Switzerland, France, and Italy in April 1958. His talks in Germany with Blessing, ministers and senior officials of the government, and commercial bankers were cordial, but yielded little immediately by way of funds. While government loans were as yet unheard of in Germany, the central bank could not invest abroad for more than three months and Iengar's roll-over proposal received only a polite hearing. Commercial banks too, spoke of their financial constraints and the undeveloped state of the German capital market. The only responsive note was struck in meetings with ministers and officials of the federal government who appeared willing to look at the Indian problem, the minister for economic affairs, for example, seeking from Iengar estimates of the assistance India might need over the next ten years to enable friendly countries to consider the forms in which they could be met. India was very far from assembling such figures. But Iengar, who meanwhile learnt that the Americans and the British were pressing Bonn to give Indian needs a careful appraisal, was reassured by the extent of the German interest, and the knowledge that it was not altogether a cold breeze blowing from the continent. The Germans were soon to react with some pique to American and British pressure to assist India, but this did not become apparent until some months later.

The response from elsewhere on the continent was less than favourable. Maurice Frere, the President of the Bank for International Settlements, threw cold water on India's chances of raising long-term credits in Switzerland and could only draw Iengar's attention to the offer he had made earlier to Ambegaokar, of his bank's willingness to buy up to \$25 million worth of three-month gold treasury bills paying 3 per cent per annum. The governors of the French and Italian central banks cautioned their Indian counterpart against expecting any help from their quarters. The two countries could for the foreseeable future use all their savings and more, while the Italian central banker advised Iengar against presenting aid estimates for a number of years since doing so might scare away, rather than attract, prospective donors.

An Indian delegation was told by the British authorities in July 1957 that there was no early prospect of raising long-term intergovernmental loans in London, and the outcome of Iengar's trip suggested that this remained the case almost a year later. His visit to Europe in 1959 however made him take a more hopeful view. Europe, he now felt, was more willing and able to assist Indian development. But such assistance would not become available until the third plan, by which time, Iengar felt, mobilizing external resources might pose fewer challenges than raising the necessary domestic resources. His advice to the government in 1958 was that since the US government too, appeared unwilling yet to take on the burden of financing India's development needs, the Finance Ministry should focus its energies on the World Bank, primarily, and the Fund, seeking if necessary appropriate amendments to their charters and functional changes to enable these institutions to play a greater role in the development processes of countries such as India.

Iengar also took advantage of a visit to the US in 1959 to tour some countries in Latin America, chiefly to study the reasons for their success in attracting American investment despite running high rates of inflation. Recognizing Latin America's place in US priorities but also sensitive to the role played by the policy environment there, Iengar suggested that India should not rule out making policy and procedural changes to attract private capital flows from abroad.

The Aid India Meeting of August 1958

To avoid the danger of running ahead of events, let us merely note here that little came out of Iengar's recommendations. Hopes in 1958 remained focused as they did for several more years afterwards, on multilateral and intergovernmental assistance, and by the summer of that year India began knocking more insistently at the doors of the major western capitals. As diplomatic cables which flowed between Delhi, London, and Washington reveal, Indian officials expected in June 1958 that the country's external reserves would be drawn down to the 'minimum safe level' by the end of the year. Iengar confided to T.T. Krishnamachari in August 1958 that the payments India owed during the remaining part of the year were so heavy that 'without further assistance, we shall run through all our sterling balances and yet be compelled to default'. The problem now was to find a 'total of Rs 560 crores, and ... a good part of it within the next few months so that we would not default on our obligations'.⁴

⁴Rs 560 crores (or \$1,176 million) was really the Finance Ministry's estimate adjusted for the US loan, which subsequently materialized, of \$225 million.

It was felt both in India and elsewhere that the only alternative to external assistance was to discontinue issuing import licences and risk a consequent 'breakdown'. Spurred by such tidings, in June 1958 the Chancellor of the Exchequer and the Commonwealth Secretary advised the British Prime Minister, who was then in Washington, to take up the Indian crisis at the highest level and impress upon the US President the 'need, in the interests of both of us, to keep it going'.

The German disinclination at this time to come to India's assistance was no longer a secret. Although import restrictions were already hurting its industrial interests in the former colony, there was only a limited amount of money on offer yet in Britain, rather more sympathy, and now some willingness to pull wires in Washington. A possible key to resolving India's difficulties lay somewhere in Washington. But neither was this key yet in Indian hands, nor was there any assurance that substantial assistance lay behind the doors it opened. The American Development Loan Fund held the greatest promise at this time, but appropriations for it were still a matter of dispute—the Congress would soon reduce allocations from the Administration's recommended figure of \$600 million to \$400 million—and no single country was generally allowed to borrow more than a quarter of this fund. India needed much larger amounts to get through the remainder of the year without a general breakdown in its foreign trade, and the prospects for additional assistance appeared bleak in the absence of a new US aid law over which hung a dense legislative and political cloud. Since Indian hopes now rested on getting the Americans to make a substantial commitment and then using that lever to prise open European vaults, the whole aid operation appeared poised in the early summer of 1958 on the same knife-edge as the future of the second plan itself.

That the blade was blunted rather than sharpened immediately and thereafter may be attributed principally to the proto-consortium of the World Bank and donor countries which met for the first time in August 1958. The idea for several countries and the international organizations to get together appears to have cropped up at almost the same time in different capitals, so that it is impossible to suggest who, if anyone, was its author.

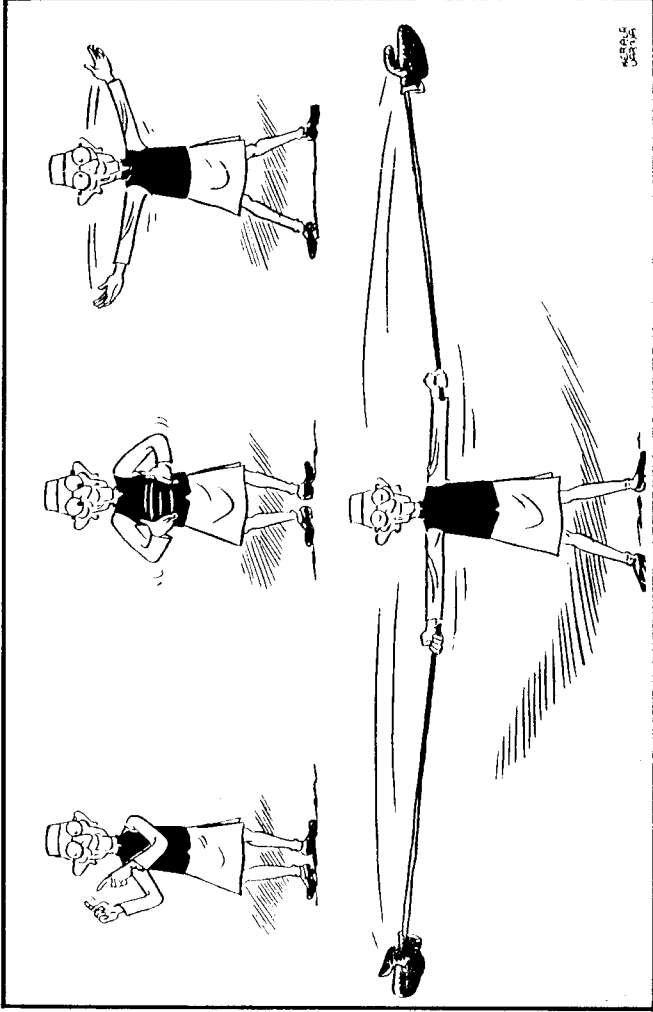
According to the recollections of B.K. Nehru, who was the principal Indian participant in the country's aid negotiations during these months, 'foreign aid was anathema' to the Indian political leadership which was also initially sceptical of raising any large amounts abroad in the form of assistance. Once Jawaharlal Nehru and the Home Minister, G.B. Pant, overcame their reluctance and the former gave him the signal which he sought to proceed, B.K. Nehru got in touch with Eugene Black at the World Bank to mobilize funds for India. According to B.K. Nehru, India did not

wish to go to 'individual creditors and ask them for money' since this would be 'most undignified and politically impossible'. The World Bank was India's 'international banker', and it was up to this institution to raise the resources it needed. This approach accorded with the earlier decision to conduct aid negotiations at the technical level. Although politics, and in particular the cold war, played a major role in influencing their attitude towards India, western governments were not disinclined during these years to keep up the appearance that external assistance was a matter to be settled between officials rather than between politicians. (For example, they made a conscious effort in August 1958 to distance the visiting Indian Finance Minister, Morarji Desai, from the first 'consortium' meeting, whose dates were so timed that he could be presented a reasonably firm aid package when he came calling at London, Washington, and other western capitals at the end of the month.) Though it would come back to haunt India before long, the decision to encourage the World Bank to play the key coordinating role in these exercises appeared to B.K. Nehru and other officials in India as the only reasonable course to follow in 1958.

Meeting the British Chancellor in London in June 1958, B.K. Nehru confided 'India's hopes' of getting a few countries to 'join with the international financial organizations in a combined operation of assistance' and reported that he was on his way to Washington to discuss the proposal with the US administration, and with the Bank and the Fund. Eugene Black, who generally supported India's development aspirations and requirements, appears to have been persuaded by Nehru and by the delay in the US voting any special assistance to India to moot the possibility of a 'meeting of the interested parties to discuss the [Indian] situation and to see if they could agree upon both the problem and the possible solutions'.

Britain too was concerned about India. The rapid reduction in its sterling reserves was a source of worry, as were the political and financial consequences of a possible default by India. Nor was politics far in the background and an economic collapse in India was feared to affect western, and particularly in the wake of the recent Suez crisis, British strategic interests in the region. On the other hand, there was little that Britain on its own could do to help. For some time past its officials had been urging India to turn to the US and Germany, and a meeting such as the one proposed by Black had the advantage of serving Britain's interests without necessitating any great increase in its financial commitments. Finally, if the international organizations were involved, they could be persuaded to 'do the shooting' and impose greater budgetary and payments discipline upon India 'without producing intolerable political friction'.

The Magnitude Of The Problem



The Finance Minister stated in Parliament that the foreign exchange gap for the remainder of the Plan period has shown a marked increase.

- Shankar's Weekly, 24 Aug. 1958

Britain was not opposed even to taking the initiative. Doing so held some risks—for instance perhaps of having to put up more money than it intended—but also offered gains in the form of better relations with the commonwealth. In an unexpected development, whose ironies Nehru and other Indian officials would no doubt have relished had they known of it, a race developed between the British and the Americans (who shared Britain's general concerns about India but wanted for domestic political reasons to cede initiative to the World Bank) and Eugene Black's invitation landed in London before officials there could send out their own. The immediate object of these exercises was to hold a meeting of donors to evaluate the extent of the Indian problem and, if possible, make tentative commitments in time for Morarji Desai's visit.

The first meeting of what was to become the Aid India Consortium three years later convened in Washington on 25 August 1958 with five countries (the USA, Britain, Canada, Germany, and Japan) and the World Bank participating. The Fund too was invited. But Per Jacobsson was opposed to participating. For one, he felt upstaged by Black's initiative. Jacobsson believed India was the Fund's problem, wanted himself to lead a mission to the country, and was reportedly annoyed at not having so far received an invitation from Delhi. He disagreed with the objects and methods of the second plan, and boasted publicly to having told P.C. Mahalanobis in Delhi in February 1958 that there were 'very few countries that he could not succeed in ruining'. Besides, participating in Black's meeting could prejudice the Fund's future negotiating position with India and its standing as the 'only body likely to bring effective pressure to bear on the Indians to put their internal financial house in order'. In the end, the Fund consented to sending an observer.

In other respects too, despite the race to convene the August meeting, imponderables overshadowed hopeful signs. France was invited but did not attend. Canada was an unenthusiastic participant, and it too consented in the end to come as an observer. The German and Japanese commitment to extend aid was uncertain and it was far from clear what, if anything, the Americans would be able to do beyond extending assistance from their development fund: much of the early pencilled arithmetic for instance, assumed no credit for US contributions. Questions hung in the air about the extent to which India's financial problems were caused by defence imports and how these should be tackled. The longer-term prospects for assistance were also not much in focus, and already there was some fear that the assured availability of longer-term credits over a number of years would encourage India's economic ambitions and demands for larger external assistance to finance them. The impact on the fiscal policies and development programmes of other

developing countries of a 'bail out' of India was another source of concern. Nor had any attention been given yet to the conditions attending any assistance promised to India. So much so, when asked a week before the meeting what he expected its outcome to be, B.K. Nehru reportedly confessed that he had no answer. Last but not least, premature leaks in the press about the meeting and its aims angered Indian officials, led to questions in Parliament, and threatened to curb their ability to express or make any commitments about the future. An advantage of the proposed consortium approach was that it spared India the necessity of approaching donor governments individually. This had several advantages, one of which was that of avoiding or minimizing bilateral tying and other pressures.⁵ But the publicity generated by the meeting appeared to bring the wisdom of this approach into question.

It was agreed between Nehru and Black that though its officials would be on hand to offer clarifications or more information, India would not be represented at the meeting. The latter practice was however soon to change. The first Aid India meeting convened as planned in Washington on 25 August 1958. It would be tedious to summarize the series of statements, some quite lengthy, which participants made. It is sufficient to note that despite the disapproving noises made by the Fund observer, India's development plans attracted a large measure of support. There was some apprehension about the soundness then and in the future of India's economic policies, and the view was pressed that the 'core' of India's investment programme should be clearly indicated to minimize any possibility of departures from it. Such a 'core' plan had already been finalized in Delhi and given its finishing touches in consultation with Black, who was therefore sufficiently familiar with the Indian financial position to distinguish between its immediate needs (covering the period up to March or June 1959) and those arising over 1959-61. The World Bank determined in consultation with Indian officials that the former were of the order of \$350 million, while \$580 million more would be required over the next two years. Commitments at this meeting fell short of the latter target with no participant other than the World Bank able to indicate yet a firm and unqualified figure, but there was time enough to meet it, and the August 1958 meeting was a useful starting point for the purpose.

Of greater immediate relevance and relief to India, the 1958-59 target of \$350 million was achieved in full, though not without some arm-twisting by Black. At the end of the first round, commitments totalled \$302 million,

⁵ In later years, however, India saw no choice but to conduct bilateral aid negotiations with donor countries prior to consortium meetings to finalize commitments, and afterwards to extract the promised aid.

Favourable Atmosphere

— *Tol.* 29 Aug. 1958

which rose to \$332 million at the end of the second. As the momentum of commitments appeared to slacken, Black underlined that the \$18 million shortfall would lead to further import curbs in India, and offered to add \$10 million from the Bank's kitty if someone else put up the remainder. This in the event Britain did to become the largest single contributor to the pool with \$108 million, followed by the World Bank with \$100 million. The US was in no position to commit anything further than what was available under its development loan fund, and this amounted to \$75 million.⁶ Germany came up with \$40 million, while Canada (\$17 million) and Japan (\$10 million) made up the rest. No political conditions were attached to the aid. The only economic condition was that the 'core' of the plan as determined by the Indian authorities and conveyed to the World Bank would be implemented. Though unexceptionable in principle, India objected to this condition being explicitly tied to the announcement of the assistance as Britain sought, and the latter had to be content when Morarji Desai visited

⁶ US P.L.480 assistance was excluded both from consortium commitments and Indian plan and official estimates of external assistance.

London a few days after the Washington meeting, with a general statement of its purpose. Desai, with not a little support from Black, also set his face against Britain's suggestion to release a summary of the World Bank's report of the negotiations.

The 1959–61 payments gap was met without much difficulty in subsequent meetings held during the next two years of the donors' group. Despite a loosening of import curbs (which some countries privately felt amounted to a minor breach of the 1958 agreement), the payments pressure also eased in India thanks to an industrial recession. Some discussion was aroused by India's desire to see a larger level of external reserves at the end of the second plan than was envisaged in August 1958, but its estimated financial requirements were largely met both in 1959 and 1960.

FOREIGN AID FOR THE THIRD PLAN

Discussions in western capitals, in particular London and Washington, about third plan estimates and their foreign exchange implications began in a desultory way from early in February 1959. There were fears in London and Washington at this time that India might feel encouraged by the favourable outcome of the 1958 meeting to raise its sights. Figures of a third plan outlay of Rs 10,000 crores were in the air in India and rumours circulated in western capitals that though the Finance Minister wished to reduce expectations about the plan and the Prime Minister himself was said to be 'irritated' by talk of the 'symmetry' of a Rs 10,000 crore plan, political compulsions might force India once again to adopt a larger plan than it could afford on the strength of its own resources. B.K. Nehru, among others, was believed in western capitals to be encouraging the planners to think big, and pressing upon them the view that he or India could mobilize aid each year of up to one billion dollars. In the beginning British nervousness about the likely direction of the third plan was matched by that in the US. The Under-Secretary of State for Economic Affairs, Douglas Dillon, confessed to the British ambassador in spring 1959 that he feared the effect on Latin America of the practice western donors followed, of leaving India free to determine its investment outlays and thereafter stepping in to help finance them.

Voices of doubt grew fainter in the next few months as the political environment for aid began to turn more favourable, all importantly in the US. The congressional resistance to foreign aid weakened at this time, and Dillon even spoke of a strong lobby of Congressmen taking a close and positive interest in the affairs of developing countries. The bill which would lead eventually to the setting up of the International Development Association was

on the drawing board and prospects for its passage were considered bright. Finally, the Kennedy-Cooper resolution (named after its movers John F. Kennedy and John Sherman Cooper) urging greater aid to India also helped focus public attention on the country's financial requirements. There was already a large body of economists based, among other places, at the Massachusetts Institute of Technology (MIT) who thought India should go in for a big, rather than a moderate, third plan, and canvassed academic and political support for the idea. The 'big-plan campaign' was believed to have the influential support of W.W. Rostow, while the Kennedy-Cooper resolution endorsed it by suggesting abandoning the existing US practice of annual aid appropriations and replacing it with one permitting a long-term commitment such as would enable India to make its investment plans in a stable and predictable external financial environment.

This thrust accorded with India's perception of its own interests. India's external reserves at the end of the second plan stood at Rs 304 crores (or the equivalent of three months' imports). As the Reserve Bank warned the government, there was now little possibility of using them even as a cushion for large, import-intensive development outlays. But the second plan gamble having largely succeeded, and encouraged by the donor response India's needs had recently evoked, some officials in India hoped now to sustain large investments by tying up foreign assistance over a ten- or fifteen-year period. At the end of this period, they and the US proponents of the 'big push' view believed, India could afford to dispense with external aid.

Economists and public figures campaigning in the US for liberal assistance to India organized a large conference in Washington in the summer of 1959. This conference was inaugurated by the Vice-President, Richard Nixon, and attracted over five hundred influential delegates including Senators John Kennedy and Hubert Humphrey, Chester Bowles, the former US ambassador to India and now a congressman, and the noted British social scientist, Barbara Ward. H.V.R. Iengar was the principal Indian participant, while many others made presentations. A crisis had broken out in Berlin and another conference was about to convene in Geneva when the India conference began. In his inaugural speech, Richard Nixon declared that posterity would regard India's economic development as having been more critical to the future of mankind than the Berlin crisis or the Geneva conference. The rhetoric no doubt reflected an ambitious politician's desire to talk up the event and his own contemporary role—only the previous day the US Secretary of State had left for Geneva in a blaze of publicity—but it nevertheless set the tone for the deliberations that followed. The Republican endorsement also gave a bi-partisan aspect to the

proceedings and firmly established Indian economic development in American external economic priorities for the next two or three years.

In another significant development, in 1960 the United Nations General Assembly passed a resolution urging developed countries to transfer one per cent of their national income as aid to developing countries. Proposed by B.K. Nehru, the motion initially evoked fierce opposition from most developed nations, and during six weeks of often passionate debate its mover was advised more than once to withdraw the resolution and avoid its defeat. In the end the Indian resolution was carried unanimously, with even the US delegation voting in favour at Washington's direction. With reconstruction largely accomplished and a certain prosperity in the air, the aid environment in Europe too, as Iengar had anticipated a year earlier, began to turn more benign at this time.

Wishing to enable it to embark on the third plan with a measure of confidence and following a suggestion embodied in the Kennedy-Cooper resolution, early in 1960 Black proposed a visit to India of a mission of three prominent bankers to report at first hand about its economic conditions. Although not everyone in India was enthusiastic and some even apprehended that the mission was intended to guide the formulation of the third plan in its preparatory stages, a team of 'three wise men' as they came to be called—Herman Abs, Oliver Franks, and Allen Sproul—visited India in February–March 1960. Following discussions with the government and the Bank and with prominent businessmen, the team endorsed the Indian view that its development programme depended on a 'very substantial increase in foreign assistance' above the amounts provided during the second plan. A large part of this, it also recommended, should be in 'the form of grants and loans, not made strictly on commercial terms'. The team's report also represented a stamp of approval on the resources arithmetic of the draft plan. According to I.G. Patel, the report of the 'three wise men' was 'one of the most heart-warming documents in the annals of international relations'.

This visit was followed by a World Bank technical mission headed by Michael Hoffman which endorsed the outlines of the third plan and its emphasis on industry. Attempting anything less, Hoffman argued, would mean admitting defeat from the outset. His report too advocated aid in the form of grants and soft loans, and cautioned that the third plan would stand or fall on the amount of foreign aid available.

Views such as these created a favourable environment for the reception of the third plan. Though at Rs 7,250 crores (this was later revised upwards) the plan was initially smaller than many had hoped or feared, Britain, which faced a deteriorating external position, appears to have been nervous about

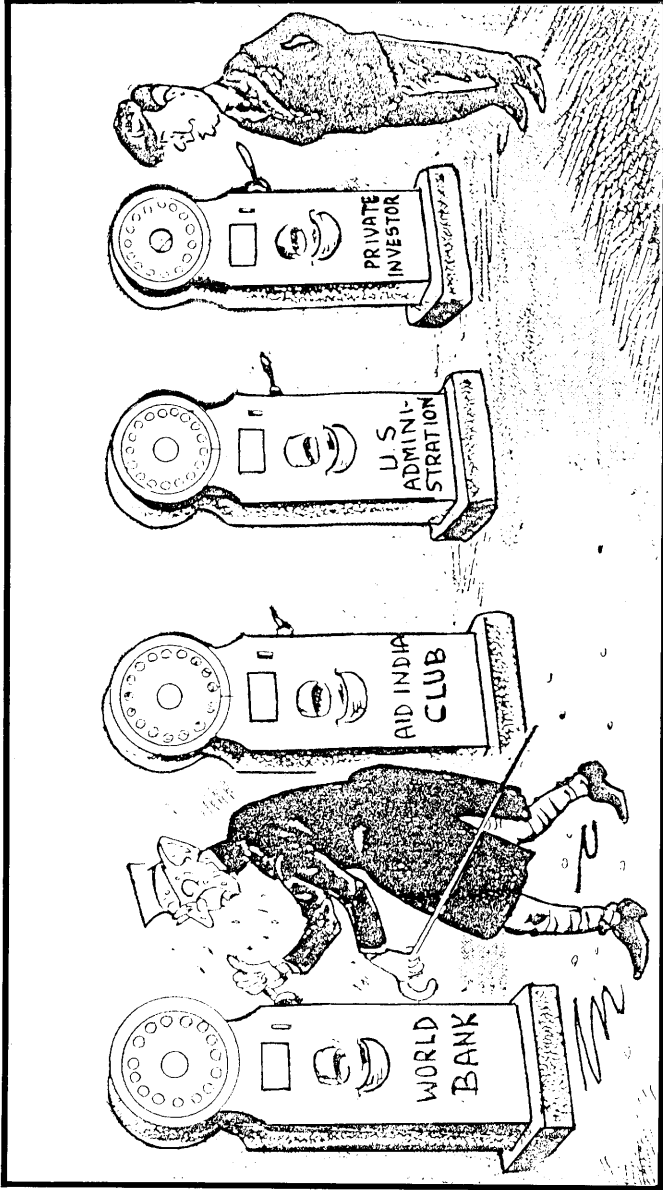
the plan assuming Rs 2,200 crores in the form of net external assistance.⁷ But the US administration felt even in September 1960 that there was no 'substantial fault' in the plan, and that the growth rates it proposed were 'minimal' and the 'least the ... Indian government could put forward'. Nor was Dillon 'unoptimistic' that the foreign assistance proposed in the plan would be forthcoming, with the US itself proposing to put up more money than before. There were some private reservations, notably about the proposal for a nuclear power reactor (opinions about which remained divided even among the member nations of the group), and open criticism of plans for a fourth steel plant and the exclusion of the private sector from new coal and oil projects. Britain attempted to cool wider western enthusiasm for the third plan and was not very forthcoming with promises, particularly of 'untied' aid. But neither factor had immediate impact on India's aid prospects. The September 1960 donors' meeting, which for the first time is referred to in some papers as a 'consortium', generally endorsed the third plan. It also encouraged the belief that the necessary external resources would be made available on relatively soft terms. In fact, the meeting explicitly urged members to eschew short-term credits, refinance short-term or medium-term credits falling due during the third plan, and ensure that the 'bulk of future aid to India' was in the form of 'long-term loans (with a maximum period of grace) not repayable in foreign exchange'.

These funds were not found without difficulty, while the rupee repayment idea was never actively pursued. Despite some misgivings about the wisdom of the consortium departing from its earlier purpose of meeting only to address severe balance of payments difficulties, the American view prevailed that the 1961 meeting should make aid commitments for the next two years. But Germany, as Iengar had already warned the government after a visit to that country, was yet unprepared to make a commitment which would satisfy the Americans, who pressed for an adjournment of the March 1961 meeting until the end of May. With Britain also taking the view that it would only match the German contribution, the early omens for mobilizing external assistance for the first year of the third plan were not very propitious. Nevertheless in a subsequent meeting, aid pledges amounting to \$2,225 million were made for the first two years of the plan, of which \$1,295 million was for the first year alone.

Next year too, it was not all smooth sailing. The US commitment of \$500 million was conditional on other countries together matching this amount.

⁷ This figure also excluded P.L.480 loans. The donor club expected India's gross external aid requirements, i.e. including P.L.480 credits and aid repayments, for the third plan to be in the region of Rs 3,200 crores.

Hit The Jackpot



The Finance Minister is in Washington attending the "Bank-Fund" conferences.

— Shankar's Weekly, 23 Sept. 1962

Were that to happen, commitments would amount to \$1,200 million (including the World Bank's own assistance of \$200 million). This was thought to be just adequate, with some possible support from the Fund, to meet plan and balance of payments requirements for 1962–63. But the May 1962 meeting of the consortium broke up over differences about Italy's contribution, and by the time the consortium reassembled in July, there was some crystallization of donors' opinion against India over Goa and the decision to buy MiG aircraft from the Soviet Union.⁸ The July meeting was however the largest until then, with a total of ten member countries attending. The combined European contribution came up to \$435 million now, which the US agreed to match. Together with the commitments of the World Bank and the International Development Association (or IDA set up in 1960), pledges for 1962–63 came up to \$1,070 million, thus bringing the total commitments for the first two years of the third plan to \$2,365 million.

This was no doubt an impressive achievement, both on India's part and that of the donors. Even at the reduced figure of \$980 million, the US contribution to this total was the largest aid commitment by that country since the Marshall plan, and clearly signalled its determination to impress upon other consortium members the importance of jointly supporting the Indian plan. When B.K. Nehru, who confided to some friendly western officials that he had become a 'missionary in the cause of foreign aid and tend[ed] sometimes to lose touch with reality', first proposed an annual aid package of a billion dollars, he was reportedly told by the World Bank President, among others, that the idea verged on lunacy. Hearing of it as a 'boast' by Nehru to encourage Delhi to launch another ambitious plan, officials in London were inclined initially to do everything possible to douse India's expectations. That India secured the commitment it sought at least for the first two years of the plan was an outcome partly of favourable political factors. But it was also a tribute to international statesmanship and India's skilful economic diplomacy.

The aid achievements of 1961–63 were not without blemish. Even after these substantial commitments, there was an estimated balance of payments gap of \$152 million in 1961–62 and \$131 million in 1962–63 (this doubled to \$260 million because of the \$65 million shortfall in European commitments and matching US reductions) which could have been met by a stepping up of what was sometimes loosely referred to as 'general purpose aid'. The

⁸ The Indian policy towards Rhodesia too was mentioned in the same context. According to a British view, which apparently evoked sympathy in the US Congress, Indian officials did not believe that aid 'could be affected by their general attitude and to disillusion them might clear the air', and help improve relations in the long run.

consortium countries were aware of this gap. Some of them even contributed to the gap by first underestimating project costs when tied aid was negotiated, and advising India only when the project approached completion that it would be 'technically unviable' unless larger allocations were made for the import of spares. Nothing was done by the consortium to address the mismatch between assistance to build capital and that to help maintain it. To some extent, the expectation was that payments problems caused by maintenance imports were for the Fund to handle. India was not unwilling to go to the Fund, and was in fact to do so not long afterwards. But wisely, it preferred to save that option for a payments crisis brought on by a drought.

To the extent the payments gap arose because of maintenance imports necessitated by investments financed by project assistance, the best way to address it would have been as part of a wider assessment of the external financial implications of the third plan. Indian planners themselves had underestimated maintenance imports, and 'allocated' only Rs 200 crores for 'components and balancing equipment'. Both they and their prospective donors thereafter lost sight of even these figures in the melee caused by the manner in which aid negotiations were often conducted—frequently despite the initial Indian aversion to them, in bilateral negotiations—more to maximize commitments than to ensure the quality of the assistance extended or received. Despite the World Bank's advice and the Indian need for untied aid, there was little wider acceptance of its necessity. No major country wanted to untie its assistance if others continued to tie theirs, on the plea that doing so would amount to diverting its expenditures to other markets. Besides, the American approach of offering matching assistance was meant to put pressure on other donors to raise their contributions. But this had the unexpected and unintended outcome of forcing India to accept unattractive shorter-term tied loans from other donors in order to reap the advantages of American matching. Despite this, as we just saw, the US willingness to pledge another \$65 million could not be translated into commitment.

It is not the object of this chronicle to estimate how far the nature of the aid negotiations and the resulting quality of the assistance received by India were responsible for the bottlenecks and underutilization of industrial capacity that became increasingly evident from about 1963–64. As the World Bank representative in Delhi confessed to his British interlocutors in 1963, the manner in which aid was made available to India led to a 'ludicrous position' in which 'it was easier for India to find foreign exchange to build a new plant than to buy small amounts of spares to make existing plants workable'. By the middle of 1963, as we note in greater detail in the next chapter, western donors began to fret about the slow pace at which the assistance given in the preceding years

was beginning to produce results. Some, especially in Britain, began to canvass the advantages now of extending balance of payments assistance to India, but at the cost of aid to finance capital building, precisely at a time when a capital goods sector was gradually coming into existence in India.

Finally, aid terms were not as liberal as India hoped or the World Bank sought. The Germans refused to extend maturities beyond twenty years while the others lagged even further behind, France seeking repayment within ten and Japan, Canada, and Britain preferring to wait upon events or tying terms to details of individual projects.

Although impressive in quantitative terms, the Reserve Bank began soon to look askance at the quality of the assistance made available to India. A working paper by V.G. Pendharkar drew attention to the preponderance of tied aid and the costs of such assistance. Tying, he pointed out, came in the way of committed assistance being utilized at all, let alone effectively or efficiently. Besides, already by 1961 there was concern within the Reserve Bank about the sustainability of India's accumulating debt burden. In a note entitled 'Some problems relating to India's capacity to bear the growing burden of external borrowing', the Bank drew the government's attention to the rapid growth since 1958-59 of service payments on external public debt from an annual average of Rs one crore in the first plan to an average of Rs 10 crores in the second. Rapid rise in the volume of debt, quicker utilization, the rise in creditor countries' domestic interest rates since 1957, and shorter maturities were responsible for this phenomenon. For instance, American wheat loans and technical credits, and the World Bank assistance obtained before 1957 had long maturities and grace periods. But loans contracted after 1957, the Reserve Bank analysis pointed out, were largely medium-term loans with relatively short grace periods. The country's capacity to earn foreign exchange through exports was therefore a crucial factor in determining its future debt servicing capacity. But with export performance lagging behind during the second plan, the debt service ratio had risen to 12 per cent of export receipts and would rise to 19 per cent at the end of the third plan. Further, with foreign assistance likely to finance over a quarter of the third plan investment, India was certain to encounter more severe debt servicing problems in the future. Since there was little immediate prospect of boosting exports and imports could not be curtailed without affecting investment, the Reserve Bank recommended securing a larger quantum of longer-term and untied aid and seeking postponement of amortization payments.

Finally, disbursements were several steps behind commitments and the tied nature of much of the assistance made it difficult for the borrower to

match inflows and outflows. In particular, there was a perceptible widening during 1961–63 of what the World Bank referred to as the ‘payments gap’, and which the Finance Minister, Morarji Desai, defined as the gap caused by ‘imports ... outside the credits available ... for machinery, components and other development requirements ... [and the] discharge of debt obligations’. A new factor which boded ill for the health of India’s external accounts was the decline in invisible receipts due to lower remittances, gold smuggling, and other ‘confidence movements’. Thanks to these factors, India continued to live from hand to mouth even during the early third plan years despite the relatively large amounts of external assistance it received, some increase in commodity exports, and lower imports.

India Returns to the Fund: July 1961 and 1962

Faced with falling reserves, an anticipated lag between aid commitments and disbursements, and a large repayment to it of the 1957 drawings, India approached the Fund in July 1961 for a drawing of \$250 million. Not only did a drawing of this size exceed India’s gold tranche and the first credit tranche and call for substantial justification, an additional complication of the proposed transaction was that it involved a roll-over of the earlier drawing. But following encouraging signals from the Fund management, India decided to lodge its request which also attracted support from a sympathetic Fund staff. Confirming that there was a ‘substantial uncovered payments gap’ for the year as a whole, the staff analysis stressed that ‘the crucial factor in the reserve situation’ would be the ‘rate of utilization of aid funds’ and that ‘any lags in disbursement of funds will add to the burden on India’s foreign exchange reserves’. This led to some rumblings in the Fund Board that India was being allowed to roll over its debt to the Fund, that it should be asked to submit a statement of intent since its request exceeded the first credit tranche, and finally that what India was seeking was development finance rather than payments assistance.

Aware of these criticisms, the Indian Executive Director, I.G. Patel, drew the Board’s attention to the unsatisfactory state of India’s foreign exchange reserves and the need to prevent any further reduction in its already depleted reserves either due to anticipated seasonal trends or delays in disbursing aid. As Narayan Prasad before him, Patel also emphasized that the Fund could not wash its hands of unexpected balance of payments difficulties merely because they arose from a member-country’s development plan. Though some members of the Board addressed mild cautionary remarks towards India in the discussions which followed, there was a large measure of support for the Indian drawing, and Per Jacobsson himself saw the Indian request as opening the door ‘for a

more liberal policy in regard to the use of the Fund's resources in the future'. Of the total drawing of \$250 million which India availed of in August 1961 in a currency mix designed more to address the lender's concerns than the borrower's needs, India utilized \$127.5 million to repurchase the amount outstanding under the 1957 drawing and the remainder to bolster its reserves.

The relief afforded to the reserves by the Fund drawings of August 1961 was short-lived. Although year-to-year variation in reserves might appear small, the weekly reductions in these balances were often substantial. After rising slowly until December 1961, India's exchange reserves began declining quite steadily until June 1962. The gold and foreign currency assets of the Issue Department of the Bank also fell steeply during these months. The latter aggregated Rs 220 crores in June 1961 of which about Rs 118 crores were in the form of gold, and the remainder in the form of foreign securities. Foreign securities held in the Issue Department dropped to Rs 93 crores (or only about Rs 10 crores above the legal minimum) the following month before recovering handsomely to about Rs 126 crores in January 1962. Thereafter they fell once more to about Rs 92 crores in June 1962.

On 4 June 1962, the Governor, P.C. Bhattacharyya, attended a meeting of the committee of economic Secretaries to discuss the precarious external financial position. He spoke to the committee at length about the decline in the foreign assets of the Issue Department. Reporting the Bank's assessment that the problem was not a 'short-term one', Bhattacharyya argued that there was 'no alternative to curtailing imports as a matter of long-term policy'. Although Bhattacharyya did not disclose this to the meeting, import restrictions were dictated also by the need to convince the Fund (which India would soon approach for a standby arrangement) that its foreign exchange earnings would suffice to meet repurchase obligations. There was, according to the Governor, still some fat that could be trimmed in the import of spares, components, and raw materials for non-essential industries, and he advocated a 'total ban on import licences for at least three months except in cases where aid was already available'. The Indian economy, Bhattacharyya argued, had withstood quite well the shortage of spares during the second world war and even managed some efficient import substitution in these goods. With the Indian industrial structure having grown more diversified in the meantime, the dislocation caused by drastic reductions in imports of spares would only be temporary. Bhattacharyya also conveyed reports of the Bank's surveys which indicated that nearly 60 per cent of those travelling abroad did not draw any foreign exchange, and that half of those so travelling stopped first in Malaya or the Middle East, 'no doubt for getting foreign exchange illegitimately'. This, mainly, had caused remittances from Malaya to dwindle from Rs 21

crores a few years earlier to Rs 3 crores at present. Another consequence of unauthorized travel was the leakage in official receipts from tourism. While inflows of tourists had more than doubled from 67,000 to 1,50,000 in recent years, official receipts from tourism were stagnant at about Rs 4.5 crores, and the Bank's estimates put the amount of tourism receipts lost to the treasury at Rs 10 crores to Rs 15 crores each year.

At Bhattacharyya's instance, the committee recommended stopping all unauthorized travel and the issue of import licences, except where imports were financed out of aid, for two months. Although there was no hint of this in the meeting of the committee of economic Secretaries, the fall in the Issue Department's reserves to about 5 per cent above the minimum currency cover appears also to have set off an unacknowledged trigger. For according to a report L.K. Jha was apparently authorized to convey to the British High Commission in Delhi, on 8 June the Union Cabinet was on the verge of suspending the minimum legal currency cover requirements. But it was argued out of this course by the 'personal intervention' of the Prime Minister, Jawaharlal Nehru, 'exercising a mainly political judgement'.

Nehru, according to Jha, wanted to delay the denouement in the hope of avoiding it altogether. In a statement he made to the Lok Sabha the same day, the Finance Minister drew the members' attention to the severity of the crisis but merely adverted to the possibility of suspending currency cover requirements. Calling for 'social discipline and solidarity ... to put our foreign exchange position in order', Morarji Desai declared that there came

a point in the history of every nation when it must demonstrate that it is prepared to take whatever action ... may be necessary to pursue the paramount objectives so vital to its sense of dignity and purpose.

But the only action he announced immediately was a ban on all unauthorized foreign travel. Further measures were announced to regulate travel for business or education, and Desai promised other measures to curb imports. It is also interesting to note here in passing, since more will be said on this subject in the next chapter, that the possibility of devaluing the rupee was considered for the first time during these weeks, though only to be rejected almost out of hand.

In the event, the foreign currency assets of the Issue Department continued to fall below the 8 June trigger level and bottomed out at about Rs 88 crores in January the following year. A recourse to the Fund was an obvious solution, but one which Delhi was reluctant to adopt since the recently incurred 1961 obligation of \$250 million was still on its books. There were suggestions that

some members of the Fund Board thought India was already over-borrowed; while Per Jacobsson was also believed likely to insist on a Fund mission for levels of drawings or standby which took India close to its second credit tranche in whose neighbourhood intending borrowers were usually asked to submit stabilization plans or letters of intent about future policies. But the initial Indian reluctance melted in June as its external reserves position deteriorated and the promise of an untied loan from Germany failed to materialize.

In favour of India's request was the fact that its balance of payments need had become suddenly more pressing because of the slow pace at which western donors moved to fulfil their aid commitments. While the US would be disposed to support the Indian application, Britain, Germany, and other members of the consortium too, would be unable to oppose it. Informal consultations with the Fund also suggested that while India would be expected to explain its reasons for not changing the rupee parity, such a request would be made largely to keep up appearances. The Fund was expected to be satisfied by the measures India had already taken at the beginning of June 1962, not without a shrewd appreciation of their possible bearing on attitudes in Washington, to restrict imports and plug leaks in invisible receipts. Some action on the monetary policy front was also called for and since the Bank and the government already had such measures under discussion, there was little delay in tightening the quota-slab system of accommodation in July 1962 and putting up the coupon rates on central government loans floated later the same month. Once these measures were adopted, India applied to the Fund for a one-year standby arrangement of \$100 million. This was sanctioned with relatively little controversy, and India drew its first \$25 million of this standby within days thereafter.

Following this drawing, India's exchange reserves began recovering from July 1962 and, despite a substantial dip in November 1962, continued to rise through the following months, thus staving off the need for the kind of drastic action contemplated at the Cabinet level in June. The pressure on the Bank's foreign exchange assets revived in 1963, and although the renewal of the July 1962 Fund standby was accomplished with little difficulty, there were now some signs that even the nominal aid outlook was undergoing some change along with the western world's attitude towards India's development needs. These and subsequent developments form the subject of the next chapter.

As an institution, the Reserve Bank played a relatively minor role in mobilizing long-term external assistance, nor indeed was this any part of its remit. Individual Governors were involved directly or indirectly with aid negotiations and were otherwise generally kept informed by the government.

The Bank's London office helped coordinate aid exercises in Europe, and its manager there, in particular V.G. Pendharkar and his successor, S.D. Deshmukh, participated in discussions with the European donor countries. But, for the most part, the Bank's exertions were confined to preparing technical material, such as balance of payments figures and forecasts. Interestingly, donors were quite willing to support balance of payments needs as established by the Planning Commission and the Finance Ministry until the early 1960s, but once external payments pressures began to worsen from about 1962–63, the Bank's estimates and forecasts began effectively to provide the test of 'need'. In fact, the balance of payments projections arising out of the mid-term appraisal of the third plan discussed in the next chapter, were worked out at the Bank which also formulated, at the government's behest, parts of the reports presented to the consortium in 1964 and 1965.

In addition, successive Governors of the Bank were engaged in a continuing dialogue both with governments and with central banks in some other countries. These efforts too were followed up and sustained, sometimes even initiated, by the Reserve Bank's office in London. Though willing partners in cooperation, central banks traditionally adopted a more conservative posture on foreign aid than their respective governments, and attempted generally to exercise a restraining influence on their enthusiasm to extend assistance. Although it was not their sole, or even main purpose, the Reserve Bank's dialogue contributed towards moderating the resistance of its counterparts to extending liberal assistance to India.

The Reserve Bank was also a key Indian interlocutor with international agencies, more so until the mid-sixties with the IMF than with the World Bank. As many aspects of the policy regime, including those relating to the monetary sector, came under closer scrutiny by the aid agencies from the mid-sixties, the Bank's function as a credible intermediary between the country and international institutions expanded in scope, and it was drawn more closely into discussions and negotiations about Indian financial requirements and policies. The Reserve Bank also played an important part in the operational aspects of multilateral lending and in ironing out creases in procedures and perceptions relating to them. Even with members of the consortium, bilateral aid negotiations were often hostage to several aspects of the contemporary policy regime and its working, and the Bank was often called upon wherever possible to address the interests of the donor nations without compromising India's interests or the integrity of the policy regime. Finally, the Reserve Bank acted at the government's urging to explore the possibility of securing official assistance and export credits from countries such as Switzerland which were not part of the existing consortium arrangements.