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Indian Financial Policy

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Presentation to the Indian Parliament, on February 27, 1954, of the budget for the fiscal year ending March 31, 1955, focusses attention on the financial policy of India. The new budget provides for a very large deficit, a substantial portion of which is to be financed by issuing Treasury bills. In his budget speech, however, the Indian Finance Minister took the position that the risk of inflation inherent in such a budget would be minimized by the prevailing world economic outlook, a balance of payments deficit, and the need to increase money supply to some extent to sustain expanding production and offset deflationary tendencies in other sectors of the domestic economy.

Unless anti-inflationary forces are in fact present in other sectors of the Indian economy, the new budget may cause legitimate alarm. Should inflation become acute in India, the familiar sequence of rising imports, falling exports, dwindling foreign exchange reserves, and intensification of trade and exchange restrictions would be likely to develop. If India should begin to draw heavily on the central reserves of gold and dollars of the sterling area, the prospects for an early return to the convertibility of sterling would be impaired. Moreover, should a spiral of rising prices and rising costs of production occur in India, it would interfere with the country's economic development program under its Five-Year Plan to the extent that it resulted in a reduced volume of development for a given outlay.

A realistic appraisal of the prospects is in order. Since the record of the past is often a useful starting point to evaluate the present and look into the future, the analysis will be based upon a detailed study of India's financial position in 1953.

The 1953-54 budget

For the fiscal year ending March 31, 1954, the Central Government anticipated total expenditures of 7,080 million rupees, and receipts of about 5,150 million rupees, leaving a deficit of about 1,930 million (see Column 2 in Tables 1 and 2) 1/. Net long-term debt repayment was expected to require about 190 million rupees, most of this in connection with the proposal to float a new medium or long-term loan of some one billion rupees to replace

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1/ In the form in which the budget is traditionally presented, total receipts, total expenditures, and the difference between the two are not readily apparent. For the purposes of this study, the figures submitted in the budget documents have been rearranged so as to yield these significant magnitudes (see Tables 1 and 2). An explanation of this rearrangement is given in the footnotes to these tables.

TABLE 1

Indian Budget in Selected Years
(In millions of rupees)

	(1) 1952-53 Actual	(2) 1953-54 Budget estimate	(3) 1953-54 Revised estimate	(4) 1954-55 Budget estimate
Ordinary Revenue 1/	4,351.0	4,392.6	4,136.9	4,528.7
Receipts of Special Development Fund (Foreign Assistance) 2/	343.9 5/	297.2	234.3	451.2
Receipts of "Depreciation and Other Reserve Funds " 3/	512.9	462.8	407.6	427.4
Total Receipts	5,207.8	5,152.6	4,778.8	5,407.3
Ordinary Expenditure 1/	3,961.8	4,388.1	4,306.5	4,670.9
Less: Appropriation for Reduction or Avoidance of Debt 4/	50.0	50.0	50.0	50.0
Adjusted Ordinary Expenditure	3,911.8	4,338.1	4,256.5	4,620.9
Capital Expenditure Not Met from Revenue 1/	391.2	766.4	639.0	1,457.5
Loans and Advances to States, etc., for Development 1/	853.9	963.3	1,165.5	1,842.1
Expenditure of Special Development Fund 2/	198.2	441.9	422.8	554.5
Expenditure of "Depreciation and Other Reserve Funds" 3/	505.5	570.8	568.4	568.3
Total Expenditures	5,860.6	7,080.5	7,052.2	9,043.3
Surplus (+) or Deficit (-)	- 652.8	- 1,927.9	- 2,273.4	- 3,636.0

SOURCE: Government of India, Budget of the Central Government for 1954-55, as laid before Parliament, 1954, New Delhi, February 27, 1954.

Footnotes on next page.

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TABLE 1

Footnotes

1/ As per budget documents.

2/ In the budget documents, the receipts and expenditures of the Special Development Fund are included under the heading "Other Deposits and Advances," in the capital budget. This heading also covers the operations of such diverse items as the Government's Cash Balance Investment Account, the Discount Sinking Fund, the several accounts covering prepayments and refunds of taxes, etc., which it does not appear proper to include in estimates of total receipts and total expenditures. It also includes the operations of certain special funds, typical of which is the Fund for Development of Handloom and Khadi Industries. These may deserve the same treatment as the Special Development Fund, but sufficient information concerning them is not available to permit a correct appraisal of their nature. Accordingly, for the purpose of this paper, they remain included in the item "Other Deposits and Advances" (see Table 2). In any case, the amounts involved are small.

3/ In the budget documents, the receipts and expenditures of these funds are deducted from each other and only a net figure is listed under this heading in the capital budget. The receipts consist of that portion of the profits of railways, posts and telegraphs, telephones, and other commercial activities of the Government which is appropriated to "Surplus" and earmarked for renewal and development of facilities. The remaining portion of these profits, which has not been so earmarked, is already included in ordinary revenue and it seems proper in estimating total receipts, to include the whole of these profits. By the same token, since expenditures from the "Depreciation and Other Reserve Funds" are incurred for renewal and development of facilities and are not listed elsewhere, it seems proper to include them in the estimate of total expenditures.

4/ In the budget documents, this item is included both as an expenditure in the ordinary budget (under the heading of Debt Services) and as a receipt in the capital budget. Clearly, this is a bookkeeping transaction and it seems proper, in estimating total receipts and total expenditures, to deduct it from the total ordinary expenditures as listed in the budget document, and to ignore the corresponding receipt in the capital budget.

5/ Includes 3.2 million rupees, representing "Sale Proceeds of American and Lend Lease Surpluses," which, in the budget document, are listed separately from the Special Development Fund.

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TABLE 2

Financing of the Indian Budget Deficit in Selected Years
(In millions of rupees)

		(1) 1952-53 Actual	(2) 1953-54 Budget estimate	(3) 1953-54 Revised estimate	(4) 1954-55 Budget estimate
(1)	Surplus (+) or Deficit (-) as per Table 1	- 652.8	-1,927.9	-2,273.4	-3,636.0
(2)	Miscellaneous Accounts and Transactions:				
(3)	"Other Deposits and Advances" (net) 1/	- 351.9	+ 15.1	+ 643.5	+ 296.3
(4)	Adjustment to exclude Special Development Fund 2/	- 142.5	+ 144.7	+ 188.5	+ 103.3
(5)	Adjusted "Other Deposits and Advances" (net)	- 494.4	+ 159.8	+ 832.0	+ 399.6
(6)	Remittances (net) 1/	- 82.3 3/	+ 19.7	+ 14.9	- 1.2
(7)	Net Receipts (+) or Disbursements (-) from Miscellaneous Accounts	- 576.7	+ 179.5	+ 846.9	+ 398.4
(8)	Net Increase (+) or Decrease (-) in Unfunded Debt 1/	+ 487.4	+ 556.7	+ 536.4	+ 606.2
(9)	Net Increase (+) or Decrease (-) in Funded Permanent Debt 1/	+ 277.6	- 188.3	- 391.4	+ 252.6
(10)	Total (Sum of lines 7, 8, and 9)	+ 188.3	+ 547.9	+ 991.9	+1,257.2
(11)	"Inflationary" Gap (line 1 minus line 10) 5/	- 464.5	-1,380.0	-1,281.5	-2,378.8
(12)	Net Increase (+) or Decrease (-) in Floating Debt 1/	- 171.0	+1,098.5	+ 798.5	+2,500.0
(13)	Increase (+) or Decrease (-) in Government's Cash Balance	- 635.5 4/	- 281.5 4/	- 483.0 4/	+ 121.2

1/ As per budget documents.
2/ The receipts and expenditures of the Special Development Fund were included in Table 1. See footnotes 2 and 5 to Table 1.
3/ Net receipts of 8.7 million rupees, representing "Transfer of Cash between England and India," have been deducted from net disbursements of 91 million listed under "Remittances." The item "Transfer of Cash between England and India" shows no net balance in 1953-54 (budget and revised) and in 1954-55.
4/ Differs slightly from figure listed in budget document due to rounding.
5/ In the Indian budget terminology, this is the "Overall Deficit."

SOURCE: Government of India, Budget of the Central Government for 1954-55, as laid before Parliament, 1954, New Delhi, February 27, 1954.

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a 3 per cent issue of some 1,170 million which was due to mature during the year. To meet these requirements, the Government was counting on about 180 million rupees from the operations of miscellaneous special accounts (line 7 in Table 2). It also expected to raise about 560 million rupees by borrowing from the Post Office Savings Banks, the State Provident Funds, and other similar accounts, and by selling National Savings Certificates, Treasury Savings Deposit Certificates, and other similar instruments to the public and particularly to small savers. This left a sum of about 1,380 million which was to be financed partly by drawing down the Government's cash balances and partly by issuing Treasury bills.

Budgetary performance, however, appears to have differed from this in a number of respects. According to revised estimates recently submitted by the Finance Minister to Parliament (Column 3 of Tables 1 and 2), revenues were about 375 million rupees less than originally predicted, mainly because of lagging customs receipts, lower railway profits, and the failure of Pakistan to make expected payments on its partition debt to India. The revised estimates leave total expenditures approximately at the level originally budgeted. However, direct development expenditures are now expected to fall short of original estimates by about 200 million rupees, while the estimated amount of Government lending to the States, primarily for development, has been raised by roughly the same amount. The revised estimate of the deficit is about 340 million rupees larger than the original estimate.

Requirements for funds on account of debt transactions have been raised by about 230 million rupees. Net long-term debt repayment alone is now estimated to have required about 200 million rupees more than had been anticipated, largely because the debt refunding operation, which was carried out in June and July, involved the flotation of a 750 million rupee bond issue, about 250 million rupees less than had been planned.

Against a total estimated increase in requirements of about 570 million rupees, the operations of miscellaneous special accounts apparently yielded 670 million rupees more than had been anticipated. Of this amount, 480 million rupees are attributable to the operations of the Cash Balance Investment Account. Partly this reflects net open market sales by the Government of its own securities held in reserve. Primarily, however, it reflects the fact that when the Government redeemed the 3 per cent loan of 1953-55, in connection with the debt refunding operation, large amounts of the maturing loan, perhaps as much as 350 million rupees, were held in the Government's Cash Balance Investment Account. For obvious reasons, the probable availability of funds through this account had not been revealed in the original budget documents.

As a result of these factors, the revised estimate of the probable expansion in Treasury bills and utilization of cash balances is about 1,280 million rupees, about 100 million less than originally anticipated. Even this, however, overstates the actual expansionary influence of the budget.

Such an influence must be measured in terms of the cash operations of the Government, and it is likely that cash disbursements, in particular, were significantly smaller than the amounts obligated as the development program gathered momentum. In the first eleven months of the fiscal year, actual expansion of Treasury bills and utilization of the Government's cash balance amounted to only 280 million rupees. It seems most improbable that cash operations in March were such as to require use of these means of financing to the extent of another one billion rupees.

The 1954-55 budget

The new budget (see Column 4 in Tables 1 and 2) calls for total expenditures of about 9.05 billion rupees and total receipts of about 5.4 billion, leaving a deficit of about 3,650 million rupees. While revenues are expected to be somewhat larger than in the current year, this will be more than offset by an increase in expenditures due primarily to the rising tempo of economic development. Expenditures for economic development are estimated at 3,935 million rupees in the new budget, compared with 2,535 million in the budget for the 1953-54 fiscal year.

To finance the deficit, the Finance Minister is counting on about 400 million rupees from the operations of miscellaneous special accounts (line 7 in Table 2). A further 600 million rupees is to be raised by borrowing from the Post Office Savings Banks, the State Provident Funds, and other similar accounts, and by selling National Savings Certificates, Treasury Savings Deposit Certificates, and other similar instruments to the public and particularly to small savers. A new medium or long-term loan of 750 million rupees is to be floated, but two outstanding loans totalling about 500 million rupees are to be redeemed during the year. Total financing from these sources is, therefore, estimated at about 1,250 million rupees. To finance the balance of about 2,400 million, the Finance Minister anticipates that Treasury bills will be issued for 2,500 million rupees, allowing an increase in the Government's cash balance of about 100 million.

The need for inflationary financing -- The likelihood of such an expansion in Treasury bills taking place depends in part on the extent to which expenditures may fall short of the targets. The Finance Minister recently stated that India would be fortunate if the Five Year Plan were implemented to the extent of 85 per cent. Since total contemplated outlay by the Central Government under the Plan was 14.2 billion rupees over the five year period, such a rate of performance, if applicable equally to the state and central government segments of the Plan, would involve the failure on the part of the Central Government to spend 2.1 billion rupees. The deficiency so far acknowledged for the first three years of the Plan is about 400 million. The greater part of the total deficiency will, therefore, affect the fiscal years 1954-55 and 1955-56 (the last two years of the Plan). No allowance for this has been made in the budget estimates. It may be estimated roughly that in the year 1954-55 development expenditures by the Central Government will fall short of budget estimates by perhaps 700 million rupees.

It is also possible that revenues of the Central Government may fall short of estimates. However, the amount of the deficiency is likely to be much smaller than in the case of expenditures. The principal question concerns whether any payments on the partition debt will be received from Pakistan during the year. Although the first two annual payments expected in 1952 and 1953 were not received, the Finance Minister has included the sum of 90 million rupees from this source in the estimates of revenues for 1954-55. His stated hope that this issue may be settled in the near future, with payments beginning before March 31, 1955, may perhaps be taken with some skepticism. On the basis of available information, none of the other estimates of revenues appears to be open to serious question and it may be estimated roughly that Central Government revenues in 1954-55 are likely to be smaller than anticipated by not more than about 100 million rupees. If these estimates are correct, the actual deficit for 1954-55 may be 600 million rupees less than is now anticipated. Moreover, the cash deficit may be still smaller, if cash disbursements continue to be less than the amounts obligated.

The performance of the Indian money market in 1953 suggests that no particular difficulty should be experienced in 1954 in floating the contemplated new medium or long-term loan. Its prospective amount is the same as that of the 3-1/2 per cent loan floated in June 1953. The success which attended the flotation of this loan and subsequent flotations of large issues of industrial debentures and of loans of ten of the Indian States indicates that in the future the market may be tapped with more confidence that appeared justified in the past. The loans floated by the ten States in July totaled 280 million rupees, more than twice the largest amount ever floated by Indian States at any one time, and they brought in 25 per cent more than the goal. Ability of the Reserve Bank to reduce significantly its holdings of Government securities through open market sales during the year, discussed in detail below, gives further indication of the potential resources which may be raised in the market.

It is possible that the Government's Cash Balance Investment Account will again hold substantial amounts of the loans due to be redeemed in 1954. These loans, however, amount to only about 40 per cent of the amount of the loan which was redeemed in 1953. If the same proportion of the maturing loans is held in this Account this year as was held last year, only about 150 million rupees in additional funds may become available. The need for new short-term borrowing may be correspondingly reduced, unless it is decided to adjust the size of the proposed new issue downward, as was done in 1953. This need might also be reduced if the Cash Balance Investment Account engages in open market sales of Government securities as it did in the fiscal year 1953-54. For obvious reasons, no allowance has been made for these possibilities in the budget.

In summary, the actual expansion in Treasury bills may be substantially smaller than is now being planned. Even at best, however, it is likely to be considerably more than the probable amount of financing by means of Treasury bills and utilization of cash balances actually undertaken in the fiscal year 1953-54. The conclusion remains that the expansionary pressures stemming from the budget in 1954 are likely to exceed greatly those generated by the 1953-54 budget.

The balance of payments

In 1953, the expansionary pressures stemming from the budget were reinforced by the fact that India enjoyed balance of payments surpluses in the first quarter and apparently again in the fourth quarter, which more than offset deficits in the second and third quarters (see Table 3). Imports increased somewhat in the first quarter but declined gradually each month after April, even though import restrictions were somewhat relaxed for the second half of the year. In December 1953, imports were one-sixth below the level of December 1952. Exports fell off in the second and third quarters of the year, but recovered in September, and their level in the fourth quarter exceeded that of the corresponding quarter of 1952 by about 4.6 per cent. A substantial export surplus occurred in the fourth quarter following deficits in the first three quarters. By comparison, the value of exports exceeded that of imports by less than 1.5 per cent in the fourth quarter of 1952. While fourth quarter figures on invisibles are not yet available, it is likely

TABLE 3

India's Balance of Payments
First Three Quarters of 1953 and Estimates for the Fourth Quarter
(In million rupees)

	Jan.-March	April-June	July-Sept. 1/	Oct.-Dec. 3/
Imports, c.i.f.	1,348	1,573	1,415 2/	1,237 3/
Exports, f.o.b.	1,293	1,222	1,230	1,482 3/
Trade balance	- 55	- 351	- 185	+ 245
Official donations (net)	+ 24	+ 57	+ 4 2/	+ 57 3/
Other invisibles (net)	+ 172	+ 190	+ 183	+ 180 3/
Current account (net)	+ 141	- 104	+ 2	+ 482
Errors and omissions	+ 63	+ 78	- 29	?
Capital account (net)	+ 204	- 26	- 27	?

1/ Preliminary
2/ According to the U. S. Department of Commerce, Survey of Current Business, April 1954, page 21, U. S. aid to India in the third quarter was $7 million. This suggests that net official donations may have been as high as 35 million rupees. If so, imports were correspondingly larger.
3/ Estimated. Trade figures are from International Financial Statistics. Official donations are based on the figure ($12 million) for U. S. aid to India in the fourth quarter given in the Survey of Current Business, April 1954, page 21. Other invisibles are assumed to have been about the average of the first three quarters.

SOURCE: Reserve Bank of India Bulletin, October 1953 and January 1954.

TABLE 4

India's Balance of Payments with the Dollar Area
First Three Quarters of 1953
(In million rupees)

	Jan.-March	April-June	July-Sept.	Oct.-Dec.
Imports, c.i.f.	332	264	220	n.a.
Exports, f.o.b.	327	287	277	n.a.
Trade balance	- 5	+ 23	+ 57	n.a.
Official donations (net)	+ 23	+ 57	+ 4	n.a.
Other invisibles (net)	+ 4	+ 4	+ 17	n.a.
Current account (net)	+ 22	+ 84	+ 78	n.a.

SOURCE: Reserve Bank of India Bulletin, October 1953 and January 1954.

that net invisible earnings continued at about the same rate as in the first three quarters. Movements of the foreign exchange holdings of the Reserve Bank, which are usually closely related to the balance of payments position on current account, support the judgment that a fairly large surplus was recorded in the fourth quarter. 1/ In relation to the dollar area, a surplus was recorded in each of the first three quarters (see Table 4), and judging from the movements of India's dollar holding as reported by U. S. banks 2/, probably also in the fourth quarter. For 1953 as a whole, it seems probable that there was a deficit on merchandise account of about 375 million rupees which was more than offset by net invisible receipts of approximately 725 million rupees, excluding official donations.

1/ Foreign exchange holdings of the Reserve Bank rose about 157 million rupees (about $33 million) in the fourth quarter. This compares with an increase of about 181 million rupees (about $38 million) in the first quarter and declines of about 105 million rupees (about $22 million) and about 62 million rupees (about $13 million) in the second and third quarters respectively.

2/ Dollar holdings of the Government and banks as reported by U. S. banks rose about $7 million in the fourth quarter. This followed increases of about $12 million, $11 million, and $5 million in the first, second, and third quarters, respectively. It seems reasonable to assume that most of this represents a rise in official holdings, since Indian exchange control probably limits the holdings of commercial banks to relatively small and stable working balances.

It does not seem likely that the balance of payments will again show a surplus in 1954. The increasing tempo of economic development, which is largely responsible for the increase in the budget deficit, may also lead to a significant increase in imports. Deliveries under the United States and other foreign assistance programs may rise by as much as 100 million rupees. Other imports of developmental goods and imports of consumer goods also may rise, perhaps as much as another 400 million rupees. In particular, imports of sugar are likely to increase by about 250,000 tons costing India about 136 million rupees. An increase in expenditures on foodgrains of about 195 million rupees (about $41 million) also is to be expected. The volume of foodgrain imports is not likely to exceed the level of 1953, but a shift from wheat to rice is anticipated. Whereas India imported less than 200,000 tons of rice from all sources in 1953, a recent agreement with Burma provides for the purchase of 900,000 tons which Burma probably will deliver in 1954. The additional expense or rice may be about $95 million (about 452 million rupees). 1/ At the same time, wheat imports may be 700,000 tons less and cost about $54 million (about 257 million rupees) less than in 1953. 2/ Continuation through 1954 of the import liberalization introduced in the last half of 1953 may permit some increases in other types of imports.

If the level of economic activity abroad remains high, most Indian exports may continue substantially at the 1953 level. Exports of textiles from India, however, may suffer somewhat as a result of relaxation by the United Kingdom and some of its dependencies of restrictions against imports of Japanese textiles. The loss of export earnings from this source may be placed tentatively at about 75 million rupees. If these estimates are correct, the 1954 trade deficit may amount to about 950 million rupees. 3/ Net invisible earnings, excluding official donations, may continue at about the same rate as in 1953 (approximately 725 million rupees), so that a current account deficit of the order of 225 million rupees ($47.25 million) may occur.

India's prospective balance of payments deficit for 1954 would appear likely to manifest itself primarily in sterling, and the dollar position should remain relative strong. 4/ Indeed, having repaid about $36 million of its indebtedness to the International Monetary Fund on March 1, 1954,

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1/ Burmese rice cost India about $168 a ton in 1953. The 1954 price will be $134.40 a ton, if the entire quantity purchased is delivered during the year. While $36.40 a ton is to be offset against the prewar Burmese debt to India, making the net cost to India only $98 a ton, this does not affect the balance of payments on current account.

2/ India's wheat imports in 1953 were all made under the International Wheat Agreement as it stood before the 1953 renewal and the estimated c. and f. cost to India was about $77 a ton. It may be assumed that this is also the price which India may have to pay for wheat under the International Wheat Agreement in 1954.

3/ In the course of parliamentary debates on the new budget, the Indian Finance Minister stated that 750 million rupees of the proposed issue of Treasury bills would probably be matched by an import surplus of this magnitude. This estimate however, refers to the fiscal year 1954-55, not to the calendar year 1954.

4/ Assuming no serious downturn in the level of economic activity in the United States.

India intends to repay another $36 million before March 1, 1955. Total repayments to the Fund during 1954 may amount to about $46 million (220 million rupees). At the same time, the dollar position is likely to be bolstered by receipt of net official donations from the United States and Canada which may amount to as much as 300 million rupees ($63 million) and by partial utilization of the as yet undrawn balance of loans from the International Bank.

Foreign exchange reserves

India's foreign exchange reserves consist mostly of sterling held in London. Utilization of the sterling balances is governed by an agreement with the United Kingdom which provides that India shall hold £310 million ($868 million) as a currency reserve, and that the United Kingdom shall release sterling from India's blocked account with the Bank of England for for use in current transactions at the rate of £35 million ($98 million) a year over a six-year period beginning July 1, 1951. Releases need not be made if the balance in the unblocked account exceeds £340 million ($952 million), but amounts not released in any year shall be added to the sums available for subsequent release, and in any event, any remaining blocked balance shall be released on July 1, 1957.

The total amount of sterling available to India for use in current transactions between July 1, 1951, and December 31, 1953, may be estimated at £195 million ($546 million), of which £105 million ($294 million) represents the first three annual releases of £35 million each, and £90 million 1/ ($242 million) is the estimated unused balance from earlier releases. Between July 1, 1951, and the end of 1953, India's sterling balances in fact declined by about £100 million ($280 million), leaving about £95 million ($266 million) of the available amount not used. During 1954, India can presumably draw on this balance plus the fourth release of £35 million which will become available July 1, 1954, a total of £130 million ($364 million), or 1,733 million rupees. The estimated balance of payments deficit for 1954 is about one-eighth of this amount, less than half of a single annual sterling release under the agreement with the United Kingdom.

India desires to conserve a portion of its foreign exchange holdings for future contingencies and is cooperating with the United Kingdom and other Commonwealth sterling area countries to restore the international position of sterling. However, utilization of sterling balances in 1954 on a scale somewhat larger than now appears likely would seem to be consistent with these objectives and would strengthen the anti-inflationary forces.

1/ According to the Eastern Economist, November 26, 1951.

Prices, money supply and bank credit

In 1953, the budget deficit and the balance of payments surplus did not result in inflation. The wholesale price index rose from 372.7 in December 1952 to 410.4 in August 1953, but thereafter declined and stood at 389.4 in December 1953, only 4.5 per cent above the level of twelve months earlier. Money supply and bank credit followed the usual seasonal pattern, both increasing from fall to spring and decreasing from spring to fall. At the end of December 1953, money supply stood at 18,150 million rupees, only about 2.8 per cent above the level of twelve months earlier, and bank credit was 4,738.1 million rupees, 2.3 per cent below the level of twelve months earlier. About half of the small increase in money supply represented the gradual introduction of Indian currency in the State of Hyderabad, in replacement of Hyderabad currency which had not been included in calculations of money supply. The improvement in the trade balance during 1953, noted earlier, was in line with these developments.

Monetary policy and debt management

The maintenance of a substantial degree of financial stability and the favorable export and import performance were made possible in part by the Reserve Bank which followed a restraining open market policy throughout 1953 and into 1954. This merely continued the monetary policy first put into effect in November 1951. At that time, the Reserve Bank raised its Bank rate from 3 to 3-1/2 per cent and withdrew the support which it had previously given to the Government securities market. After a brief period of standing on the sidelines, it reentered the market on a limited basis for the purpose of ensuring orderly price movements.

The importance of the Government securities market from the standpoint of monetary policy stemmed from the fact that, traditionally, Indian commercial banks sell Government securities from their portfolios to obtain the means of financing the seasonal expansion of the demand for credit arising from the marketing of the crops, and repurchase them when demand for credit seasonally falls off. Until November 1951, the Reserve Bank stood ready to buy unrestricted amounts of Government securities from the commercial banks in the busy season which runs from fall to spring and to resell them in the slack season which runs from spring to fall. During the 1951 slack season, however, commercial bank credit contracted by only about half as much as it had expanded in the previous busy season and commercial banks repurchased much smaller amounts of Government securities than they had sold in the previous busy season. In this situation, the Reserve Bank acted to increase its control over the money market and to restrain credit. Under the new policy, it undertook to meet the legitimate demands of banks for funds by means of advances against Government securities and on a limited basis against commercial bills. The new policy made it possible to prevent further acquisition of Government securities by the Reserve Bank in the busy season which would not be fully offset by sales of these securities by the Bank in the slack season. At the same time, it enabled the Bank to adjust its holdings of Government securities in relation to the requirements of financial stability.

In 1953 and early 1954, this policy led to a substantial reduction in the Reserve Bank's holdings of Government securities. Small net open market purchases in the first half of 1953 were more than offset by large net sales which took place gradually beginning about the middle of June. Commercial banks probably absorbed a large proportion of the securities sold by the Reserve Bank between June and October, totaling about 233 million rupees. After the return of the busy season, in November, commercial banks once again became net sellers of Government securities, but net sales by the Reserve Bank continued, albeit on a reduced scale. In the last two months of 1953 and the first two months of 1954, the Reserve Bank's holdings of Government securities declined by about 37 million rupees. Net purchases of Treasury bills amounting to about 90 million rupees were more than offset by net sales of securities with longer maturity which totaled about 127 million rupees. Between April 3, 1953, and February 26, 1954, the Reserve Bank disposed of Government securities worth about 425 million rupees (about 8 per cent of its holdings on April 3, 1953), including nearly 280 million rupees between June 26 and July 17, very largely as a result of the redemption of the 3 per cent loan of 1953-55. Net sales by the Bank on its own account apparently were about 145 million rupees in the first eleven months of the fiscal year 1953-54.

The operations of the Government's Cash Balance Investment Account significantly reinforced the influence of open market policy. As mentioned earlier, this account is now estimated to have contributed 480 million rupees toward the financing of the budget deficit. Partly, this reflects the fact that it held large amounts, at most 350 million rupees, of the 3 per cent loan of 1953-55. Partly, however, it reflects net sales of at least 130 million rupees of Government securities held in this Account between April 1, 1953, and March 31, 1954. Total net sales of these securities by the Reserve Bank for its own account and by the Government's Cash Balance Investment Account were, therefore, quite substantial. They significantly exceeded net purchases by commercial banks which amounted to only about 160 million rupees during the first eleven months of the fiscal year.

Production and terms of trade

The maintenance of financial stability and the favorable trade developments were further facilitated by significant increases in production recorded during the year. The industrial production index, which averaged 128.9 in 1952, averaged 134.1 over the first eleven months of 1953, or about 4 per cent higher. Food production also increased in 1953, especially production of rice (13 per cent), wheat (12 per cent), and other cereals (11.7 per cent). Larger acreages and better yields due to favorable weather conditions contributed to this performance. This enabled India to reduce foodgrain imports to about 2 million tons in 1953, compared with 3.9 million in 1952, and 4.7 million in 1951. Greater availability of goods to some extent helped to offset the inflationary pressures.

A marked improvement in the terms of trade in 1953 also played a significant part in the favorable trade developments. The deterioration in the terms of trade which had taken place throughout 1952 was finally halted in the second quarter of 1953, and the terms of trade index which had been about 84 in the first quarter had recovered to above 97 in November, the last month for which figures are available. Import prices declined more than 10 per cent in the first eleven months of the year, while export prices after falling during the first three months of the year recovered all of this ground in the next six months and were about as high in November as they had been in December 1952. The decline in import prices materially contributed to the fall in the value of imports noted earlier, but there was also a contraction in volume. The recovery of export prices contributed to the small increase in the value of exports, but there was also a small increase in volume.

The employment situation

Finally, India's ability to maintain financial stability in 1953 in spite of a budget deficit and a balance of payments surplus was enhanced by the existence of a substantial amount of urban unemployment, and by a tendency of this unemployment to rise more noticeably than had previously been the case. On the basis of the available statistics, which are admittedly inadequate, unemployment appears to have risen about 25 per cent during the last nine months of 1953. This reflects the fact that additions to the labor force as a result of the growth in population have exceeded the creation of new jobs under the development program. The situation has become serious enough to induce the Indian Planning Commission to revise and augment the Five Year Plan for the purpose of providing more jobs. In such an environment, expansionary forces had less chance of generating inflation than would have been the case in a situation of low and stable unemployment.

The lesson of 1953

India's experience in 1953 may be summarized as follows. Expansionary pressures stemming from a budget deficit and a balance of payments surplus were offset by expanded production, improved terms of trade and the anti-inflationary policy of the Reserve Bank. Rising urban unemployment also helped to neutralise these pressures and internal financial stability was maintained. Exports increased somewhat, and imports fell off significantly.

Prospects for 1954

The Reserve Bank may be expected to continue its anti-inflationary policy in 1954. Nevertheless, it seems probable that some increase in the money supply in the hands of the public will take place during the year. To a certain extent, such an increase may be desirable to sustain the high levels of production already achieved in various lines and to permit India to improve upon them. Agricultural production, and especially rice production, is expected to be significantly larger in 1954 than in 1953, and increased availability of goods, particularly foodstuffs, should help materially to maintain internal financial stability. At the same time, the continued existence of a significant amount of urban unemployment and the continued tendency of such unemployment to rise suggest that the risks involved are likely to be smaller than would otherwise be the case. The probable absence in 1954 of external upward pressure on prices such as resulted from the Korean outbreak should further minimize these risks.

The Indian Finance Minister is fully aware of the dangers involved in the budget and he has promised that Government policies would be reconsidered should major changes in the economic situation or climate occur. However, he points out that "in the context of our developmental needs, it is important for us not only to live within our means but also to live up to our means." On the basis of his careful consideration of all aspects of the situation, he expects that the new budget "will prove reflationary rather than inflationary," and he concludes that "in the conditions as they now are and are likely to be in the near future, we are not taking any undue risks in going forward in the manner I have indicated."

The above analysis would appear to confirm this judgment. On balance, while the new budget significantly reinforces the expansionary pressures, the likelihood that development expenditures will fall short of targets to a greater extent than revenues fall short of estimates, the probable emergence of a balance of payments deficit, continuation of the present monetary policy, the need to sustain an expanding volume of production, and the existence of apparently rising unemployment may enable India in large measure to avoid inflation in 1954.