APPENDIX B

P.L.480 Arrangements

As is well known, India experienced persistent shortages of foodgrains and other agricultural commodities such as cotton in the 1950s and 1960s. Even in years of normal monsoon and despite low per capita levels of cereal consumption, India was barely self-sufficient in food during these decades. With inadequate food stocks, especially with the government, a poor monsoon or a drought could mean widespread starvation in the absence of imports. The latter were constrained by foreign exchange shortages from 1956–57, so that thereafter India depended on imports of food financed by grants or soft loans.

The United States was the largest source of food assistance to India. In 1951, it exported 2 million tonnes of wheat financed by a loan of about $190 million (Rs 90.3 crores) repayable in dollars. Thereafter, almost the entire US food assistance to India took the form of loans repayable in rupees.

Between 1955 and 1957, India imported wheat (and cotton) worth nearly $68 million under the US Public Law (or P.L.) 665, whose sale proceeds, deposited in rupees with the State Bank of India, were used to finance projects such as the Rihand dam. The bulk of the American food aid to India was, however, extended under P.L.480 whose stated objectives were to use that country's food surpluses to 'combat hunger and malnutrition' and 'promote, in other ways, the foreign policy of the United States'.

India was the largest beneficiary of the P.L.480 programme. In the seventeen years from July 1954, total shipments under P.L.480 to all countries amounted to $23,392 million. Of this, India (which did not begin receiving P.L.480 assistance until 1956–57) accounted for $5,611 million, or nearly a quarter of the total. Besides foodgrains, particularly wheat (or wheat flour), rice, and jowar, India imported cotton, tobacco, soyabean oil, milk powder, and some other dairy products. Though the private sector too, imported commodities such as cotton under the agreement, P.L.480 imports were principally made on the government account.

Four 'titles' were listed under P.L.480. Until such sales were wound down from 1966, Title I allowed the US to export its agricultural surpluses against payment in the currency of the importing country. Nearly 90 per cent of the P.L.480 assistance to India came under Title I. The Indian government received credits from the US government, either in the form of dollar funds made available to the India Supply Mission in Washington to buy imports covered by the agreement, or less commonly in the form of direct commodity assistance. Rupee proceeds from the sale of commodities imported under the agreement were banked in India, and used to finance agreed projects and activities and meet the expenses of the US embassy in India.

Cumulative imports under P.L.480 amounted to over $4,131 million by the end of December 1967. The bulk of this comprised wheat ($2,807 million), followed by cotton ($375 million), and rice ($208 million). Of the counterpart amount, $2,495 million (60.4 per cent) and $818 million (19.8 per cent) were given to the Government of India as loans and grants respectively. Loans to private enterprises totalled $272 million (6.6 per cent), while $546 million were used to finance the expenses of the US government in India.

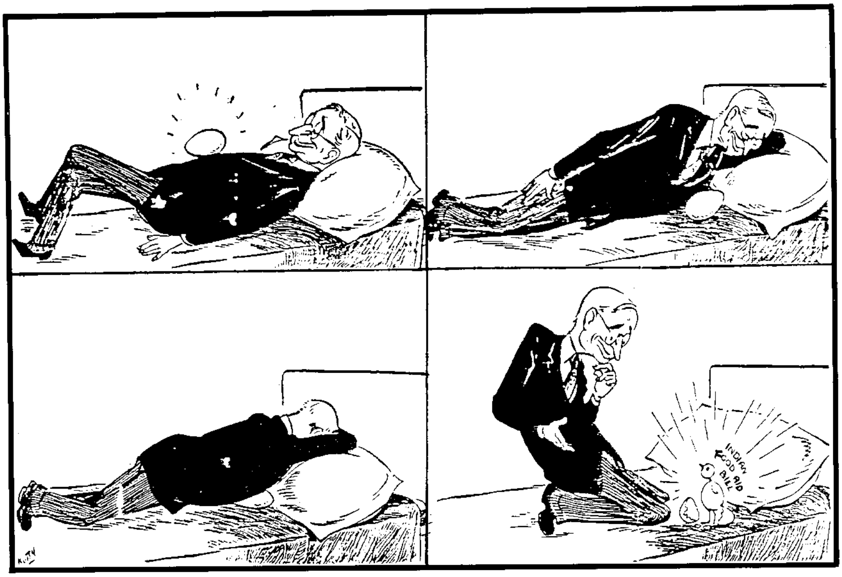
P.L.480 Controversies

P.L.480 imports aroused intense controversy and debate in India. The wider debates reflected, partly, the difficulties of reconciling the immediate objective of ensuring adequate supplies of cheap food through imports, and the longer-term objective of stepping up food production, among other means, by improving incentives for farmers. Some macroeconomic effects of P.L.480 imports were also debated. Odd as it might appear, much of this debate related to the 'inflationary' consequences of P.L.480 financial arrangements, and it is with the latter that the remainder of this appendix is mainly concerned.

The primary disinflationary impact of P.L.480 imports, especially of foodgrains such as wheat, could hardly have been doubted. According to some estimates, total net imports of wheat amounted in some years to 60 per cent or more of domestic output. They also exceeded the estimated marketable surplus of the crop in ten of the seventeen years between 1951 and 1967, sometimes by more than 100 per cent. Imports under P.L.480 (Title I) alone accounted for more than three-quarters of total wheat imports by India during 1957–67.

On the other hand, P.L.480 imports did not, unlike normally financed imports, lead to a transfer of funds abroad, but to their accumulation as banking funds in India. In the first agreement between the Indian and US governments under this legislation, almost the entire rupee counterpart funds of P.L.480 sales were deposited with the State Bank of India. By prior agreement, these were invested predominantly in Government of India

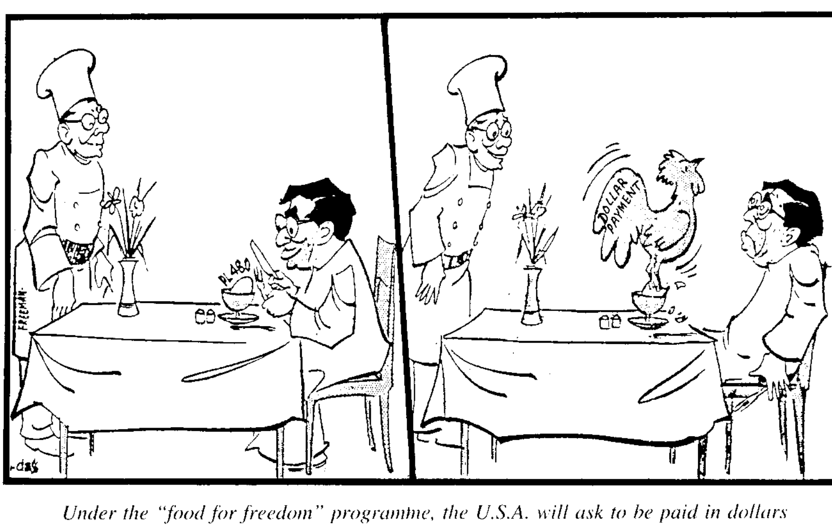
Truman's Triumph



The bill to supply 2 million tons of food grains to India has been finally approved by the U.S. Congress: (A man created a sensation by personally hatching an egg. — News item).

– *Shankar's Weekly*, 17 June 1951

Between the cup and the lip



Under the "food for freedom" programme, the U.S.A. will ask to be paid in dollars for its food exports.

– *Shankar's Weekly*, 24 July 1951

securities. About 80 per cent of the programme funds were given as loans or grants to the Government of India for developmental purposes. Some 5 per cent was earmarked for loans by the Exim Bank in Washington to American firms and their collaborators, and the remaining money was placed at the disposal of the US government. However, owing to delays in concluding agreements for utilizing them, funds to the credit of the US Government rose substantially to amount to a little over Rs 250 crores by the end of May 1959.

Though the State Bank did not profit greatly from the P.L.480 banking arrangement, this was widely seen as a form of discrimination in favour of that institution. More serious, in the Reserve Bank's view, was the fact that besides distorting figures of bank deposits, P.L.480 balances with the State Bank artificially inflated subscriptions to government loans. The Governor, H.V.R. Iengar, warned the government in July 1959:

> This lends an air of unreality to our loan operations and it is desirable that we should, as soon as possible, rid ourselves of the complacency that inevitably arises from the shadowy nature of these subscriptions ....

The Bank's advice to the government was to deposit these funds with it. Following discussions with American officials, it was decided that up to a fifth of P.L.480 funds would be deposited with the State Bank, leading Indian private-sector banks, and American banks such as the First National City Bank of New York and the American Express Banking Corporation. The larger part of these balances was deposited in an account with the Reserve Bank's Delhi office, and operated by the US disbursement officer. Since the Reserve Bank was precluded under section 17 of its Act from paying interest on deposits, P.L.480 balances were invested in multiples of Rs one lakh in special non-negotiable securities issued by the Government of India. These securities carried an interest rate of 1.5 per cent per annum and were 'payable on demand'. Balances below Rs one lakh were kept in the account and did not earn any interest. Whenever it became necessary to utilize P.L.480 rupee counterpart funds, the special securities were redeemed to the required extent, and the corresponding amount placed at the disposal of the US disbursement officer. The latter then transferred the funds either to the government as loans and grants—almost 80 per cent of P.L.480 funds were utilized in this way—or to other agencies such as the US embassy.

P.L.480 and Deficit Financing

It was argued, notably by B.R. Shenoy, who became Professor of Economics at Gujarat University after a long stint at the Bank, that P.L.480 financing and disbursement arrangements constituted an addition to deficit financing. The sum and substance of Shenoy's arguments was that the government redeemed special securities not out of its own revenue receipts or by borrowing from the public, but by creating ad hoc treasury bills.

Shenoy's arguments evoked a well-reasoned response from V.V. Bhatt and D.R. Khatkhate, both economists at the Bank, which was published in its *Bulletin*.[1] This study argued that the potential net impact on bank credit to government and money supply of (a) payments to the US embassy, (b) their investment in special government securities, (c) sale to the public of commodities imported under P.L.480 and P.L.665 agreements, and (d) the expenditure of rupee counterpart funds, was neutral. While ad hoc treasury bills issued originally by the government to finance (a) would be retired with the proceeds of (b), the rise in the government's cash balances as a result of (c) would be offset by the redemption of special securities required to finance (d). A similar effect would obtain on private-sector balances where the latter sold commodities imported under these agreements. However, should the government utilize these imports to build larger stocks or subsidize their sales, net bank credit to the government as a result of these transactions would rise to the extent (a) or (d) (assumed here to be equal) exceeded the proceeds of (c). Likewise, net bank credit to the private sector would expand to the extent the latter used imports to build their inventories. These results were valid regardless of whether P.L.480 funds were deposited with the Reserve Bank or the State Bank.

Bhatt and Khatkhate also pointed out that the *actual*, as distinct from the *potential*, monetary impact of the government's imports under P.L.480 and P.L.665 was likely to have been contractionary. This was because while imports aggregated Rs 633.5 crores between 1956–57 and 1961–62, disbursements (or expenditures) of rupee balances amounted only to Rs 243.5 crores. Therefore, on the assumption that there was no increase in the government's stocks and that its sales were not subsidized, the net contractionary impact of these transactions would have amounted to about Rs 390 crores.

The government, too, was generally content to argue that these operations did not exert an impact over and above that caused overall by its budgetary intervention, since all P.L.480-related transactions were reflected in the budget. This was no doubt true in the strict accounting sense, and many were content to adhere to this truth rather than venture an investigation or judgement of the net impact of these budgetary receipts and disbursements in relation to a

[1] 'Effects of the United States Commodity Assistance to India on Money Supply', *Reserve Bank of India Bulletin*, January 1963.

carefully chosen set of counterfactuals sensitive to a variety of real and monetary sector possibilities.

The manner in which the government financed its redemption of special securities posed a relatively more limited and simpler set of alternative possibilities, and therefore its impact remained at the centre of attention where Shenoy had placed it. This issue, mainly, was debated at a special conference in November 1967. The significance of this conference lay in the list of its participants. Though organized by Shenoy's Economics Research Centre which was a private body, it was inaugurated by the Deputy Prime Minister and Finance Minister, Morarji Desai, and its three sessions were chaired by L.K. Jha, Governor of the Reserve Bank of India, John Lewis, Minister and Director, USAID in New Delhi, and D.R. Gadgil, Deputy Chairman of the Planning Commission. Those presenting papers at the conference included officials of the Bank (notably the two authors of the *Bulletin* article who reiterated its principal conclusions) and of the Ministry of Finance, B.R. Shenoy himself, and the US disbursement officer in New Delhi.

Finance Ministry officials maintained that since all P.L.480 transactions passed through the budget, their net effect formed an integral part of that of the budget as a whole, and that 'no further adjustment' was called for on their account in the budget deficit. Other papers pointed out that the actual monetary impact of P.L.480 expenditures depended on whether the government redeemed special securities out of current budgetary receipts, borrowings out of genuine private savings, or through borrowings from the Reserve Bank. The US disbursement officer conceded that the net additional 'cash outlay' necessitated by the redemption of special securities accounted for a small part of the central government's budget, while Shenoy himself maintained that the government financed P.L.480 expenditures, in the ultimate analysis, by creating ad hoc treasury bills and borrowing from the Reserve Bank.

The controversy over the inflationary implications of P.L.480 financial arrangements was prolonged for some more years, with parliamentary and expert committees pronouncing their views upon the subject. The controversy was, in the final analysis, perhaps irresolvable so long as P.L.480 funds existed in some identifiable form.

Redeeming P.L.480 special securities did sometimes pose financial problems for the government. Its cash balance turned negative on one occasion. On another occasion, the resulting increase in the Bank's net credit to the government led to a breach in the net domestic assets ceiling agreed between India and the IMF as part of the March 1965 standby arrangement. But even if the government redeemed special P.L.480 securities entirely through resources raised against ad hoc treasury bills, it did not follow that this represented an addition to the 'planned' budgetary deficit. Equally, on the other hand, those holding the contrary view might argue that the 'planned' deficit was higher than it would have been had P.L.480 receipts not been available to the government. Thus, in essence, the P.L.480 monetary controversy revisited the familiar debate over whether the availability of any form of lending or assistance *encouraged* a government to run deficits or merely financed deficits determined *ex ante*. This debate, over whether or not deficits arose before the resources to finance them, has taken place in a variety of contexts, including most recently that of the Latin American debt crisis. Discussions in the west, too, about aid to India in the 1950s and 1960s focused on whether such aid plugged or widened resource gaps.

Unpublished Sources

F 103	Accounting Procedure under P.L.480
CF(B)16	Foreign Aid Loan Agreements with USA—P.L.480