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## Crisis and Devaluation, 1963–67

The Chinese invasion in October 1962 produced a measure of sympathy and support for India in western capitals, and a modest quantity of defence assistance which the US and Britain agreed would not be counted towards consortium loans. Some British officials even pressed for the initiation of rupee payment arrangements on a small scale as a means of easing India's balance of payments problems, but the suggestion was shot down by the Bank of England.

In fact the Bank of England, principally, was engaged during these very weeks in reviewing aid policies towards India. Officials at this institution felt 'various fundamental things' were going wrong in India, 'constructive remedies' were not easy to suggest much less implement, and that the World Bank should be encouraged to carry out a 'fundamental and comprehensive review' of the current third plan position. There was also talk in Whitehall departments of how aid to India could be used as a lever to secure wider British objectives in the region. Although such issues could not be openly aired in consortium talks, some officials noted, efforts should be made before the consortium formally met to consider the 1963 aid package, to persuade India, which was now 'defensively insecure and financially sick', to reconsider its views on matters of strategic interest to Britain and the western world. At the consortium itself, according to this view, India should be asked to 'remodel' the third plan to suit 'realities'. In particular, its government should be encouraged to pause for breath and not undertake any new projects except where these might lead directly to orders for British industries with excess capacity. Other considerations, such as India's preference for pursuing new oil projects in the public sector rather than allowing the Burmah Oil Company to expand its refining capacity, also began to figure in the British calculations about this time.

While many in Britain and elsewhere felt a review of India's recent development experiences was called for and the Indian government too, would

soon carry out such an exercise, the more extreme views did not yet evoke widespread support even in Britain. India felt it needed new aid commitments of \$1,255 million for 1963–64, of which \$317 million were meant to finance the ‘disbursements gap’. British officials urged their Indian counterparts to consider whether they should not give the latter overriding priority, only to be met with the firm riposte that the overall level of commitment should also receive ‘its proper share’ of attention. For their part, the Americans continued during the early summer of 1963 to press Britain and the other European countries to make aid commitments totalling one billion dollars for 1963–64 largely in the form of long-term aid with lengthy grace periods and carrying low rates of interest, and were even willing to make approaches at the political level to secure pledges of this magnitude.

#### REAPPRAISING ASSISTANCE TO INDIA

Meanwhile, however, an important change was coming over the World Bank’s outlook on India. Probably underestimated at the time, this change had important consequences for India’s external aid environment during the next few years. Thanks to the Indian strategy, which was not always realized, of not pressing individual donor countries for development assistance at the bilateral political level and relegating the task of mobilizing it to the World Bank, the latter emerged during the Black years as the leading protagonist of consortium assistance to the world’s most populous democracy. This approach may have been justified in 1958–59 when western governments tended to be several steps behind the World Bank in wanting to lend large amounts to India. But the inherent paradox in the Indian aid strategy was revealed before long, as the case for assisting India came to rest most strongly on political considerations to which western capitals were more sensitive than a financial institution such as the World Bank. This was a benign paradox so long as both the World Bank and western governments recognized the imperative need to assist India without expecting too much immediately in return. But not only did donors soon begin to insist on elaborate bilateral consultations of a nature which India had earlier hoped to avoid, the World Bank-led consortium approach made the availability of western development assistance hostage to the Washington institution’s attitude towards Indian economic developments and policies. There was little the World Bank could do, even should it be so inclined, where consortium members were unwilling to grant assistance. But where the latter were willing and the World Bank was not, it was well placed thanks to its facilitating role, to apply the brakes on assistance to India.

One can detect a palpable shift in the World Bank's approach towards aid to India from 1963. This shift coincided with a change of guard at that institution. In January 1963 Black was replaced after thirteen long years by George Woods. Even in comparison with Black, Woods was probably not poorly disposed towards India, and officials (including P.C. Bhattacharyya who as Governor of the Bank was closely involved with the events described here) recall or refer to him as someone who was 'extremely friendly and sympathetic' to India. Woods also fancied himself as something of an expert on the country, having spent some time there first in 1952 as part of a steel mission and again in 1954 along with the group which went to India to give some shape to proposals for a private sector development bank. A detailed review of the World Bank's activities and commitments was perhaps inevitable after the change in its leadership. How far this review was motivated by Woods's desire to fill Black's larger-than-life absence at the World Bank will remain a subject of speculation. But undeniably, India was a big part of the World Bank's activities. Not only did Black invest a considerable proportion of the institution's energies and funds in India, the consortium approach he pioneered was now something of a model for other countries, and any review of the World Bank's approach towards its principal developing country client was bound to have an impact on its wider activities. Besides, there were also some misgivings at the World Bank about the way things were developing in India, and it would have been surprising indeed if its new head did not lend his ears to those voicing them. Among the latter were Peter Wright, who was in charge of India at the World Bank and whom Woods soon promoted to more responsible positions within the institution, and Ben King, its controversial representative in India. Whatever the underlying reasons, therefore, Woods's arrival coincided with an increasingly critical review by that body of the planning and development process in India.

Not that such a review was not otherwise indicated. Nor was it the case that critical World Bank reviews of India's economic performance were unknown before Woods. Both in 1961 and 1962 the World Bank passed adverse comments about some Indian policies. But Woods's intervention appears in the summer of 1963 to have been based on some mistaking of the nature of pressures caused notably by a poor harvest in 1962-63 and the difficulties of financing maintenance imports, to which attention was drawn in the previous chapter, as signs of a deeper malaise within the development process. Whether or not the latter betrayed such a malaise is not the issue here. But Woods's diagnosis of it at this time was general rather than yet specific or pointed. Indian economists and officials too shared many misgivings about the direction of the country's economic policies, and despite the often

politically-charged debates surrounding the issue, many in India recognized the pressing need for larger investments to boost agricultural production and strengthen the infrastructure. Headed by Woods, who had earlier been a trustee of the Rockefeller foundation, the World Bank would soon make agriculture one of its main priorities in India. But the first major initiative Woods took on India—in the form of a letter he wrote to Finance Minister Morarji Desai in June 1963—did not dwell upon agriculture. The letter spoke of the low rates of growth in recent years of the Indian economy and about promoting exports, improving the climate for private investment, pricing policies, the necessity for relaxing import controls, increasing domestic interest rates, and tackling the population problem.

Indian ministers and officials appear initially to have been baffled, even bemused, by Woods's intervention. But Desai responded politely to suggest that the Indian government kept the planning process under continuous review and that it was willing to discuss the situation in greater detail in the winter. Thanks to the challenges they posed and the increasingly adverse economic and security environment, the Indian government was inclined to subject third plan outlays to continuing review. T.T. Krishnamachari, who was soon to become the Finance Minister, even compared the plan to a child about whose changing needs a father could not be dogmatic or inflexible. But the government could not afford to suspend the plan pending the review, and Desai's letter to Woods emphasized the importance of avoiding any break in development assistance which, if anything, would have to be larger than at the beginning of the third plan. Besides meeting India's needs for non-project assistance, Desai argued, the next consortium round should make fresh commitments for development in basic sectors. The latter was a euphemistic reference to the need to step up outlays on agriculture and infrastructure.

Woods's letter, which some officials of the World Bank and western governments soon began describing as a demarche, spoke of the difficulties he expected in persuading members of the consortium to address themselves to a further aid request when questions were being raised about the results of past aid, the government's future intentions, and the steps it was taking to tackle the present position. In spite of aid pledges from the consortium having exceeded amounts originally contemplated, Woods pointed out, the growth of the Indian economy had fallen far short of expectations, and there was no sign yet of reduced dependence on external support. Nor did the consortium, according to the World Bank chief, have a clear idea of the Indian government's economic programmes and policies for the next three years and into the fourth plan. Declaring his interest in addressing donors' purported misgivings about continuing assistance to India, Woods sought from the government an

outline report on these issues. Whatever its overt concern, this letter was seen within the World Bank as a way of putting India 'on notice' and signalling the institution's displeasure with the government for not having responded adequately to its earlier reports.

The World Bank President's remarks about donor fatigue may not have been altogether misleading. Even in April 1962 when he was in India at the head of a World Bank team, Peter Wright spoke to I.G. Patel, Chief Economic Adviser at the Finance Ministry, about the critical attitude donor countries were more and more disposed to adopt towards 'economic conditions in India'. But the warning, however well meant, was issued so far in advance that it was almost certainly premature. It is worth noting, for example, that the US attitude as evident in its approach towards the consortium process remained highly supportive until at least 1964 while even in Britain, alarms began to be raised only from the spring of 1963. Attention has already been drawn to the expressed American determination to ensure that India received one billion dollars in the form of consortium assistance in 1963-64 and its willingness to use political levers to achieve this target. In the consortium meetings that took place over June-August 1963, aid pledges totalled \$1,052 million (against an Indian indent for \$1,255 million). Half of the former amount was expected to be lent at 'nominal interest rates', almost 90 per cent of it was on long-term, lengthy grace basis, and about two-fifths of the pledges were expected to translate into 'general purpose' assistance for maintenance imports whose financing had recently become a source of some anxiety in India. Although officials in some countries privately voiced misgivings about the prevailing economic conditions in India, the only recorded critical tone in the 1963 consortium deliberations was adopted by the World Bank representative, who drew the donors' attention to the contents of Woods's letter to Desai and proposed a full meeting of the consortium at the end of the year to consider the results of the government's review of the third plan. To a great extent, therefore, the World Bank at this stage was engaged in crystallizing donors' attitudes towards India rather than merely reflecting it.

Some may be tempted to suggest that the Finance Ministry and the Reserve Bank saw the consortium approach as a means of bringing greater financial discipline to bear on the country's planners. There is no evidence that such was the case. The Bank blended unobtrusively into the background so long as the going was good, and was only indirectly involved with aid negotiations or strategies. As for the Finance Ministry which played the principal role in these affairs, it is worth noting that some of its officials, including notably B.K. Nehru, were widely credited with promoting the idea of a 'big' third plan dependent for its success on large annual aid flows. Whatever their

earlier motivations, however, Indian policy-makers soon began to look askance at the World Bank's new approach which, along with the emerging aid environment, provoked them to undertake a detailed aid strategy review in Washington in October 1963. Discussions at this review meeting, which was attended among others by Bhattacharyya, B.K. Nehru, and L.K. Jha, were also framed by persistent suggestions from the World Bank and some western governments that the former should shed its responsibility for the consortium process and that meetings of donors should in future be organized by and in India. As pointed out in the previous chapter, when the consortium arrangement was first instituted in 1958 India was not formally represented at donors' meetings. This changed shortly when its representatives were invited to attend meetings of the consortium, much to the discomfort of some donor governments who felt the departure inhibited free debate. But taking the lead and organizing meetings of this body was another matter altogether. India was reconciled now to striking bilateral assistance deals within the consortium framework, but separate consultations with individual donors about organizing consortium meetings were an unnecessary complication capable in certain circumstances of enhancing donor leverage. Besides, officials felt, frequent consortium meetings in India (at one stage the World Bank suggested quarterly meetings) would only trigger needless publicity and controversy within the country. If adopted, the new proposals would in the short run cause a setback to aid for India. In the long run they might end the consortium approach altogether.

The Washington meeting of Indian officials took note of the decline in the consortium's interest in aid to India. With donor governments preoccupied with their own growth and balance of payments problems, east-west tensions easing, congressional attitudes in the US changing, many more developing countries queuing up for assistance, and India already receiving substantial allocations of IDA credits, some diminution in western enthusiasm was perhaps only to be expected. But the World Bank-led consortium approach too, was debated at this meeting. Believing the Washington institution to be the villain of the piece, one or two officials argued that Indian interests were better served by getting out of its clutches and seeking aid through bilateral diplomacy. As Finance Minister, T.T. Krishnamachari ventured similar views when the consortium process was suspended in 1965. Nothing came of them even then, and in 1963 the balance of advantage was judged unambiguously to lie in not allowing the World Bank to 'slide out of its responsibility for getting Consortium aid to India'.

The World Bank's efforts to promote doubts about Indian economic policies which were only privately voiced earlier, formed the background to the Indian government's mid-term appraisal of the third plan. The appraisal highlighted

some notable achievements, but was frank in admitting the slippage which had arisen because of bad harvests, poor resource mobilization by state governments, their diversion of project funds, and the shyness of private investors. India's inability to finance the faster than expected growth in maintenance imports had also led to substantial unutilized capacities in industry. Exports, on the other hand, were not as buoyant as hoped, while the decline in invisible receipts worsened the position. Finally, the appraisal referred to the administrative and managerial challenges of implementing plans and plan projects. Its medium-term forecast was however less gloomy than its evaluation of the recent past, and the appraisal anticipated higher rates of growth, if not necessarily a reduction immediately in external imbalances, over the next two or three years if harvests lived up to Indian hopes.

The mid-term appraisal, in formulating whose sections on finances, balance of payments, and foreign aid forecasts and receipts, the Bank played the major role, was published in November 1963. Thereafter until March 1964 when the consortium met in Paris to consider the report, officials of several western governments and the World Bank were closely engaged in studying and commenting on its analysis and projections.

L.K. Jha represented India at the Paris meeting, and with the appraisal already on the table, used the opportunity to press for untied aid and loan negotiation procedures which enabled some global consortium evaluation of the quality of pledged aid. He spoke of the costs of tied aid, and the World Bank representative supported Jha by pointing out that imports financed by tied aid often cost twice or three times their price in the world market. According to the record maintained by one donor participant, Jha was alternately 'conciliatory, thoughtful, adroit, and evasive' and he reportedly left his audience with 'mixed feelings of admiration for him as a performer and discontent with the net product'. There was little discussion of fourth plan assumptions and outlays other than the suggestion that the latter should be determined with abundant caution. But a notable feature of the meeting was that unlike even in 1963, there was no explicit discussion of the period over which India's development needs would have to be met, and no member dissented from the US view that 'everyone must be prepared for a long haul'.

As commitments went, the Paris meeting was not a failure. Nor was donor fatigue much in evidence yet, as pledges totalled over \$1,000 million against India's total estimated needs of \$1,150 million. In fact as late as October 1964, John Lewis the newly arrived head of the USAID mission in India who was believed by knowledgeable diplomats in Delhi to be 'close to President Johnson', is reported to have disclosed to them his view that 'India's importance was such that the volume of American aid would not fall off'.

As well as its longer-term financing needs, by the autumn of 1964 attention in western capitals began to focus increasingly on India's emerging debt repayment and servicing problem. This issue came to the fore partly because of Indian preoccupations with framing the fourth plan. Annual debt servicing and repayment obligations during the third plan years were believed to be in the region of about \$300 million, and were expected nearly to double during the fourth plan. Although the problem was not yet imminent, the absence of any definite knowledge about how these liabilities would be financed, clouded the outlook for the fourth plan and the possibility of even working towards reasonable ranges of possible investment outlays. Indian officials canvassed with their western counterparts the idea of donors 'undertaking', rather than yet 'committing', to make available net aid of \$1,000 million each year during the fourth plan. Initial exercises about the feasibility of securing more than \$1,500 million each year in the form of gross aid led to proposals for rolling over repayments falling due. The World Bank and the United States had recommended that practice to some consortium members in the early 1960s, and while not explicitly invoking this precedent, Indian officials hoped to use it to gain some breathing space and a better outlook on fourth plan financing.

Repayments owing to Britain and the World Bank were the cause of the hump immediately facing India. In fact its officials expected—wrongly as it later turned out—a doubling of the country's debt repayment obligations to Britain even between the penultimate and concluding years of the third plan, and London was therefore the first western capital at which they raised the possibility of rolling over maturing debt. British officials, who tended generally to look askance at debt roll-overs, did not demur at the principle underlying the Indian proposal. It became immediately clear to them that, however it was used, gross assistance of amounts committed or disbursed during the third plan would not go very far in the fourth, and debate centred mainly on whether these maturities should be rescheduled or debt repayments 'refinanced'. Officials in London preferred the latter because the former implied a default, but Indian officials resisted the idea for fear that the resulting increase in gross aid commitments would further fuel the resentment other developing countries were reported to feel about the size of concessional aid flows to India.

The wider differences over how to handle the Indian debt servicing problem related to timing, i.e. whether it should be taken up at the consortium level after the fourth plan was ready sometime in October 1965 or it should be tackled first to enable a clearer outlook for the planning exercise. Opinions were divided on this, and though there was some suspicion that India advocated the latter course because it wanted the debt servicing problem out of the way to better apply pressure on consortium members to make large aid contributions



to finance imports during the fourth plan, officials even in London felt there was a sound case for distancing the two questions.

There was little, however, which Delhi or London could do immediately as George Woods set his face firmly against taking up the debt problem until 1965–66. Woods's resistance arose initially because he hoped to raise capital for the World Bank in Europe's financial markets, where any talk of debt rescheduling or financing could damage his institution's creditworthiness. But soon he began explicitly to regard World Bank assistance and concessions on debt repayment as instruments of leverage with which to press reforms on India and persuade its government to formulate an acceptable fourth plan. He therefore resolved to suspend discussions about the former until his leverage package was fully assembled. In fact, as Peter Wright underlined to his British hosts who voiced some anxiety about India's debt servicing abilities in November 1964, 'it would be most unwise to pursue with George Woods [who was expected soon in London] the question of Indian debt'. Wright also told British officials that little would be gained by talking the matter over in Washington or Bonn, and that Britain should not discuss the subject with Indian representatives when they arrived to discuss aid for 1965–66. Debt rescheduling was nevertheless raised at the highest level between the two governments in the closing weeks of 1964, and officials in London anxious to avoid a crisis found Woods's approach to the problem 'disturbing' and lacking in a 'sense of urgency'. However, as a lender 'claiming a privileged position' of the one to whom the likely defaulter owed the largest repayments in the immediate future, Woods managed to have his way.

Meanwhile, Woods was also giving considerable thought to assembling his leverage package. From April 1964 he began pressurizing the Indian government to accept a strong World Bank mission to India. The Indian government ignored the suggestion for several months, but in meetings with him in August 1964 Woods persuaded the Finance Minister, T.T. Krishnamachari, to accept it. Woods agreed in return not to advertise the mission's report and to publicly disclaim any intention of dictating terms to India about the shape and size of the fourth plan. The stated purpose of the mission was to help the World Bank familiarize itself with Indian conditions, but Woods's 'deeper purpose' according to the institution's representatives in Delhi was to 'establish the faults in Indian planning procedures and Plan implementation ....'

In May 1964 Woods persuaded Bernard Bell, a consultant applied economist, to head the mission, which was despatched to India soon after TTK acquiesced to it. British efforts to draw the World Bank into discussions over ways to tackle the Indian debt problem coincided with Woods's growing

suspicion that Indian officials were not cooperating with his Bell mission. Speaking to London officials who insisted on tackling the subject with him when they met in December 1964, Woods expressed himself dissatisfied with the help the mission received from the Indian government and announced his intention to 'use his willingness to assume the lead in the indebtedness discussions to secure the full cooperation of the Indian authorities' in its work. Woods also apparently informed his hosts that his 'own approach to the fourth plan would be a severe one' and not be confined to 'endorsement or purely academic comment'. Besides, while acknowledging the political arguments of the US, Britain, and the others against 'any major change of policy', he declared that the World Bank's examination of the fourth plan 'might be the occasion for something of a showdown' with India. Woods also confided to officials in London that he wanted to examine World Bank loans to India in a 'very critical' manner. Among Bell's many suspicions in December 1964 was that Indian officials hid balance of payments figures from him because 'defence imports were the source of the trouble', and speaking to L.K. Jha in London over lunch the same month Woods insisted that his approach to the debt problem and to aiding the fourth plan would depend on an annual assessment of the balance of payments implications of Indian defence expenditures. As matters turned out, however, the explanation for Bell's failure to get the latest payments estimates in Delhi was that the Reserve Bank was still compiling these figures and forecasts in November 1964 from information on import licences which was in some disarray, and it would be several more weeks before they could be conveyed to his mission with any degree of assurance.

While western donors were no doubt less enthusiastic in 1964-65 than before about extending assistance to India, the World Bank appears to have been the only donor afflicted by 'fatigue' until the spring of 1965, when US resistance to aiding India became palpable. The US refused for the first time to increase its aid commitments that year, yet total consortium commitment came up to \$1,027 million, or nearly the same amount as that committed the previous year. That a large part of the commitment was not translated into credits, among other factors because of the suspension of US aid to India after September 1965, is another story.

#### SCRAPING THE BOTTOM OF THE BARREL, 1965-66

In the mid-sixties, India owed substantial repayments not only to the World Bank and other members of the consortium, but also to the International Monetary Fund. Under an agreement reached with the Fund in June 1964,

India was committed to repurchasing \$200 million in three half-yearly instalments between the end of March 1965 and the end of March 1966, and a further \$25 million at the end of July 1966. Unlike the previous year when they were more or less steady between June and December and rose towards March 1964, external reserves fell steeply between June and December 1964 from about Rs 278 crores to Rs 237 crores, and it became clear to the Indian authorities early in the winter of 1964 that they would not be able to adhere to the repayment schedule agreed with the Fund. About this time, Anjaria, who was now the Indian Executive Director at this institution, invited Bhattacharyya's attention to the uneasiness in Fund circles about India's economic situation and the rupee's viability.

The closing months of 1964 were a turning point also for the Reserve Bank's own role in India's external economic diplomacy. Its officials provided technical support, prepared papers for government negotiators, compiled the data on which to make decisions and projections, but contributed relatively little until this point directly to aid or external policy negotiations. The danger of external reserves breaching the minimum currency cover in the summer of 1962 spurred the government into consultations with the Bank, which was also involved in drawing up the Indian strategy for the July 1962 agreement with the Fund. Once the immediate crisis passed or officials in Delhi learnt to live with it, little time was lost in relegating the Bank to its earlier supporting role. When the World Bank left it to India to prepare the country brief for meetings of the consortium in 1964 (and 1965), the Reserve Bank deputed a senior official to help the government fill the breach. As the crisis intensified from the winter of 1964, the profile within the Indian economic policy establishment of the Governor, if not that of the Bank itself, grew considerably sharper. Bhattacharyya's intervention grew more effective and assured after TTK's star began to wane in the summer of 1965, and thereafter for the next two years, he became the key member of the small core group of officials coordinating India's external economic policies. It needs however to be stressed that few others at the Bank were directly involved in the exercises leading to the rupee's devaluation in June 1966.

To return to the main themes of this chapter, Anjaria's letter led Bhattacharyya to ask officials at the Bank to examine whether it was possible to refinance in some way the debts owing to the Fund. In a brief note, M. Narasimham pointed to the difficulties of repeating a refinance operation, and instead suggested approaching the Bank of England for a short-term line of credit that would enable India to meet its repurchase commitment. As pointed out above, thanks to Woods's resistance, Jha's recent efforts to secure some debt refinancing assistance from Britain had largely drawn a blank. But

the chances of the Reserve Bank securing a loan from the Bank of England to enable repayment to the Fund were judged to be brighter, and this was eventually one of the options which engaged the attention of the Indian authorities in 1964–65.

With reserves not showing much seasonal buoyancy and substantial repayments owing to the Fund, the situation called for some hard decisions. B.K. Nehru, who was the Indian ambassador in Washington, felt steps should be taken to suspend or reduce the statutory currency cover. But Bhattacharyya and S. Bhoothalingam, Secretary in the Finance Ministry, rejected the advice on 'psychological' grounds: with the deteriorating price situation and 'loud thinking elsewhere on the value of the rupee', it was imperative to examine other possibilities, including rescheduling the Fund repurchase obligation. Following this, Nehru and Anjaria were asked to explore with Pierre-Paul Schweitzer, Managing Director of the IMF, the course of action India should adopt to postpone its repayments, while L.K. Jha who was already in London sounded out officials at Threadneedle Street.

Jha's talks in London revealed that British support would be forthcoming for a \$150 million drawing from the Fund to tackle payments pressures arising from leads and lags and psychological factors. While his interlocutors cautioned against India seeking a re-phasing of the agreed payment schedule, the Bank of England was not averse to advancing a loan which could be utilized to repay the Fund in full. But there were doubts in London about its ability to find the currencies acceptable to the Fund unless Britain's own external position improved in the meantime, so that in Jha's judgement, India could not expect more than \$100 million from the Bank of England. There was also some crossing of wires, Jha apparently canvassing the possibility of a longer-term arrangement whereas Narasimham's proposal and Bhattacharyya's communications with his London counterpart referred to a short-term operation. Despite the resulting confusion, Bhattacharyya and the Governor of the Bank of England reached agreement on a short-term credit. But the credit was never drawn, first because the necessity for it receded after the Fund drawing discussed below, and later because of the suspension of western assistance to India in 1965.

Meanwhile consultations with the Fund revealed three alternative courses of action available to India. The first was to repay \$75 million at the end of March 1965 and apply in April for a standby of \$100 million. But the March payment too posed problems. The second option was to secure its postponement until May, in the meantime seek a standby of \$100 million after the Fund team returned from Art. XIV consultations in India, and use these proceeds to repay the amount owing in March and a portion of that falling due in

September. This alternative, it was expected, would necessitate a letter of intent from the government conveying its assessment of the future outlook of policy and trends in India. The extreme option was to seek a standby before the Fund team visited India in March 1965, but the catch here was that such a request would signal a deeper disequilibrium in the economy, necessitate 'special consultations', and entail stiffer and quantifiable terms and conditions.

Initially, Bhoothalingam and Jha were in favour of the second alternative. But with the payments situation showing no signs of improvement and reserves continuing to fall despite the export season being well under way, Bhattacharyya held a meeting at the Bank with the Secretaries of the Finance Ministry in December 1964 at which it was decided to approach the Fund forthwith for a standby, advancing the consultation, should one prove unavoidable, from March to January 1965. The Bank and the government also decided that if the reserves position became really critical, the former's gold holdings should be temporarily augmented by stocks of confiscated and indigenously produced gold, and the corresponding amount of foreign exchange released for current deployment.

Thanks to a transfer of confiscated and domestically-mined gold valued at Rs 16 crores from the government's stocks, India's official reserves of gold coin and bullion went up from Rs 117.76 crores in December 1964 to Rs 133.76 crores in February 1965. But holdings of foreign securities continued to fall, and despite the busy season having got under way, there was little sign of any sustained improvement in reserves. More than once in the past two months, the Bank and the government had considered suspending the official reserve requirement since the gold and foreign currency assets of the Issue Department barely amounted to Rs 203 crores during these weeks, but held off for fear of the impact of the move on public confidence in the rupee. The task of restoring reserves could no longer be postponed, even if it required recourse to a Fund standby accompanied by tough conditions. This recognition was followed by a frenzied exchange of cables between Bombay, Delhi, and Washington, the upshot of which was a decision to announce a few corrective measures before the proposed Fund mission arrived in India. The Finance Minister would also make a statement on the critical external payments position when Parliament opened for its budget session. As in the past, the merit of adopting such a course was that it would make it easier for the Fund management to support India's request while enabling the government to truthfully argue that these measures were not the handiwork of agencies in Washington. The Finance Minister's statement in the Lok Sabha on 17 February 1965 underlined that the foreign exchange holdings of the Reserve Bank stood at their lowest level since independence at Rs 78 crores, and that a

suspension of the official reserve requirement was averted by transferring additional gold to the Issue Department. Shortly before the Finance Minister rose to address the Lok Sabha, the Bank put up its lending rate by one full point to 6 per cent. With a repayment to the Fund imminent, TTK told the House, further recourse to its assistance and immediate fiscal and monetary measures were unavoidable. The situation facing India was so serious that 'even with temporary relief from the Fund', it would be necessary to maintain the 'strictest discipline on all fronts' to avoid the 'periodic repetition' of similar situations in the future.

The two-member Fund team arrived in Delhi four days after TTK's parliamentary statement and held discussions with officials of the Bank and the government, chiefly on the letter of intent containing a list of measures the Indian government had taken or would take to deal with the payments crisis. The technical sessions covered the government's plans for market borrowing, the quantum of credit expansion during the busy season, the projected increase in money supply, and some details of export promotion measures. With the help of their latest payments forecasts, Indian negotiators convinced the team that a standby of \$150 million would merely result in a 'shoestring' operation and that a standby of \$200 million was more in line with India's immediate payments needs.

These negotiations resulted in some broad agreements on the letter of intent. But a consensus did not altogether prove easy. The Indian effort from the outset was to take whatever fiscal and monetary measures appeared necessary. Apart from the Bank rate which was put up successively in September 1964 and February 1965, the accommodation regime introduced at the beginning of the busy season was also intended to make credit dearer to private sector borrowers. Nor were there differences between India and the Fund on the need for fiscal restraint or on fresh efforts to promote exports. A monetary budget to guide action in the forthcoming months was not as welcome to the Indian authorities, but in the end they and the Fund team worked out a mutually agreed programme. A Fund stipulation requiring fresh consultations and agreements before making further drawings in the event of India departing from agreed policies proved more contentious. In particular, Indian officials resisted the link the Fund sought to forge between the net domestic assets of the Reserve Bank being held within agreed limits and the country's eligibility to make a drawing under the standby. As Bhattacharyya wrote to Schweitzer at the beginning of March 1965 about the divergence between the Indian and Fund views on the subject, a 'direct link between credit limits only and further drawings' was unnecessary when there was already prior agreement to initiate consultations before any changes were

made to agreed policies. 'In the ultimate analysis', Bhattacharyya told Schweitzer,

relations between the Fund and its members have to be based on mutual trust and the policies that the Fund considers appropriate can be made acceptable only to the extent that member countries consider them their own rather than those stipulated by the Fund as a precondition to drawings. As you can well imagine, there is criticism here that some of the measures we have taken must be at the request of the Fund and political susceptibilities within member countries cannot be ignored when, as in our case, the Fund and the member are agreed on the substantive issue. In the present standby, we have agreed to go much further in our letter of intent than we have done in the past; and we are rather at a loss to understand why a specific binding in regard to credit ceilings is considered more important than our express intention to consult and come to mutual agreement regarding further drawings ... whenever a shift in any aspect of policy outlined in our letter of intent becomes necessary.

Bhattacharyya also asked Schweitzer not to restrict the drawing to \$125 million until the end of May, rather than the end of April as India sought, since by doing so the Fund would be defeating the 'very purpose' of the standby arrangement. India, he said, could not be sure that the present position in which 'we are just able to avoid suspending legal foreign exchange reserve requirements will not appear again in May'. A freer drawing regime would also do more to restore confidence than one which merely enabled India to live from hand to mouth.

The Board of the Fund approved the Indian request for the standby arrangement on 19 March 1965. While Bhattacharyya's request for speedier drawings was accepted, the ceiling on net domestic assets (as defined on p. 102) remained a salient feature of the 1965 standby. The agreed ceiling was set at Rs 3,044 crores until July 1965. (In February 1965 these assets stood at Rs 2,819 crores). Alongside this ceiling, the Bank also indicated to the Fund its hopes—which in the event were not realized—of contracting bank credit during the 1965 slack season by about Rs 200 crores. But thanks to faster than expected growth in bank credit and large issues of ad hoc treasury bills during February–April 1965, the Fund ceiling was in danger of being breached even before the current busy season ended. At the same time foreign exchange reserves continued to decline rapidly and it seemed only a matter of days before they dropped below the legal minimum. With little time to lose, Delhi

instructed Anjaria in Washington on 20 April to ensure that a Fund drawing was 'effectively transferred to the Reserve Bank on or before the 25th'. The government hoped the ceiling would remain intact until the drawing was made. In order to ensure that it could remain so, the State Bank of India was instructed to repay a portion of the accommodation it had earlier availed of from the Reserve Bank. Besides leading possibly to new conditions, fresh consultations necessitated by the breach could prove to be prolonged, and time was a luxury Indian policy-makers could not afford in managing the country's precarious external finances during these months.

### DEVALUATION

The March 1965 standby arrangement proved rather more difficult to negotiate than earlier ones. But one of its more noticeable features was that the arrangement made no explicit reference to a devaluation. At almost the same time, however, the World Bank campaign, which led directly or indirectly to the rupee's devaluation in June 1966, was well under way. Intended as a lasting solution to India's nearly chronic external payments problems, the devaluation's positive effects were immediately swamped by those of two successive droughts and a liberalization experiment which foundered on the western inability to deliver the assistance promised to India to facilitate the reform's success.

For much of the 1950s, the rupee was a stable currency. India, it will be recalled, followed the sterling when the latter devalued in September 1949. But the boom in the prices and exports of primary products arising from the Korean war and the intensification of domestic inflationary pressures in 1951 led to calls in India to revalue the rupee. Pakistan's refusal to devalue in 1949 had had the effect of disrupting trade between the two neighbours, and the exchange rate between their rupees became another item in the growing list of disagreements between them. Consequently, many in India also saw revaluation in 1951 as an opportunity to restore India's trade with Pakistan, particularly that between West Bengal and East Pakistan.

The demand for revaluing the currency in 1951 was not confined to India or to the rupee. Governments of several European countries faced similar pressures in some form or another in the early 1950s. Preferring trade liberalization to revaluation, the International Monetary Fund opposed any change in par values, but revaluationists received powerful support from the United Nations Economic Commission for Europe. In the early stages particularly, the demand for a higher rupee was voiced most strongly in India by the *Eastern Economist*. The suggestion was considered at some length at



the Bank by B.K. Madan, who felt it was 'devoid of economic justification' and would, if adopted, harm India's trade. While the devaluation of 1949 was a 'compulsive necessity', revaluation in 1951 was not. The government accepted Madan's argument for the time being. But it also appears to have wished to keep its options open, with Finance Minister C.D. Deshmukh underlining that unlike devaluation, a 'revaluation ... could be considered at leisure'.

Indian policy-makers were inclined to suspect a degree of special pleading in the *Eastern Economist's* campaign. The latter gathered some momentum after John Matthai, Finance Minister in 1949 when the rupee was devalued, lent his support to it. Matthai saw revaluation as a 'powerful defence against steadily mounting inflationary pressures'. Apart from lowering the prices of imported foodgrains and the capital goods needed to implement India's development plans, a higher rupee would also reduce costs and prices in two of India's major industries, jute and cotton textiles. The Bank's Department of Research and Statistics, however, preferred to focus on the external arguments. Madan maintained in April 1951 that the international price and demand outlook was now uncertain. Export prices had probably hit a plateau, and the improvement witnessed in India's balance of payments in 1950 could prove temporary. Though embarrassed by his public advocacy of a dearer rupee, neither Deshmukh nor Rama Rau could make much impact on Matthai, who continued to stress the domestic arguments in support of his view. But Madan's prognosis was borne out with unexpected swiftness within days of a dinner meeting between Rama Rau and Matthai in June 1951 at which they agreed to disagree, when trade figures for April 1951 showed a deficit for the first time in several months.

With inflation a major source of anxiety at home and relations with Pakistan on the mend, Deshmukh too, appears at this time to have been attracted by the domestic advantages of a higher rupee. But apart from adverse trade effects, the Bank was also concerned that the rupee might be unable to withstand speculative bear pressures which would be more intense if it alone was revalued. If at all India wanted to revalue, Rama Rau advised the government, it should do so only after countries such as Australia and Ceylon whose financial positions were stronger, made the first move. Important as they were, nor should the Indian response be dictated solely by the need to restore economic ties with Pakistan. The latter's non-devaluation remained an aberration and although recent events might obscure the fact, its current parity would not be sustainable in the long run.

Rama Rau's suspicions of a speculative movement were reinforced by the large spot and forward sterling purchases (aggregating to nearly Rs 220 crores)

the Reserve Bank made in February and March 1951. These pressures subsided following Deshmukh's denial that the government intended to revalue the rupee, while the campaign for a revaluation died down with the easing of the Korean war boom.

Thereafter, the possibility of a change in the rupee's par value was considered in the late 1950s, but only in the context of the devaluation of the sterling or its prolonged instability. There were dissenting voices, notably that of B.R. Shenoy, a former Bank economist and Alternate Executive Director at the Fund. Shenoy argued in 1958 that the stagnation of Indian exports at the pre-war level and their declining share of the domestic product, persistent payments difficulties despite drastic controls, and the wide gulf between domestic and world prices of importables and gold, together pointed to an over-valued rupee. Around the same time, articles appeared in financial papers expressing doubts about the rupee's stability in the face of the domestic and external financial challenges of the second plan.

Responding to these doubts, the Bank initiated a study of the rupee's stability at the instance of the Governor, H.V.R. Iengar, early in 1958. Few at the Bank, including Iengar, had any doubt at this stage about the rupee's intrinsic soundness, and the study appeared to confirm that there was little or no impairment in India's export competitiveness. The general weakness of India's export performance in recent years owed more to structural causes which were not easily amenable to correction through a change in the exchange rate. There was some nervousness in the exchange markets in June 1958, attributable no doubt to the crisis in India's external finances which was coming to a head at this time. But the increase in the demand for sterling proved to be temporary, with a speech Iengar made in Bombay to the Progressive Group at the end of June 1958 helping to put the lid on rumours of a rupee devaluation.

The Bank had several means open to it of keeping a watch on the rupee's external alignment. Apart from tariffs and subsidies, neither of which were yet as important as they were soon to be, inflows and outflows of foreign exchange, rates the rupee fetched in the black market, and movements in gold prices, the Bank also kept a close watch on the utilization of import licences and the changing premiums on them. Although it was evident that the prevailing rate was not an 'equilibrium' rate in the sense the markets might regard one, the Bank remained firmly of the view that devaluation had little role to play in balancing India's external accounts. There were doubts about the responsiveness of export demand to price changes, and since a large proportion of India's exports depended directly or indirectly on agriculture, doubts too, about the responsiveness of supply to price incentives.

The relatively easy availability of long-term external assistance diverted attention from major corrective measures until the middle of 1962 when there was a renewed sense of crisis. As pointed out in the last chapter, though pledges were still in accord with requirements, there was a lag in disbursing assistance. There was a mismatch besides, between project assistance and that to finance maintenance imports, and finally a slump in India's invisible receipts. In this background and partly in anticipation of a searching examination by the Fund of the appropriateness of the prevailing exchange rate, the Bank conducted a study of devaluation as a possible solution to India's external problems. This study, which Pendharkar completed in June 1962, was largely dismissive of the benefits of a parity change. Apart from the doubts about supply and demand elasticities Madan voiced in 1958, Pendharkar pointed out that Indian manufactures whose exports could benefit from a devaluation were subject to quota restrictions in the developed world. Pendharkar was also concerned about the terms of trade effect of a rupee devaluation and its potential for triggering 'beggar-thy-neighbour' responses by India's competitors. A rupee devaluation in the present circumstances made sense only if competitors such as Ceylon or Pakistan embarked on parity changes, and not otherwise. If India devalued 'ahead of its competitors, ... she may be obliged to do it again'. Further, as L.K. Jha at the Finance Ministry elaborated on Pendharkar's note, by cheapening India's price-inelastic exports, devaluation might actually reduce and not increase India's foreign exchange earnings. Selective subsidies, both Pendharkar and Jha agreed, offered the better course to higher exports than a general instrument like devaluation which would also disrupt the third plan by putting up domestic prices and debt servicing charges in rupee terms.

The Bank of England too, appears to have thought at this time that rupee devaluation was a 'course of despair' capable of producing little beneficial effect in a planned, mixed economy in which tradable goods were pre-empted by the State to achieve plan targets. London's arguments partly reflected the fear that a rupee devaluation might inaugurate a prolonged period of instability of sterling area currencies, but appear in this instance to have helped reassure the Fund. For several months thereafter, devaluation was not actively canvassed or debated in official policy circles or in the international agencies. The Fund mooted a suggestion in February 1963, though more in the context of Pakistan than of India, for a joint devaluation of the so-called 'rupee countries' to ensure that no single country derived any competitive advantage at another's expense. But little was heard of the idea subsequently. Visiting India several months later, the Governor of the Bank of England reiterated that the proper time to consider a change in

the par value of the rupee would be when there was 'enough production in the country ... [to] generate an export surplus ....'

Despite the Fund's silence on the exchange rate in March, speculation about an Indian devaluation assumed significant proportions by the summer of 1965. To some extent it was sparked off by the Bell mission which was currently engaged in preparing its report. Although supposedly a secret, Bell missed few opportunities to make his preference for a devaluation more widely known in India and elsewhere. Moreover, despite drawings from the Fund of nearly Rs 24 crores in the first quarter of 1965-66 and nearly Rs 12 crores in the second, reserves continued to fall until September. India was forced to seek the postponement of its obligation to repurchase \$25 million at the end of September 1965, and this request was approved by the Executive Board of the Fund without event only because Schweitzer, who did not place it on the formal agenda, managed to see it through on a 'lapse of time' basis.

Meanwhile, early in June 1965, Bhattacharyya, Bhoothalingam, and Jha (now the key official in Shastri's secretariat) submitted a report to the Prime Minister signed by several other senior officials of the Government of India including I.G. Patel, outlining a further series of measures to restrict imports, and monitor remittance of export receipts and invisible outflows to check disguised capital flight. As well as a response to the immediate crisis, this memorandum reflected the official Indian response at this time to the Woods-Bell devaluation campaign.

The prevailing sense of uncertainty over future Indian policies led to the Fund postponing a Board meeting called for 7 July 1965 to discuss its Art. XIV consultation report on India. About the same time Bernard Bell and Andre de Lattre—a former French civil servant George Woods roped in to strengthen the World Bank in its negotiations with the Government of India—were busy presenting the mission's findings to officials of the Indian government. Bell and de Lattre pressed hard for a devaluation, but did not greatly enhance their case by threatening a cut off or reduction in assistance should India refuse. With T.T. Krishnamachari rejecting the advice and Prime Minister Lal Bahadur Shastri still supporting his Finance Minister, there was little immediate prospect of India heeding the World Bank's counsel. But the markets, if not public opinion, remained uncertain, and following discussions with Shastri and the approval of the Union Cabinet, TTK went on the air on 17 July 1965 to rule out a devaluation which he said was merely an 'opiate' and not a lasting answer to India's 'problem of living within ... [its] means'. He underlined the government's determination to 'restore strength' to the balance of payments by 'selective deployment of the instruments we have already forged'. To argue the case for a general instrument like devaluation

and against a 'discriminating approach to the problem of export promotion and import substitution' amounted to assuming that India had already arrived 'at that stage of development and technology where structural rigidities are no longer relevant ....' This, TTK underlined, was 'not true'. Finally, the Finance Minister called for a 'greater sense of discipline and determination ... over a period of years ... reflected continuously in our budget and credit policies and, indeed, in the size of our plans for development' to avoid similar crises recurring in the future.

The Finance Minister's broadcast advertised the willingness of those opposing devaluation to contemplate a relatively modest fourth plan. Though it did not immediately scotch the debate within India on the future of the rupee, TTK's speech helped dispel some of the uncertainty and clear the way for the Fund's Board to discuss the Indian report. At the same time, although many at the Fund felt the rupee parity was in need of correction and Schweitzer himself broached the need for radical policy measures to Bhattacharyya and Bhoothalingam when they met him in September 1965, its officials were sensitive to the Indian reluctance to devalue and looked for acceptable variants of multiple exchange rates. Thus in meetings with I.G. Patel in September 1965, Fund officials mooted a plan to replace import entitlement licences (against exports) with a system of tax credit vouchers at rates varying from 10 to 50 per cent of the foreign exchange surrendered by exporters and importantly, by recipients of remittances from abroad. Estimated to cost Rs 250 crores, Fund officials proposed an additional duty on imports (to be called a 'price equalization tax') to finance the subsidy. While leaving the exchange rate untouched and not formally constituting a multiple exchange practice, this scheme, officials at the Fund felt, had the effect of 'making a substantial move forward on lines' that were 'economically justified'.<sup>1</sup>

This plan may have given birth to the National Defence Remittance Scheme introduced in October 1965, under which recipients of remittances from abroad were extended the benefit of import entitlement licences;<sup>2</sup> but little else since Indian government officials did not wish to raise import duties any higher than they already were. It is nevertheless useful to recall this plan here, if only to show that at the same time as Woods and Bell were talking in increasingly strident tones about devaluation, the Fund, which according to Patel was the World Bank's 'silent and ... sullen partner' at this time, was

<sup>1</sup> Anjaria felt Schweitzer consented to these measures, which just stopped short of multiple currency practices, in the eventual hope of convincing India to devalue.

<sup>2</sup> As mentioned in appendix E, the success of this scheme helped India weather the adverse aid environment during these critical months.

willing to consider alternative options. In fact, as late as December 1965, Schweitzer confided to B.K. Nehru that while his first preference was for a 'straightforward devaluation', the Fund was not 'dogmatic' and would be willing to accept a 'well coordinated set of measures for exports, imports, and invisibles ... which would yield the same results as a straight devaluation'.<sup>3</sup>

Although these were progressively tightened after 1956, officials at the Finance Ministry had never really been happy with controls, nor with a system of multiple exchange rates. Moreover, they were always quick to take note of the 'gentle pressure' that international agencies invariably exerted on any country which began taking recourse to export subsidies, and by 1965, it was becoming amply clear that only a devaluation could unify India's multiple exchange rates. The demands of the third plan prevented them from pressing their views insistently upon their political masters. But this plan was due to end in March 1966. Besides, although the World Bank's bullying approach made devaluation unpalatable, it was perverse to reject the policy merely on that account if Indian interests independently dictated otherwise. An early and precise appreciation of the policy changes needed to overcome the external crises in an enduring way would also give the Indian authorities some control over the timing and sequence of devaluation and connected measures. Thus by the winter of 1965, a distinct change overcame the official Indian attitude towards devaluation.

This change owed in considerable measure to growing unease about the efficiency costs of the controls regime. But there was scepticism too, about the incentive effects of import entitlement and other subsidy schemes. Although the latter amounted to devaluation, neither the government nor intending exporters could precisely estimate its extent which varied with the size of the subsidy and the premiums at which import licences could be sold. The success of such schemes also hinged on high import premiums, or on imports remaining scarce. On the other hand, difficulties in securing imports affected output and capacity utilization in industry. Considerations such as these motivated a searching internal examination within the government of India's exchange rate policies following which Bhattacharyya, Bhoothalingam, and Jha, who together formed a closely knit core team handling economic affairs at this time, moved quickly to abandon the step-by-

<sup>3</sup> Arguing the case for devaluation, Schweitzer reportedly told Nehru that from the 'political point of view' too, the 'present time might be appropriate' to devalue, 'since a combination of several unfavourable circumstances—Pakistan, China, the drought, and maybe, even the Americans—could be blamed for the present impasse and the need for resolving it in a manner that would help the economy to conserve and produce more foreign exchange'.

step adjustment of the existing system of controls and incentives they had sponsored earlier, in favour of a more realistic exchange rate and liberalized trading arrangements. As the Finance Ministry observed in one of its notes, the current method of taxing imports and subsidizing exports had a number of loopholes, and the overwhelming body of opinion among economists about the means by which to deal with India's external imbalances 'pointed in one direction—that is making foreign exchange worth more in rupees than before'. The political opposition to devaluation too, weakened quite suddenly in December 1965 following the resignation of T.T. Krishnamachari, who B.K. Nehru suggests was eased out by the Prime Minister, Lal Bahadur Shastri, to make way for the reform.<sup>4</sup> And by the end of 1965, according to Patel's recollections, the government had made up its mind to devalue. Shastri's unexpected death in Tashkent in January 1966 had little impact on this decision, as the new Prime Minister, Indira Gandhi, was quick to grasp its necessity.

Accompanied by Patel, Bhattacharyya flew to Washington in February 1966 to explore a possible drawing from the Fund and discuss with Woods a timetable for meetings of the aid consortium. To India's discomfiture, in December 1965 it breached the net domestic assets ceiling agreed under that year's standby arrangement. But with reserves still precariously placed and large repayments falling due, India was faced with little other choice than going to the Fund for a straight drawing arrangement. At first Schweitzer felt the budgetary and monetary outlook precluded the suggestion, and himself proposed India securing some temporary relief—either in the form of a postponement of its immediate repurchase obligations or an emergency drought-related payments assistance of \$100 million repayable in one year—followed by a substantial line of credit in the region of \$300 to \$400 million on the basis of an agreed programme. Bhattacharyya and Patel resisted this offer and maintained their preference for a normal three- or five-year drawing of \$200 million. A one-year loan, in their view, would do little to solve India's problem, while postponing repurchase obligations would only raise fresh doubts about India's future intentions. A large loan of the size Schweitzer proposed would inevitably bring pressure on India to review its exchange rate, and although a decision in this regard had already been made, Indian officials were keen to avoid any link being drawn between the government's move on the exchange rate and the Fund drawing. Although the \$200 million sought by the Indian team was known to be inadequate for the country's payments needs, the difficulty of reaching agreement on fiscal and monetary matters made a larger

<sup>4</sup> B.K. Nehru, *Nice Guys Finish Second: Memoirs* (New Delhi, 1997), pp. 447–48.

arrangement unlikely. 'At the back of our mind', Bhattacharyya noted in his record of discussions with Schweitzer which he sent to the new Finance Minister, Sachindra Chaudhuri,

there was also the consideration that agreement with the Fund on a programme relating to fiscal and monetary matters might prove difficult as long as we have not been able to make satisfactory arrangements to ensure greater fiscal discipline on the part of the State Governments.

Besides, what India really needed was 'long-term money for import liberalization'. Bowing to the Indian argument, Schweitzer agreed to sponsor as a special case, a drawing of up to \$200 million repayable by December 1967, if India could demonstrate that the total impact of the drought exceeded that amount. India accepted this stipulation, thereby signalling its recognition of the 'special character' of the proposed drawing.

Bhattacharyya expected Schweitzer to present to the Fund's Board a proposal to allow India to draw \$150 to \$175 million. In the event, a proposal envisaging a drawing of \$187.5 million came before the Board for approval on 23 March 1966. Not wishing to encourage a protracted debate, Frank Southard, Schweitzer's deputy who chaired the meeting, acknowledged that the drawing was meant to meet an emergency and that it did not conform to 'established policies' of the Fund for drawings in the higher credit tranche. However, the principal justification for the proposed transaction was that, but for it, urgently needed 'policy adaptations' could be delayed by a worsening economic situation.

Deliberations at the Board were not altogether critical of India. But members were worried by the precedent of India making a drawing in the higher credit tranche without a mutually agreed reform programme. The rupee parity also figured prominently, with several speakers stressing the need to find a lasting solution to India's recurring payments troubles through exchange rate adjustments and vigorous export promotion measures. A devaluation was very much part of Bhattacharyya's brief in February 1966 and he was authorized to inform Schweitzer during the loan negotiations that 'the Government of India have decided in favour of a formal change in the par value of the Indian Rupee to be made in June 1966'. But with talks at the Fund making good headway without any assurance of a devaluation, and sensitive to the difficulties of a new government which was still feeling its way, Bhattacharyya refrained from conveying the Indian decision himself, or during his talks at the Fund. India, the Governor was content to explain to the Managing Director of the Fund, recognized that there was a 'continuing



foreign exchange problem'. It was still involved in 'examining ways and means of solving ... [its] chronic difficulties' and proposed to 'remain in continuous touch with the Fund' in its search for an 'enduring solution'. But after having secured agreement on the drawing arrangement, Bhattacharyya instructed Anjaria to inform Schweitzer orally whilst transmitting the formal request for the drawing, that

the Government of India have accepted the advice of the Governor, Reserve Bank of India that the official par value of the rupee has to be changed, and that the timing of this will be around June this year.

Across the street at the World Bank, prospects looked dim for an early resumption of consortium meetings. With India's debt problem still hanging in the balance, the World Bank offered to explore possibilities of refinancing or postponing repayments owing to the 'original members' of the consortium who accounted for the bulk of India's debts. There was some discussion of whether these arrangements should not cover only the repayment of principal. While India wished interest payments also to be covered, Bhattacharyya conveyed his preference for 'new loans which would enable ... [it] to repay the amounts due', over a mere postponement of its obligations. Aware that India's repayment obligations to the World Bank could not be refinanced directly, Bhattacharyya and Patel sought and obtained from that institution a loan of \$50 million to finance the 'import of industrial components and materials'. This amount equalled the principal due on World Bank loans in 1966-67, and the loan was extended on terms which avoided any repayment obligations during the fourth plan.

The Government of India's *Economic Survey* for 1965-66, which was presented to Parliament on 15 February 1966, referred in rather guarded terms to the possibility of a devaluation. The problem of achieving balance of payments 'viability' the *Survey* said, 'was a '... basic one' which required 'continuing effort on a variety of fronts'. This failed however to throw inquisitive members off the government's trail, and a barrage of questions followed in both houses about its plans for the rupee. While the Minister of State for Finance refused, understandably, to confirm or deny members' allegations, the Planning Minister, Asoka Mehta, denied that the government was 'considering the question of devaluation'.

As already pointed out, Prime Minister Indira Gandhi was converted soon after she entered office to the idea of a devaluation. Yet, anticipating opposition from within her party and the government in an election year, Indira Gandhi not only chewed patiently on the arguments Bhattacharyya and Jha gave her

in favour of the course, she also invited leading economists to advise her on the implications of the step. In addition, according to the recollections of some officials, she formed a secret committee early in 1966 to examine all options and report about their likely economic consequences. Besides Indira Gandhi herself, the committee comprised Sachindra Chaudhuri, Asoka Mehta, Food and Agriculture Minister C. Subramaniam, and Bhattacharyya. Bhoothalingam, Jha, Govindan Nair, Patel, and V.K. Ramaswami were the other members. Few outside it were aware of the committee's existence or its remit, and no one from the Reserve Bank other than the Governor was involved in the exercise. This committee came out in favour of devaluation accompanied by appropriate policy changes, including liberalizing trade.

In March 1966, Indira Gandhi visited the United States. Her visit was preceded by that of a technical mission comprising I.G. Patel, M.R. Shroff, and V.K. Ramaswami which held discussions with the Fund and the World Bank. The climate for it was vitiated somewhat by a senior US official telling the *New York Times* that the US and other donor countries believed the rupee was overvalued and that the matter was under discussion with the Indian government. In a conscious decision to underplay the devaluation angle, Govindan Nair was the only Finance Ministry official chosen to accompany Indira Gandhi to Washington.

Discussions Indian officials now held at the Fund centred largely on the size of a possible rupee devaluation. Some thought had been given to this in India in February, when it was felt that 'an increase of 50 per cent in the rupee value of foreign exchange' was the maximum extent of devaluation necessary. This figure was based on 'two considerations'. The first was that of increasing the rupee receipts of exporters sufficiently as to enable existing export subsidies to be eliminated and 'leave a margin of extra-competitiveness' to take care of any 'additional difficulties ... in the future'. Here cotton textiles, on which subsidies ranged from 30 to 40 per cent, were regarded as a 'crucial area'. The second consideration was to prevent so large a rise in the rupee price of imports that it became necessary to 'lower customs duties to an extent which would have serious repercussions on ... [the] budgetary position'. For tactical reasons, it was decided to advance the case for devaluation by a third, rather than by half, and this was the view Bhattacharyya pressed on visiting Fund officials in March. However, the brief for Indian officials also cautioned that 'any suggestion of a change of the order of 50 per cent should not be resisted too stoutly'.

Some preliminary discussions at the Fund suggested that it would be satisfied with a rate of Rs 6 against the prevailing one of Rs 4.76 for the US dollar. Though it is possible that the new exchange rate was in the end set at a much

lower level to scotch speculation about another devaluation and to better mobilize assistance for the fourth plan, official records throw no light on when and why it was decided to fix the rupee at Rs 7.50 to a dollar. According to one account whose reliability cannot be verified, Indira Gandhi chose the lower rate in the course of a meeting with Schweitzer who reportedly told her that six rupees to the dollar 'would be good. Seven would be better. Seven and a half would be fantastic.'<sup>5</sup> According to Schweitzer's opening remarks at the special meeting of the Fund's Board convened on 5 June 1966 to approve the Indian devaluation, the latter was not a sudden or unprepared move but one preceded by 'continuing discussions' with the Indian government. Nor was the new parity a 'negotiated compromise'. The Indian government, Schweitzer declared, had 'fully followed the advice of the Fund management and staff'.

To return to events taking place in the spring, Asoka Mehta visited Washington in April 1966 to negotiate future levels of consortium assistance with the World Bank, only to draw a blank at that institution. Already smarting under the embarrassment of leaks to the US media about a forthcoming rupee devaluation, Indian officials were not amused when Woods raised with Mehta, purportedly in his capacity as the chairman of the consortium, the subject of India's defence spending. Unhappy at getting advice instead of aid commitments at the World Bank, Mehta met Schweitzer to sensitize him to the domestic political dangers of devaluing the rupee, and impress upon him the importance of larger external assistance in making the decision more acceptable within India. India, Mehta is reported to have told Schweitzer,

could be a great stabilizing force in the world in ten years; if, however, the situation were not handled with understanding and finesse, and if, because of pressures, or lack of faith of the donor countries, the present Government lost in the 1967 elections, India could become a major destabilizing force in the world.

Referring also to the 'critical situation in some of the key areas like Bengal', Mehta warned his interlocutors at the Fund against adopting a 'complacent' attitude towards India and underlined the need for 'understanding and an element of faith' in the ability and desire of the country's present leadership to 'bring about the desirable modifications required for India's economic growth'.

<sup>5</sup> 'The Reminiscences of Gregory Votaw', George B. Woods Oral History Project, Columbia University, p. 46, cited in Robert Oliver, *George Woods and the World Bank* (Boulder, 1995), pp. 141-42.

It is not clear whether Mehta was sent to Washington to explore the possibility of a postponement or temporary abandonment of the devaluation decision. But his visit does appear to have conveyed confusing signals, notably about whether India wanted assistance from the Fund to precede or coincide with the devaluation, or still sought, as Bhattacharyya had argued earlier, to separate the two measures. Faced with Mehta's request for assistance to enable the Indian authorities to liberalize imports, Schweitzer and Southard, according to one account of their meeting, 'fidgeted visibly'. Confusion appears to have arisen between the two sides because while Mehta spoke about assistance in general terms, Schweitzer and Southard interpreted his remarks to refer to that available from the Fund.

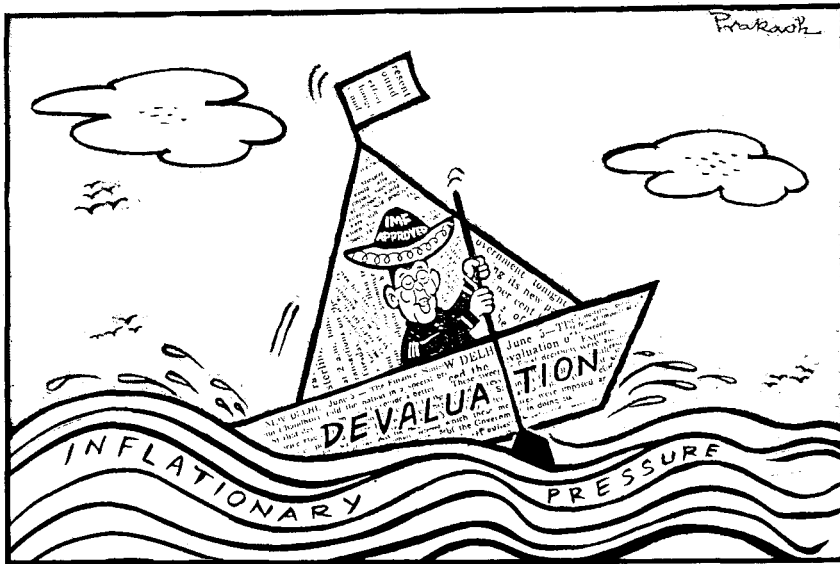
Meanwhile, the Indian authorities put together a package of measures comprising devaluation, import liberalization, elimination of export subsidies, and greater fiscal discipline, whose details were finalized during the course of May 1966. No one at the Bank, other than Bhattacharyya, knew yet about the impending change in the rupee's par value. It should not be supposed for that reason that opinion at the staff level opposed a devaluation. On the contrary, by 1965 many staff notes and memoranda began referring in guarded terms to the advantages of one, and despite the decision's great unpopularity subsequently, few senior officials of the period recall having been sceptical of the move. It was not until late in May 1966 that Bhattacharyya confided the devaluation decision to two senior officials of the Bank with whom he had a chance meeting in Delhi. One of them is reported by the other to have asked the Governor whether it might not be wiser to postpone the decision until more was known about the progress of the monsoon, only to be told in reply that events had moved too far for the decision to be delayed. With devaluation on the anvil, Bhattacharyya took even closer interest than usual in framing a restrictive credit policy for the 1966 slack season, which aimed principally to immobilize Rs 200 crores or so of additional deposits. He had been engaged for the past several months in urging greater restraint on governments' expenditures, and he now underlined to the Finance Minister that strong action was necessitated on the monetary front because the central and state governments continued to run large deficits.

The meeting of the Union Cabinet to formally decide on the devaluation was convened for the morning of Sunday, 5 June 1966, so that the decision could be communicated to the Fund and its agreement obtained before the news was made public. The Cabinet approved, not it seems without heated debate, the proposal to devalue the rupee by 36.5 per cent from 0.186621 gram of fine gold to 0.118489 gram. As a result, the rupee price of a US dollar and a pound sterling rose respectively from Rs 4.76 and Rs 13.33 to

Rs 7.50 and Rs 21. Devaluation was accompanied by the levy of export duties on a dozen commodities and the scrapping of import entitlement schemes and tax credit certificates for exports, so that the combined effect was to render the effective devaluation less than the nominal one, and greater for imports than for exports.

Following the Cabinet decision, officials of the Finance Ministry fanned out to the states as emissaries of the Prime Minister, and delivered to their chief ministers a sealed 'top secret' envelope with instructions to open it only after six that evening. Although cypher facilities existed, they were eschewed in this instance to avoid the news leaking before midnight. Anjaria was informed by cable and he, in turn, informed Schweitzer who convened an unscheduled meeting of the Board the same (i.e. Sunday) morning. Schweitzer commended the Indian decision to the Board and concluded with the hope that 'the momentous decision would pave the way for the foreign aid necessary for trade liberalization'. Having secured the Fund's approval, Sachindra Chaudhuri announced the devaluation in a special broadcast to the nation at 9.00 p.m. on Sunday. The new parity was to take effect from 2.00 a.m. on Monday, 6 June 1966. As standard practice obtained in these matters, the Reserve Bank also issued a notification closing banks to the public for two days.

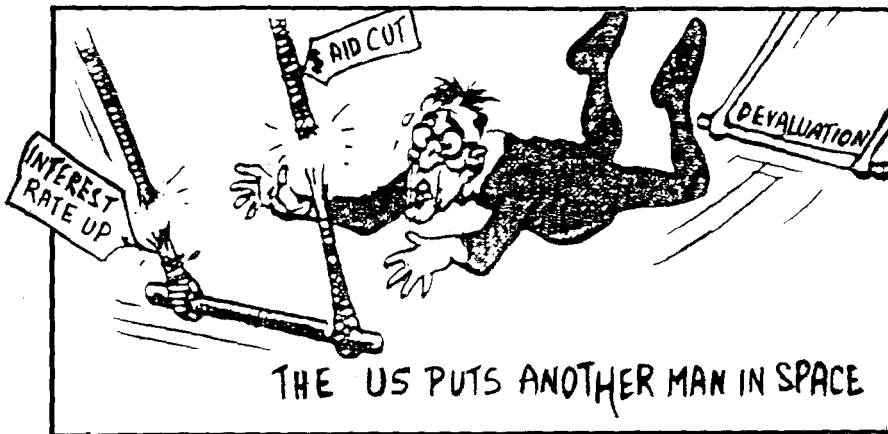
The devaluation of the rupee in June 1966 evoked a largely critical political and public reaction at home. The measure was preceded by persistent denial by the government of any intention to devalue the rupee. Such denials were unavoidable, but they also meant that the decision, when it came, took the public by complete surprise. The press reaction to the devaluation was almost uniformly adverse, even financial newspapers describing it variously as an 'ill-advised plunge', a 'leap in the dark', and an 'escape from reality'. Many commentators were openly sceptical that a cheaper rupee would boost exports, while most feared its effects on domestic prices. Representatives of industry spoke of the cascading effect of higher import prices and of their having to recast their investment and profitability calculations as a result of the government's decision. There was little support for the decision even within the ruling Congress party. The Commerce Minister, Manubhai Shah whose opposition to devaluation was public knowledge, was reportedly kept in the dark until the Cabinet meeting. K. Kamaraj, the party's strongman in the south who was soon to face a crucial electoral test in the former Madras state, smarted at not having been consulted about the decision. Nor was his opposition weakened by the efforts of a Tamil-speaking economist who was despatched urgently to explain the decision to him. Kamaraj refused to meet the economist, and afterwards gave expression to a widespread sentiment when



— Shankar's Weekly, 12 June 1966

he condemned the devaluation 'as a sell-out to the Americans'.

Though closely associated with the devaluation, the Governor chose to greet its formal announcement in Calcutta, rather than in Delhi or Bombay. Reacting to speculation about a possible devaluation in Calcutta in May, the Finance Minister had denied that the government was contemplating any such move; and it fell to Bhattacharyya, who until the decision was announced purported to be on a personal visit to the metropolis, to explain the latest turn of events to its bemused public. Meetings and press conferences which the Finance Minister, the Governor, the Deputy Governor B.N. Adarkar, and Bhoothalingam addressed individually or jointly with other ministers of the Union Cabinet or with chief ministers of states such as Maharashtra over the next few days, helped sow doubts in the minds of those who had earlier opposed the move, the *Economic Times* for example drawing back from its earlier attitude of open opposition to one which suggested that the decision placed the government of the day and its policies on severe trial. Bhattacharyya and others also used their speaking engagements to dampen expectations of inflation and to urge captains of commerce and industry to ensure that prices were not raised on stocks of goods finished or imported at pre-devaluation costs. Not only would the liberalization of imports help keep prices in check, Bhattacharyya argued in an effort to dampen inflationary expectations and speculative behaviour, higher imports would also boost domestic output through



—R.K. Laxman in *Tol*, 24 July 1966

better utilization of installed capacity in industry.

By common consent, the devaluation of 1966 failed, or it did not immediately achieve its objectives. According to the Reserve Bank's explanation at the time, the 'adjustment in relative prices, costs, and pattern of investment' necessitated by the devaluation proved 'even more difficult because of the serious drought' which affected the Indian economy for the second year in succession. The World Bank attributed the failure of the economy to respond to policy adjustments to some 'historical accidents' such as the drought-induced recession, the sharp decline in US aid, (which was virtually frozen during the critical post-devaluation period), and the protracted replenishment negotiations which greatly delayed India's receipts of the fifth and sixth IDA credits.

The package of policy measures announced in June 1966 reactivated the aid process, but aid commitments never approached the levels which the Indian government had earlier been given to understand it could expect from the World Bank and the other members of the consortium. There were definite indications in the run-up to the 1966 decision that liberalization and assistance were linked, and that the former's extent would depend on how well it was supported financially by additional non-project assistance. India and the World Bank were also agreed on the need for non-project assistance of \$900 million annually for three years after the devaluation, in addition to project assistance of \$300 million, and the latter committed itself to raising this amount.

In the event, the promised aid did not materialize. The first \$900 million was slow in coming, and it was not till November 1966 that the

financial package for 1966–67 was announced as committed. Then commenced protracted delays in committing funding for the second year, resulting from delays in IDA replenishment, President Johnson's perverse aid policies, and his insistence on counting America's P.L.480 aid commitments as part of consortium assistance. World Bank records suggest that its officials expected India to require aid of the order of \$900 million each in the first two years, and a billion dollars in the third. But when non-food imports fell as a result of the recession induced by the drought and the decline in public expenditure, these amounts were scaled down to \$600 million in the second year (1967–68) and \$900 million in the third. At the November 1967 consortium meeting, the World Bank presented an aid estimate of \$750 million for 1967–68 and \$820 million for 1968–69. While members of the consortium felt this was reasonable, chances of achieving this level of commitment for 1967–68 receded with every delay in IDA replenishment.

Meanwhile, with aid disbursements remaining slow and the drought of 1966–67 having contributed to worsening the trade position, Indian officials began once again to apprehend a serious external crisis. In fact, they expected in February 1967 that India's reserves would dip sharply in dollar terms unless import controls were restored or liberalization did not lead immediately to higher imports. Nor had India any resources of its own to repay the substantial Fund maturities falling due in December 1967, so that it was forced for the third successive year to knock at that institution's doors. After some protracted negotiations, in December 1967 India drew \$90 million under the new Compensatory Financing Facility and managed, after some considerable difficulty and firm handling by the management, to secure the Board's approval for a postponement of the repurchase of \$387.5 million due that month.

At the May 1968 consortium meeting, non-project commitments amounted to \$295 million, leaving \$1,275 million to be found in 1968–69. What eventually came through was about half that, \$642 million. Many knowledgeable officials warned that the reversal in World Bank and consortium commitments would undermine the liberalization process India was embarked upon, but to little avail. Not surprisingly, Indian government officials who were involved closely with the devaluation discussions and the talks on aid which preceded the decision felt let down by the outcome and believed India had been swindled. Its government had entered into the 1966 transaction in good faith, but the World Bank and the leading consortium members, in particular the US, did not keep their end of the bargain. Indian policy-makers felt so chastened by their 1966–69 experiences in dealing with the World



Bank and the leading members of the consortium, that these inevitably had a bearing on the country's relations with the international institution for the next few years and its economic policies during the next two decades.

With the devaluation being followed by the second drought in two years, prices in India rose steeply in 1966–67 and again the following year. The rate of growth of industrial production dropped from 3.4 per cent (pre-devaluation) to 2.3 per cent in 1966–67, and to barely 1.4 per cent in 1967–68. Nor did exports grow as expected, and the trade gap was wider during June 1966–May 1967 than during the corresponding period of the preceding year. The bulk of the export shortfall was accounted for by jute manufactures, tea, tobacco, and cotton textiles. According to a study by the Bank's Economic Department, jute and tobacco exports declined because of lower output, while weak international demand accounted for the lower exports of tea and pepper. Another Bank study pointed out that nearly 60 per cent of India's exports were now subjected to duties of up to 40 per cent of their pre-devaluation f.o.b. prices, and with earlier export incentives abolished, their competitive position had not improved to the same extent as the devaluation. But the study cautioned against reducing duties of items where India was a major exporter, since it would merely precipitate a fall in the unit value of exports. On the other hand, duty reductions could be considered where supply conditions were favourable and for markets where India was a small supplier. The study also expected the 10 per cent of exports which received cash subsidies, such as steel, chemicals, and engineering goods, to fare better in the new environment.

On the import side, devaluation was accompanied by significant liberalization measures. Special arrangements were made to import sizeable quantities of fertilizers to support agricultural production. Raw materials required for export production were allowed to be imported under open general licence. Imports were liberalized to enable full capacity utilization in fifty-nine industries. But imports failed to revive because of higher prices, the slow-down in public investment, and lower consumer demand. While imports of capital goods, in particular, were affected by the cutbacks in public investment, the Bank's assessment was that the other imports were probably being replaced by cheaper domestically produced substitutes.

Finally, the failure of the devaluation package and of aid promises to materialize led to a slowing down of the reform process. It also spurred the government to adopt modest growth targets in practice, if not always on paper, so as to minimize external imbalances and recourse to foreign aid. As a result of modest public investment and expenditure policies, the revival of the monsoon, and higher agricultural output thanks to the green revolution,

the trade gap narrowed appreciably after 1968. The ratio of foreign borrowing to the budget deficit was also brought down sharply and although the planners projected a 5.5 per cent growth rate, the actual performance projection was based on a much lower level of foreign aid and public investment. Thus during 1968–70, the Indian authorities planned for a modest recovery consistent with an import surplus which could be financed by the lower levels of aid that were now available. Despite the luckless devaluation, therefore, India achieved a measure of external economic equilibrium at the cost of reduced public investment and lower growth rates in the economy.

#### *Compensating Gulf Rupee Holders*

The rupee's devaluation in 1966 also had some unexpected effects on rupee payment arrangements with the socialist bloc and India's financial relations with neighbouring regions where the rupee was or had recently been circulating as legal tender. While the former are discussed in appendix G dealing with bilateral trading agreements, the latter are discussed below.

It was pointed out in the last chapter that fears of foreign exchange leakages motivated the Bank and the government to replace the Indian rupee circulating as legal tender in the Persian Gulf kingdoms with special Gulf notes in 1959. Rising nationalist sentiments, weaker trade and commercial links with India, the oil boom, and the overt encouragement they received from British banking interests in the region led these states to review their currency links with India. Kuwait became the first country to replace the special Gulf rupee in May 1961, with the Kuwaiti dinar. Bahrain, which accounted for nearly half the special Gulf notes put into circulation in 1959, sought to follow suit two years later. The rupees in circulation in these countries were issued against sterling surrendered to the Reserve Bank, and the latter estimated its probable sterling liability for Bahraini rupees alone at Rs 12.5 crores and that for the entire region at Rs 26 crores. Repudiation was unthinkable, but in the light of the country's external payments position, so was a one-time payment of this magnitude. It was public knowledge at the time that the efforts of the region's rulers to modify domestic currency arrangements had the active support of British commercial and financial interests in the Gulf. The first indications of Bahrain's intention to adopt a new currency emanated from the Bank of England. But efforts to rope Britain into a constructive engagement on this subject drew a blank, with its officials maintaining that they were only the messenger boys. The redemption of Gulf rupees circulating in Kuwait had taken the form of a loan repayable in 11 annual instalments, but Bahrain and India agreed on a down payment of the lower of £2 million or one third of the redemption,

with the remainder to be paid over ten years. The maximum redemption in any single year was also set at £0.4 million.

The currency changeover was set to commence in October 1965, with the debt being fully redeemed in 1975. Fearing exchange losses, Bahrain sought a guarantee clause which India successfully resisted. Conversion operations began in October 1965 when a new currency—the Bahraini dinar—was introduced. Gulf rupees withdrawn from circulation in Bahrain amounted to Rs 7.86 crores or £5.9 million at the prevailing rupee–sterling parity.

In the third phase of the rupee's withdrawal from the Gulf, the sheikhdoms of Qatar, Dubai, Sharjah and Kalba, Ras-al-Khaimah, Umm-ul-Awain, Ajman, and Fujairah moved over unilaterally to the Saudi rial, while Abu Dhabi adopted the Bahraini Dinar. Now Muscat and Oman were the only sheikhdoms where the special Gulf notes were legal tender. India's likely redemption liability in the third phase was about Rs 13 crores, and pending a settlement of the terms, these territories sought and obtained a suspense account arrangement with India.<sup>6</sup>

The rupee's devaluation in 1966 greatly complicated ensuing negotiations. In representations forwarded to India through the British government, the remaining sheikhdoms where the rupee was still in circulation insisted that their legal tender should not be affected by the devaluation, and drew a distinction between an 'internal' rupee which India was 'legally and morally entitled to devalue' and an 'external' rupee which she could not, since it was 'issued against ... foreign exchange' provided by the people of these 'overseas territories'. The sheikhdoms also complained at not having been consulted in advance about the devaluation. Initially, the Indian government maintained that there was only one currency, i.e. the rupee, printed in two distinct styles for operational convenience. There was no undertaking from India to maintain convertibility at any particular rate, nor was it practicable to consult overseas rupee territories before the decision to devalue was taken. Where India was concerned these initial exchanges drew lines in sand. Discussions which followed with a joint delegation of officials of the Gulf sheikhdoms led by Hassan Kamel, Director-General and Legal Adviser of Qatar, turned largely on whether the 1959 decision on Gulf notes amounted to introducing a currency differing in standing from the rupees circulating earlier in the Gulf. Indian negotiators pointed out that Gulf rupee notes were introduced after an amendment to the Reserve Bank of India Act, and any intention at the time to treat them differently from the other liabilities of the Reserve Bank would have been manifest in an amendment to section 33 of the Act dealing with the

<sup>6</sup> Rupees in circulation in the two sheikhdoms were estimated at Rs 3.51 crores.

assets of the Issue Department. The Gulf delegation pointed out that the failure to promote such an amendment was a lapse on the part of the Indian authorities and that the sheikdoms could not be made to bear its consequences. The mere fact that Gulf notes were legal tender only in that region and not in India sufficed, in their eyes, to distinguish them from rupees circulating within India.

At this stage the Finance Ministry decided to refer the legal aspects of the case to the Solicitor-General. But notwithstanding the precise legal position, opinion also veered round to favour an ex-gratia payment to the Gulf states to help resolve the dispute amicably and with minimal dislocation to Indian interests in the region. If this payment took the form of exports of products of industries affected by recession, it might even open up long-term possibilities for increasing India's exports to the region. After further discussions, the two sides came to an agreement in March 1968 by which the total liability resulting from the repatriation of the rupee notes was put at Rs 12.88 crores. Besides a down payment of a fifth of the resulting sterling liability, £7.2 million was treated as a sterling loan carrying an interest rate of 5.5 per cent per annum, repayable in eleven equal annual instalments commencing January 1969.

### CONCLUSION

Where the external sector is concerned, the period covered by this volume began with India in possession of large sterling reserves and facing pressures for a revaluation of the rupee. By the end of this period, the Indian development effort was gasping for the oxygen of external assistance on which it had grown to depend for the greater part of a decade. Thereafter, however, not nearly enough assistance was forthcoming from the World Bank and western donors despite a devaluation, the most important justification for whose timing was the promise of liberal western assistance to India. The failure of the promised aid flows to materialize was a sobering experience for India's policy-makers which reinforced their determination to reduce the country's dependence on external assistance to the greatest extent possible. The Indian leadership was willing in return to pay the price of more stringent controls over the external sector and lower rates of growth of output and income. The growth and financing assumptions and hopes of the late fifties and the early sixties had evaporated, but not, ironically as it happened, the trade regime which had accompanied these hopes and for liberalizing which aid and devaluation were the necessary preconditions. With one precondition, devaluation, satisfied and the other, aid, not, the events of 1965-67 mark this period down as one when the Indian economy missed a crucial turn for the better. Not because it could

not or did not back into the correct street, but because those entrusted with the responsibility for paving the street chose instead to dig it up after India had already gone down it a considerable part of the way.

**Table 14:** Foreign Exchange Reserves

Year	March	June	September	December
1955	892 (+3)	877 (-15)	882 (+5)	889 (+7)
1956	902 (+13)	839 (-63)	769 (-70)	684 (-85)
1957	681 (-3)	606 (-75)	505 (-101)	448 (-57)
1958	421 (-27)	372 (-49)	335 (-37)	344 (+9)
1959	379 (+35)	356 (-23)	352 (-4)	388 (+36)
1960	363 (-25)	327 (-36)	308 (-19)	319 (+11)
1961	304 (-15)	282 (-22)	293 (+11)	317 (+24)
1962	297 (-20)	241 (-56)	246 (+5)	244 (-2)
1963	295 (+51)	289 (-6)	267 (-22)	289 (+22)
1964	306 (+17)	279 (-27)	251 (-28)	237 (-14)
1965	250 (+13)	247 (-3)	241 (-6)	285 (+44)
1966	298 (+13)	581 (+283)	493 (-88)	456 (-37)
1967	478 (+22)	461 (-17)	434 (-27)	497 (+63)

NOTES: (1) All amounts in Rs crores.

(2) Includes gold held by the Reserve Bank of India, foreign assets of RBI, and government balances held abroad. Net borrowings from IMF have been included, wherever applicable.

(3) Figures in brackets are increase/decrease in reserves.

SOURCE: *India's Balance of Payments, 1948-49 to 1988-89*, pp. 476-78.

*Unpublished Sources*

G.8	Governor's Correspondence with Government of India, Ministry of Finance
HC/WB/IMF	Material Collected from the World Bank and IMF Archives
BFF-1	Correspondence with IMF
E.S.P.	Letters from ED (IMF)
HC/IMF/ED	Letters from ED (IMF)
BFM.39	Letters from ED (IMF)
MF	Letters from ED (IMF)
BFF-14	Report of the IMF Mission to India—Bernstein Report
CDN(O)8	IMF Consultations with India—1962
HC/IMF/DISC	Record of Discussions between Indian Representatives and: <ol style="list-style-type: none"> <li>1. de Lattre and Bell in July 1965</li> <li>2. IMF staff in September 1965</li> </ol>
HC/S.65	Notes/Correspondence Regarding IMF Standby for 1965
Sy.69	RBI Act—Suggested Amendments
Sy.97	Monetary and Exchange Agreements
HC/SA	Notes Prepared by DDBF & DIF on UK and the Sterling Area
BPF-32	Material Relating to Sterling Balances Negotiations
Conf:BP.60	Convertibility—Correspondence with Government 1955
E.S.P.32	Convertibility
HC/ISM	India Supply Mission (Washington) Balances
FE(N)-4	Balance of Payments Forecasts—Transmission to Government etc.
BPE-110/55	Taking over of Balance of Payments Compilation Work from ECD
DEIO-138(33)	Devaluation of the Indian Rupee in Terms of Gold and Non-devaluation of Pakistan Rupee
HC/N.P.C.	Newspaper Cuttings on Devaluation of Rupee—1966
BP.Com.C-11A	Withdrawal of Special Gulf Notes from Bahrain
BP.CDN(R)-20	Material and Correspondence with Government Relating to Import of Currency Notes etc.
HC/BOE	Material Collected from the Bank of England Archives
CDN(R)-17	Miscellaneous Correspondence