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India and Sterling Convertibility
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The ability of the United Kingdom to make the pound sterling convertible is, to a significant degree, influenced by the financial position and prospects of the other members of the sterling area. As a member of the sterling area, India therefore holds one of the keys to sterling convertibility and it is important to inquire whether India would constitute a prop to a convertible pound or whether it might represent a drag upon British convertibility plans.

The following study of India's financial relationships with the rest of the world suggests that, with good weather and political stability in South and Southeast Asia and with continued high level economic activity in the United States, India over the next few years should not make significant net contributions to or net drawings from the gold and dollar reserves of the sterling area. At the same time, however, India is likely to incur deficits with the sterling area and the rest of the non-dollar world. Although this may constitute a source of weakness on the road to sterling convertibility, the prospective approximate equilibrium of India's dollar position represents a marked improvement over the performance of the last eight years. For proper historical perspective, however, the analysis may be carried back to 1939.

Prewar position and balances of payments

Before the second world war, India was a large debtor. Heavy public borrowings in the London market, large investments of British capital in Indian industry, trade, and agriculture, and smaller investments in the private sector of the Indian economy from countries other than the United Kingdom represented foreign liabilities in the neighborhood of $4.5 billion in 1939, (see Table 1). 1/ Indian assets abroad on the other hand were probably small (see Table 2). The excess of foreign liabilities over foreign assets gave rise to an excess of payments over receipts on investment income account. In addition, a trend toward repayment of past borrowings had developed after 1934, and the sterling debt of the Indian Government had fallen by about 8 per cent between 1934 and 1939.

Besides having to make heavy net payments on investment income account, India was contractually obligated to make periodic payments in sterling for pensions owed by the Central Government and the Indian Provinces to retired British civil servants. 2/ India was also heavily

1/ All tables are at the end of the article.
2/ Partial reimbursement came from Burma which was obligated to pay 7-1/2% of the actual yearly expenditures by India on pensions in issue at the date of separation between the two countries (1937).

dependent on other countries for many services. The large earnings from other international transactions which these conditions required came from trade surpluses and, since 1932, from large exports of gold on private account. India's balance of payments for the year ended March 31, 1939, illustrates these relationships clearly. It showed: 1/

Exports (f.o.b.)	$667.5 million
Imports (c.i.f.)	641.6
Trade balance	+ 25.9
Non-monetary gold (net)	+ 83.7
Investment income (net)	- 97.4
Other invisibles (net)	- 68.6
Net current transactions	- 56.4
Official long-term capital (net) 2/ (outflow: -)	- 38.4
Official foreign exchange (net) (decrease: +)	+ 51.4
Errors and omissions (net)	+ 43.5 3/

Prewar pattern of payments

No breakdown of the balance of payments by countries or groups of countries is available. However, on merchandise account, India had favorable balances with the Western Hemisphere (principally the United States and Argentina), with the United Kingdom, with Continental Europe including the USSR (in spite of a substantial deficit with Germany), and with the non-sterling area countries of Southeast Asia and the Far East (in spite of a deficit with Japan). Trade deficits were incurred with the overseas Commonwealth sterling area countries (largely accounted for by a large deficit with Burma), and with the Middle East. The trade surplus with the United Kingdom almost exactly offset the trade deficit with the overseas Commonwealth sterling area countries. In view of the large British investments in India, it is likely that India had net deficits on current account with the sterling area and the Middle East, which were financed by surpluses with the Western Hemisphere, Continental Europe, and the non-sterling Far East.

1/ International Monetary Fund, Balance of Payments Yearbook.
Conversion rate: $.35924 per rupee.

2/ Includes the following:

Payments to sterling provident funds	$27.7 million
Payments on account of the capital portion of the annuities created for the purchase of the railways	10.1
Repatriation of sterling debt	.4
Repatriation of rupee securities from London	.3

3/ Does not add up due to rounding.

In the year ended March 31, 1939, India sent about one-third of its exports to the United Kingdom, about one-fifth to Continental Europe, about one-sixth to overseas sterling area countries of the Commonwealth, and about one-twelfth each to the United States and Japan. It obtained about a third of its imports from the United Kingdom, about a quarter from other sterling area countries in the Commonwealth, between one-fifth and one-sixth from Continental Europe, about one-tenth from Japan, and about one-fifteenth from the United States.

Effects of the war

The second world war enabled India virtually to eliminate its public indebtedness to the United Kingdom and at the same time to build up very large foreign exchange balances consisting mostly of sterling. Availability of goods for export from the United Kingdom and other traditional suppliers was drastically reduced, while the United Kingdom and its allies stepped up their purchases from India and helped finance expansion of the Indian military establishment and Indian participation in the war. Between April 1, 1939, and March 31, 1946, war expenditures in India recoverable from the British Government amounted to about £1,304.8 million (about $5,260 million), and sterling payments made by the British Government to India on this account totaled about £1,224 million (about $4,933 million) from September 1939 to March 31, 1946. 1/ These enormous net current earnings enabled the Central Government to reduce its sterling debt to only £29.3 million (about $118 million) as early as March 31, 1944, 2/ and to acquire ownership of certain railways previously British-owned. At the same time, private Indian interests purchased from British owners a substantial but undetermined amount of shares in a variety of companies operating in India. The amounts used for all these purposes, however, were small when compared to the size of the wartime current earnings, and Indian foreign exchange holdings rose steadily, reaching the all time high level of £1,299.4 million (about $5,237 million) on April 5, 1946. Since India's net foreign obligations to countries other than the United Kingdom were relatively small, these developments turned India's position into that of a creditor, in the sense that its foreign assets exceeded its foreign liabilities.

1/ The balance appears to have been settled in rupees raised through sales of gold in the Indian market. See Reserve Bank of India, Report on Currency and Finance for the year 1944-45, pp. 38-39.

2/ This was only about one-twelfth of the March 31, 1939 level.

Indian foreign assets and liabilities since the war

In the postwar years, the Indian public debt denominated in sterling continued to fall, but a public debt in dollars arose through drawings on the International Monetary Fund in 1948 and 1949, borrowings from the International Bank beginning in 1949 and from the United States Government in 1951 and 1952 (see Table 3). Indian official foreign assets also fell after the war, but today remain very much larger than before the war (see Table 4). The foreign exchange holdings in particular are now less than half their postwar peak level but more than twelve times the prewar level. On the basis of the latest figures, India's gold and foreign exchange holdings alone (including the gold and dollar subscription to the International Monetary Fund and the International Bank) now exceed India's public foreign liabilities by nearly $1.6 billion (about £570 million).

Foreign investments in Indian industry, trade, and agriculture continued to decline after the war, particularly as the date of Indian Independence drew near, and, on June 30, 1948, exceeded the value of privately owned Indian assets abroad by about $600 million (£150 million) at book value, about $1,200 million (£300 million) at market value (see Table 5). While later figures are not available, 1/ balance of payments data show that the outflow of foreign private capital from India has continued since 1948, but that there has been a somewhat smaller return of Indian private capital from abroad. India, however, probably remains a substantial net debtor on private account.

Structure of the postwar balance of payments

On balance, India's total foreign assets today exceed its total foreign liabilities by a large margin, though a smaller one than in 1946. On investment income account, however, India remains a net debtor, albeit on a smaller scale than before the war. Its large sterling balances are primarily invested in low yielding British Government securities, whereas the bulk of its foreign liabilities have a relatively higher yield.

In other respects, however, the structure of the Indian balance of payments has undergone striking changes since 1939. Trade deficits have been incurred in every postwar year except 1950. A growing surplus on account of invisibles other than investment income account has appeared, as a result of increasing net earnings under the heading "unclassified

1/ Estimates made by the U.S. Department of Commerce, however, show that United States direct investments in India have increased from $29 million in 1948 to $63 million at the end of 1952.

transactions" believed to be services. 1/ The large net payments on government account of prewar days have largely disappeared, India having relieved itself in 1948 of the obligation to provide sterling annually for the payment of pensions to British subjects formerly serving in India, by purchasing annuities from the United Kingdom for this purpose. The prewar net outflow of gold on private account ceased early during the war and the net inflow which had existed for many years prior to 1932 was resumed. Private imports of gold were banned after the war except for negligible amounts in 1948, 1950, and 1952. It is not known how much gold may have been smuggled into the country since the war, although the amount may have been considerable judging from the large debit entries under Errors and Omissions in the balance of payments (see Table 6).

The heavy postwar trade deficits resulted at first from accumulated wartime shortages and inflated incomes in India. These stimulated domestic demand, inducing increases in imports and adversely affecting exports. Later, the trade deficits reflected the aftermath of the post-Korean raw material boom, when the high export earnings of 1950-51 again stimulated internal demand at a time when foreign demand for Indian exports and the level of export prices were receding from their 1951 peaks. They were aggravated throughout the postwar period by heavy increases in foodgrain imports above prewar levels, reflecting both higher prices and larger quantities needed to feed the growing population in the face of a relatively unchanging domestic production held back in part by unfavorable weather. Attempts were made to reduce the trade deficits by means of import restrictions, but these were partially offset by export restrictions designed to ensure adequate domestic supplies. Moreover, import restrictions were alternatively tightened and relaxed on the basis of the performance of the previous six or twelve months, so that any benefit obtained in one period was largely lost in the next.

In the six year period, 1948-53, India incurred trade deficits totaling over $1,250 million, and made net payments of more than $250 million on investment income account, but earned over $975 million from other invisible transactions (see Table 6). The six-year deficit from goods and services (excluding official donations) was therefore about $525 million 2/. In addition, India suffered a net outflow of private capital of $156 million and a net outflow of short-term foreign official and bank balances of about $13 million. Offsetting these, India received

1/ The International Monetary Fund's Balance of Payments Yearbook comments as follows concerning this item: "Some transactions recorded in the exchange record are not classified according to type of transaction. Part of these transactions have been entered on an estimated basis [under appropriate headings]; the remainder has been entered here, because it is believed that the bulk of it represents receipts and payments for services".
2/ This is fully accounted for by the net deficit on current account for the year 1949 alone.

official donations ($70 million), drawings from the International Monetary Fund ($100 million), and a net inflow of long-term official capital (largely the U.S. food loan and IBRD loans) and banking funds (about $240 million). Special transactions involving the purchase from the United Kingdom of the pensions annuities mentioned above, the acquisition of British military installations and supplies located in India, the settlement of the wartime Defense Expenditure accounts, and the demonetization of Indian currency in the British territory of Aden, also occurred during this period, at a cost to India of more than $900 million. Indian official foreign exchange and short-term bank balances abroad declined by more than $1,700 million 1/ and errors and omissions amounted to more than $500 million.

The postwar pattern of payments

A breakdown of these figures shows that the prewar relationship, under which India's current account deficit with the sterling area was financed by surpluses with the Western Hemisphere and Continental Europe, was almost completely reversed in the postwar years. Over the six year period, 1948-53, India earned a surplus of about $580 million in current transactions with the sterling area, but incurred a current account deficit with the United States and Canada of about $550 million and another with the rest of the world of about $485 million (see Table 7). Emergency imports of wheat under a loan from the United States in 1951 and 1952 totaled $190 million, only about a third of the combined six-year deficit with the U. S. and Canada. Only in 1950 and 1953 were current account surpluses (excluding official donations) earned with the U. S. and Canada, and the 1953 surplus was quite small. While the financing of the dollar deficit was facilitated by drawings on the International Monetary Fund in 1948 and 1949, International Bank loans since 1949, and U. S. and Canadian aid since 1950, India drew over $200 million from the sterling area dollar pool in the six year period (see Table 8). This compares with estimated contributions of about $344.6 million during the years 1939-46. 2/

1/ This figure does not reflect the loss in dollar value of the sterling balances on account of devaluation in September 1949. Moreover, it does not include Indian payments to Pakistan in 1948 and 1949 under the partition arrangements. Such payments amounted to about £177 million (about $713 million), of which £150 million (about $600 million) was in sterling, and the balance in gold.

2/ Reserve Bank of India Bulletin, May 1950, page 302.

The postwar reversal of the pattern of regional payments was due to war dislocations and postwar inflation in many foreign countries, which reduced the availability of exports from these countries and their competiveness relative to comparable United States supplies, and increased the attractivenss of these countries relative to the United States as markets for Indian products. As a result, Indian imports from the United States rose more than imports from other countries and exports to the United States were more seriously retarded than were exports to other countries. In particular, Southeast Asian rice export availabilities were seriously impaired and India's increased foodgrain requirements necessitated heavy purchases in the United States. Partition of India and Pakistan also helped to alter the Indian pattern of regional payments. Cotton exports to Europe and Japan from areas incorporated into Pakistan ceased to be counted as Indian exports and this contributed to the shift from a surplus to a deficit position in India's transactions with the non-dollar, non-sterling countries.

The 1953 balance of payments

Since the spring of 1952, India's balance of payments has been steadily improving. Internal inflationary forces were brought under control largely as a result of the adoption by the Reserve Bank of India in November 1951 of a restrictive monetary policy. Speculation, which had been widespread, was ended, and internal demand fell back to more normal levels. The domestic supply situation improved as a result of rising production. Imports declined in spite of a growing upward pressure resulting from efforts to promote economic development. In particular, imports of foodgrains were reduced sharply in 1953 as improved weather conditions led to greatly increased domestic crops, and imports of raw cotton fell as the previously accumulated stocks were being worked off. For the first time since the war, relaxation of import restrictions in July 1953 was not followed by an increase in imports, reflecting the diminishing influence of these restrictions. The deterioration of the terms of trade which had been in progress since mid-1951 was halted in the second quarter of 1953 and exports thereafter tended to remain stable. In 1953, India's balance of payments was in approximate equilibrium.

This improvement affected particularly the balance of payments with the United States which had supplied most of the heavy imports of wheat and cotton in 1952, and India in 1953 earned a small surplus on current account (excluding official donations) with the United States. But the balance of payments with other areas also improved and India in 1953 had current account surpluses with all areas except with the United Kingdom and Continental OEEC countries (see Table 9).

Balance of payments prospects

During the next few years, the Indian balance of payments may be expected once more to show current account deficits. The rising tempo of economic development is likely to lead to increased imports of developmental goods while rising incomes associated with increased activity and the large budgetary deficits called for by the country's Five Year Plan may result in increased imports of other goods. In addition, those imports which were comparatively low in 1953 because of inventory reductions in that year may be expected to rise somewhat. This is particularly true of raw cotton. At the same time exports are likely to show little overall change so long as world economic activity remains at substantially the same level as in 1953. India may be expected also to continue earning substantial amounts from invisible transactions, in spite of having to make net payments on investment income account. These payments are likely to remain at about the level of recent years. Continuation of the net outflow of private capital may reduce the net payments on private account, but official payments are rising as India is once more borrowing abroad, and official receipts will fall as its foreign exchange holdings are drawn down in connection with efforts to promote the country's economic development (see below).

The Government of India is counting on the anti-inflationary influence of the balance of payments to help reduce the inflationary impact of the budget and may be expected to permit the reappearance of a balance of payments deficit. While some of the restrictions on imports may be tightened to stimulate the growth of new industries, the present degree of import liberalization is likely, in general, to be maintained, if not increased somewhat. 1/ At the present time, a large number of basic raw or partially processed materials required by Indian industry and of essential consumer goods may be imported under open general license from any country and a few more items of these types may be imported under open general license from soft currency countries only. Other types of imports require individual licenses which are generally more easily obtained for soft currency country imports than for hard currency imports.

Export restrictions, which aim in general at increasing hard currency earnings and ensuring adequate domestic supplies of exportable goods, may be expected to be relaxed further as domestic production continues to rise. In 1953, however, these restrictions did not significantly reduce the volume of exports and exerted only a moderate influence over their destination, so that the impact of any further relaxation is likely to be small.

1/ A moderate amount of further liberalization has already taken place in 1954.

Restrictions on payments for invisibles are not likely to be modified significantly in the near future. Most remittances for the benefit of Indian residents are prohibited. Travel allowances, however, are granted, with more liberal amounts permitted for travel to soft currency countries than to countries in the dollar area and more liberal amounts in the case of neighboring countries than in that of other soft currency countries. Otherwise, restrictions on payments for invisibles are designed primarily to ensure the bona fide character of the proposed transfers. There are no restrictions on the remittance of dividends and interest on shares and securities held by persons permanently residing outside India. Profits of branches or subsidiaries of foreign companies operating in India may be remitted in the currency of the country of residence of the owners on presentation to the Indian authorities of audited financial statements and proof of payment of Indian taxes. Approval is required but generally granted freely for payments for services incidental to imports and for recurring contractual obligations. 1/ Foreign employees may make reasonable remittances to their own countries on account of savings and in payment of insurance premiums or other expenses or for support of their families. Approval of remittances on account of patents, royalties and rentals appears to hinge on the appraisal by the Indian authorities of the degree of benefit received by India.

India is likely to continue to suffer a small net outflow of private capital. New investments of foreign capital in India will probably remain on a small scale over the next few years as will the repatriation of Indian private assets abroad. Inward capital movements are generally free from restrictions, except that Government approval must be obtained for the use of foreign capital in new investment projects. At the same time repatriation of foreign capital from India may be expected to continue on a significant scale. Repatriation of capital owned by residents of sterling area countries and of Norway, Denmark, and Sweden is allowed freely. Capital invested by residents of other countries in projects approved by the Government after January 1, 1950, may also be repatriated freely, including since March 1953 any capital appreciation on the original investment. Foreign nationals who have been residing in India and are permanently returning to their own country or, in the case of sterling area nationals, who are permanently migrating to any sterling area country, may transfer the sale proceeds of properties, shares, etc., to their country of destination; but the transfer of such proceeds by others is prohibited and the amounts in question, as well as the proceeds from liquidated foreign investments not eligible for repatriation, are blocked. All other outward capital movements are prohibited.

1/ This includes premiums on foreign currency policies issued to Indian residents. However, Indian residents are prohibited from taking out life policies in foreign currencies.

Foreign aid from the United States, Canada, and other Commonwealth countries is likely to continue to be available for some time as past appropriations by these countries are spent with some delay. 1/ Loans granted by the International Bank will also continue to be drawn down gradually. 2/ Repayments to the International Bank, however, and servicing of the United States wheat loan of 1951, the amortization of which is due to start in 1957, will put an increasing burden on the country in the coming years. India has also announced its intention of repaying approximately $72 million of its debt to the International Monetary Fund before March 1955. 3/ The possibility of further illegal imports of non-monetary gold and of illegal exports of capital, both reflected in errors and omissions, must also be borne in mind.

India's sterling balances will have to be the principal source of financing of the future balance of payments deficits. These balances, which were blocked under an agreement with the United Kingdom, are being released at the rate of £35 million ($98 million) a year over a six-year period ending July 1, 1957, for the purpose of financing current transactions. 4/ India, however, has not been using the amounts released in the last three years, having financed its 1951-53 deficit with the unused balance from earlier releases. Indeed, its sterling balances have risen by nearly £60 million ($168 million) since July 1952, and amounted to £564.7 million ($1,581 million) at the end of March 1954, only about £19 million below the level of September 1949. The amounts available to finance future balance of payments deficits are, therefore, substantial. Even if the sterling balances are in fact drawn down at the rate of £35 million a year over the next few years, it would take more than seven years to bring them below the £310 million level at which India's gold and foreign exchange holdings would approximate 40 per cent of the currency circulation 5/ the minimum prescribed by the Reserve Bank of India Act. 6/

1/ Not to mention the possibility of future appropriations.
2/ Not to mention the possibility of future loans.
3/ India borrowed $100 million from the IMF in 1948 and 1949 and has already repaid $46.7 million, $36.2 million on March 1, 1954, and $10.5 million on July 1, 1954.
4/ Under the agreement with the United Kingdom, the sterling balances may not be used to effect capital transfers unless specifically agreed upon by the Governments of India and of the United Kingdom. In effect, this means that India cannot transfer its balances from London to New York.
5/ The currency circulation amounted to 12.3 billion rupees in May 1954. If it rises at the rate of 315 million rupees per year (about 2.5 per cent of the May 1954 level), it will reach 14.5 billion rupees in seven years. The minimun reserve required to cover such a note issue would be 5.8 billion rupees, equivalent to £435 million. If in seven years, India still holds nearly £98 million worth of gold and about £27 million in dollar deposits (the amount it now holds), the minimun sterling holdings required would be £310 million. This is also the amount which India is committed to hold as a minimum currency reserve under the sterling balance agreement with the United Kingdom. The present agreement expires June 30, 1957.
6/ The Reserve Bank may permit its gold and foreign exchange holdings to fall below the required minimum with the prior approval of the Government, but it is subject to a penalty as long as the deficiency exists.

The prospective pattern of payments

Future balance of payments deficits may well be very different from those of the last six years. Traditional prewar Indian suppliers are in a considerably better position to meet Indian demand for their products now than they were immediately after the war. Internal inflation which plagued most of the world after the war has been largely brought under control in most countries and war dislocations which limited supplies in many countries after the war have largely been overcome. Domestic demand and production in these countries stand in a more satisfactory relationship, allowing increased export availabilities at more nearly competitive prices and under more nearly competitive delivery terms. This means that an increase in Indian imports is more likely to affect the balance of payments with non-dollar countries than with the dollar area. In particular, the improvement in the rice export position of Southeast Asian suppliers should make it possible in the future to avoid large imports of dollar wheat. Indeed, the likelihood of large foodgrain imports has itself greatly diminished with the striking increase in Indian production in 1953 and 1954. While it is, of course, always possible that the monsoon will fail in years to come, the development program is resulting in an increase in the cultivated area, an increase in the yields, and an improvement in storage facilities permitting the building up of more adequate and better protected reserves, which should, in future years, act as cushions against the effects of unfavorable weather.

The prospective pattern of Indian payments is likely to involve current account deficits with the United Kingdom and with continental OEEC countries, surpluses with the overseas sterling area, Latin America, and the rest of Europe, Asia, and Africa, and approximate equilibrium with the United States and Canada. This pattern is comparable to that of 1953 (see Table 9). However, in quantitative terms, the regional deficits of the future are likely to be larger than those of 1953, and the future surpluses smaller. In particular, India may incur an overall deficit with the sterling area, and the Indian deficit with the continental OEEC countries is likely to be larger than the combined surpluses with the rest of the non-dollar, non-sterling world.

India's prospective dollar position

India today is not the dollar earner which it was before the war. Its principal dollar export, jute manufactures, has been adversely affected by the partition of India and Pakistan. Following partition, Pakistan undertook the production of jute manufactures in order to lessen its dependence upon India as a market for its raw jute and to acquire a dollar earner of its own. Pakistani jute goods have competed with those made in India and cut into their dollar markets. At the same time, there has been some tendency in world markets to substitute bulk handling or paper containers for jute products. This was particularly pronounced in 1948-49 and again in 1951 when jute prices had risen sharply. While jute prices have since fallen, the shift back to jute has been slow and some of the market may have been permanently lost to substitutes.

India's dollar imports, on the other hand, have received a special stimulus from economic development in India. Industrialization of India since the war has involved a considerable expansion of textile production. The additional imports of raw cotton which this has required have come in part from the United States. While alternative sources of supply are available, 1/ it seems likely that India will find it economical in the future to continue using substantial amounts of United States cotton. Moreover, the process of industrialization in general has led to a doubling of the volume of imports of petroleum products since 1938. Their value in 1951 was about three times that of 1938. Part of this increase required payment in dollars. Although petroleum refineries are under construction in India, the imports of unrefined oil which their operation will call for will also require some payment in dollars.

With continued high level economic activity in the United States, with favorable weather in India, and barring a serious worsening of the international political situation, India's dollar area balance of payments on current account (including official donations) may be expected to be in approximate equilibrium over the next few years.

Some long-run considerations

In the long run, economic development of India may result in some savings of foreign exchange as the country increases its production of goods which are now imported. On the other hand, increased imports of machinery, raw materials, and other goods needed to push economic development still further are likely to occur. Rising per capita income, associated with economic development, and the increase in population, which is presently at the rate of 4.5 million annually (or 1-1/4 per cent), will also result in increased requirements for all types of imports and especially foodgrain imports. There is even the possibility that improved health conditions in India will result in an upsurge in population as the death rate falls more rapidly than the birth rate. This might lead to an accelerated increase in import requirements, unless domestic production of foodgrains can be increased correspondingly. The probability, therefore, is that total imports will continue to rise in the long run, in spite of any foreign exchange savings which may result from economic development.

1/ Raw cotton imports from Egypt in particular have greatly increased since before the war. As a result, the total value of Indian imports from Egypt in 1953 was about five times as large as in 1938-39, and Egypt supplied about 3.8 per cent of Indian imports in 1953, compared to 1.7 per cent in 1938-39.

Exports in the long run may also rise as a result of economic development, although growing internal demand due to increasing population and rising incomes may adversely affect export availabilities. For a long time, however, India is likely to have trade deficits, partly offset by invisible earnings. Since foreign aid cannot be expected to continue indefinitely, and since India's foreign exchange reserves are not inexhaustible, dependence on borrowing from the International Bank and other sources, and/or on an inflow of foreign equity capital will increase. This underlies the importance for India of overcoming the factors responsible for the current and prospective short-run net outflow of private capital, and of continuing the efforts to raise agricultural yields. Failing this, economic development in India may be retarded to the point where it barely keeps up with the rising population.

The increase in import requirements resulting from the rising population may well once more necessitate heavy shipments of wheat and cotton from the dollar area. This would be especially true if an explosive population rise occurs and if agricultural production in India fails to keep pace. At the same time, if a long-term trend away from the use of jute goods in favor of non-Indian substitutes proves to have been established, India's dollar earnings may fall, unless dollar markets can be developed for other products. 1/ Under these conditions, the failure of a net inflow of capital to develop may compel India to curtail imports of non-essential consumer goods and possibly also of developmental goods. This would offset the tendency to run dollar deficits and would reduce the deficits and increase the surpluses with other areas. It is difficult to forecast what the pattern of payments might be in such a regime of austerity. One possibility is that India might have deficits with the dollar area and with the continental OEEC countries and surpluses with the sterling area and the rest of the world. However, if import restrictions succeed in eliminating dollar deficits altogether, the long-run pattern might be similar to that of the short run. In any event, in the long run, India's sterling balances may be expected to be close to the level which India considers as the necessary minimum and could not help to finance any dollar deficit of the distant future.

Conclusion

Barring a crop failure in India, a drastic reduction of rice supplies from Burma and Thailand because of international political disturbances, or a significant slackening of business activity in the United States, the dollar position of India over the next few years is not likely to jeopardize the success of the United Kingdom's plans for the restoration

1/ In this connection, manganese has recently been gaining importance as a dollar export and may offer a partial answer to any decline in jute exports.

of the convertibility of sterling. Competitiveness of British supplies with supplies from the United States, coupled with the advantages enjoyed by the United Kingdom in the Indian market as a result of imperial preference and the traditional and institutional ties between the Indian and the British economies, will be the best protection against a dollar drain originating in India. At the same time, the United Kingdom cannot count on large net dollar earnings through sales to India. Indian economic development is unlikely to permit heavy reductions in dollar purchases of developmental goods, and dollar markets for Indian goods are not likely to expand significantly over the next few years.

The expected Indian deficit with the United Kingdom is likely to be settled partly through Indian earnings from other sterling area countries and partly by drawing down India's still large sterling balances. To the extent that India's sterling area deficit diverts to India goods which the sterling area might otherwise have sold in dollar markets or elsewhere, or interferes with production of sterling area commodities destined for other markets, or leads to larger imports by the sterling area than might otherwise have been obtained, the United Kingdom may consider that these deficits weaken the position of sterling in the world.

The prospective Indian deficits with the non-dollar, non-sterling countries will provide these countries with sterling earnings. If these countries, upon the restoration of sterling convertibility, undertake to convert their sterling earnings either to finance larger dollar imports or to build up their dollar or gold holdings, pressure on the United Kingdom's gold and dollar reserves may develop. For this reason, the United Kingdom may view the Indian deficits with them with some concern. These deficits place the sterling area countries outside of India, and especially the United Kingdom, in the position of having to earn a large enough surplus with the non-dollar, non-sterling countries to recapture the sterling used by India to settle its deficits with them. Whether this is likely to occur is only one aspect of the general problem of the overall relative scarcity or abundance of sterling in the world. As such, it lies outside the scope of this paper.

From the overall standpoint, the effects of the probable deficit in the Indian balance of payments on current account on the prospects for sterling convertibility would be alleviated if a net inflow of capital from non-sterling countries were to develop in the next few years. A net inflow of such capital into India would help to offset the sterling paid out by India to finance its deficit with non-dollar, non-sterling countries and, in the case of dollar capital, would enable the sterling area to earn dollars through transactions with India.

The United Kingdom may take account of the possibility that India may occur dollar deficits in the more distant future if very large food imports become necessary to feed the growing population. These deficits might impair the ability of the United Kingdom to maintain the convertibility of sterling in the long run to the extent that they are financed in sterling. However, in view of the uncertain nature of this possibility, it would not seem to deserve much weight at this time in making plans for the restoration of convertibility.

TABLE 1

Estimated Indian Foreign Liabilities as of March 31, 1939

(In millions of dollars)

Sterling debt of:							
Government of India 1/	1,648.2	(£351.8	million	or	4,691.0	million	rupees)
Indian municipalities and port trusts 2/	49.7	(£ 10.6	"	"	141.0	"	")
Other foreign public debt	none						
British investments in Indian private sector 3/	2,811.0	(£600.0	"	"	8,000.0	"	")
U.S. direct investments in Indian private sector 4/	48.8	(£ 10.4	"	"	138.6	"	")
Other U.S. assets in India 5/	43.5	(£ 9.3	"	"	124.0	"	")
Other foreign investments in Indian private sector 6/	215.0	(£ 45.9	"	"	612.0	"	")
TOTAL	4,816.2	(£1,028.0	"	"	13,706.6	"	")

Conversion rates: £1 = $4.68 = 13-1/3 rupees.

1/ Reserve Bank of India, Annual Report on Currency and Finance.
2/ The Statist, September 2, 1939, page 282.
3/ Reserve Bank of India, Census of India's Foreign Liabilities and Assets as on June 30, 1948, Bombay, 1950, page 16. Information on British investments in the private sector of the Indian economy before the war is both incomplete and not entirely reliabile. Postwar estimates and available data on capital outflow since 1939 suggest that the actual amount was probably around £500 million (about $2,340 million, or 6,666 million rupees)
4/ U. S. Department of Commerce, American Direct Investment in Foreign Countries -- 1940, Washington, D. C., 1942, page 16. This figure applies to the end of 1940. It is taken here as an estimate for March 31, 1939.
5/ U. S. Treasury Department, Census of American-Owned Assets in Foreign Countries, Washington, D. C., 1947, pages 69 and 71. This figure applies to the end of May 1943. It is taken here as an estimate for March 31, 1939. It includes non-profit organizations ($24 million), securities ($3.5 million) bullion, currency and deposits ($1.6 million), real property ($1.7 million), interests in estates and trusts ($8.5 million), and miscellaneous assets ($4.2 million).

(Footnotes continued on next page)

TABLE 1
(Continued)

6/ Estimated on the following basis: On June 30, 1948, total private direct investments in India from countries other than the United Kingdom, the United States, and Pakistan (the latter was part of India in prewar days) were about 2.6 times as large as total private investments in India from the United States alone (see Table 5). If this ratio is assumed to have prevailed also before the war, private direct investments in India from the countries in question in 1940 may be estimated at approximately 2.6 times $48.8 million, or slightly above $126.5 million. On June 30, 1948 total private portfolio investments in India from the same countries were about 73 per cent of their total private direct investments. If this ratio is assumed to have prevailed also before the war, private portfolio investments in India from these countries in 1940 may be roughly estimated at close to $92 million. Both estimates may be rounded off to the nearest multiple of five. The total of $215 million is taken here as a rough estimate for March 31, 1939.

TABLE 2

Estimated Indian Foreign Assets

as of March 31, 1939

(In millions of dollars)

Gold	274.0	(£ 58.5 million or 780.0 million rupees)
Foreign exchange - Reserve Bank of India	213.6	(£ 45.6 million or 608.0 million rupees)
Claim on Burma	174.7	(£ 37.3 million or 497.3 million rupees)
Indian private assets in the U. S. 1/	48.1	(£ 10.3 million or 137.3 million rupees)
Indian private assets in other countries 2/	415.0	(£ 88.7 million or 1,182.3 million rupees)
TOTAL	1,125.4	(£240.4 million or 3,204.9 million rupees

Sources: Reserve Bank of India, U. S. Treasury Department.

Conversion rates: £1 = $4.68 = 13-1/3 rupees.

1/ Value of all Indian-owned assets in the U. S. as of June 14, 1941, excluding any Indian gold held under earmark by the Federal Reserve Bank of New York, but including dollar deposits of about $11 million.

2/ Estimated on the following basis: On June 30, 1948, Indian private assets in countries other than the United States and Pakistan (the latter was part of India in prewar days) were 8.6 times as large as Indian private assets in the United States (see Table 5). If this ratio is assumed to have prevailed also before the war, Indian private assets in these countries in June 1941 may be estimated at approximately 8.6 times $48.1 million, or $413.7 million. This figure, rounded off the the nearest multiple of five, is taken here as a rough estimate for March 31, 1939.

TABLE 3

Indian Public Foreign Liabilities

as of March 31, 1954

(In millions of dollars)

Sterling debt of Government of India 1/	52.1	(£ 18.6 million or	247.9 million rupees)
Dollar debt of Government of India			
International Bank loans 2/	49.55	(£ 17.7 million or	236.0 million rupees)
Drawings on the IMF 3/	63.8	(£ 22.8 million or	303.8 million rupees)
U. S. wheat loan, 1951	190.0	(£ 67.9 million or	904.8 million rupees)
TOTAL	355.45	(£127.0 million or	1,692.5 million rupees)

Sources: Reserve Bank of India, Report on Currency and Finance; International Bank for Reconstruction and Development; International Monetary Fund; U. S. Government.

Conversion rates: £1 = $2.80 = 13-1/3 rupees.

1/ As of March 31, 1953. Does not include the capitalized value of the pensions liability since the foreign exchange to discharge this obligation has been spent in advance through the purchase of pension annuities from the United Kingdom in 1948.
2/ Amount disbursed by the Bank, net of repayments totaling $5.15 million. The Bank has granted five loans to India totaling $99 million.
3/ India drew $100 million from the IMF in 1948 and 1949, repaying $36.2 million on March 1, 1954. Another $10.5 million was repaid July 1, 1954.

TABLE 4

Indian Public Foreign Assets 1/

as of March 31, 1954
(In millions of dollars)

Gold	247.0	(£ 88.2 million or	1,176.0 million rupees)
Foreign exchange - Reserve Bank of India	1,581.2	(£564.7 million or	7,529.3 million rupees)
Dollar deposits - Government and banks 2/	79.0	(£ 28.2 million or	376.0 million rupees)
Gold subscription to IMF	27.5	(£ 9.8 million or	130.6 million rupees)
Dollar subscription to International Bank	8.0	(£ 2.9 million or	38.6 million rupees)
Sub-Total	1,942.7	(£693.8 million or	9,250.6 million rupees)
Claim on Burma 3/	54.6	(£19.5 million or	260.0 million rupees)
Claim on Pakistan 4/	n.a.	n.a.	n.a.
TOTAL	n.a.	n.a.	n.a.

Sources: Reserve Bank of India; International Monetary Fund; International Bank for Reconstruction and Development; Indo-Burmese Press Releases.

Conversion rates: £1 = $2.80 = 13-1/3 rupees.

1/ Does not include the value of the pensions annuities purchased from the United Kingdom in 1948. While this is legally a foreign asset so long as the pensions liability has not been discharged, the fact that it is earmarked for a specific purpose gives it a special character. To treat it as a foreign asset would unnecessarily confuse the picture. See Footnote 1 to Table 2.
2/ It is likely that the bulk of this represents the dollar balances of the Government's Supply Mission in the U. S., since dollar balances of Indian banks are probably small, being limited to working balances under Indian exchange control regulations.
3/ Under a settlement announced April 9, 1954, the main portion of the Burmese debt to India arising from separation of the two countries in 1937 is reduced to 200 million rupees. In addition, arrears with respect to the Burmese liability on account of pensions are estimated at 60 million rupees. This does not include the capitalized value of future Burmese payments on account of pensions, for which no estimate is available.
4/ India's claim on Pakistan as a result of partition in 1947. The amount of this claim has not been agreed upon and is partially offset by counter claims being made by Pakistan the amount of which is also under dispute.

TABLE 5

Indian Private Foreign Liabilities and Assets as of June 30, 1948
(In millions of dollars)

	Foreign Business Investments in India						Other Liabil-ities	Total Liabilities		Total Assets	Net Position +Net Liabilities -Net Assets	
	At Book Value			At Market Value								
	Port-folio	Direct	Total	Port-folio	Direct	Total	Total	At Book Value	At Market Value	At Book Value	At Book Value	At Market Value
United Kingdom	123.3	572.3	695.6	163.5	971.8	1,135.3	54.6	750.2	1,189.9	177.2	+573.0	1/
Pakistan	34.1	10.6	44.7	45.0	18.0	63.0	102.8	147.5	165.8	119.8	+ 27.7	1/
Other Sterling Area	24.8	60.7	85.5	32.3	101.8	134.1	41.4	126.9	175.5	229.5	-102.6	1/
United States	3.2	51.1	54.3	4.2	86.9	91.1	22.0	76.3	113.1	25.0	+ 51.3	1/
Canada	3.9	13.4	17.3	5.1	22.8	27.9	.8	18.1	28.7	4.6	+ 13.5	1/
Other countries	12.6	58.5	71.1	16.8	100.2	117.0	12.8	83.9	129.8	34.0	+ 49.9	1/
TOTAL	201.9	766.6	968.5	266.9	1,301.5	1,568.4	234.4	1,202.9	1,802.8	590.2	+612.7	+1,212.6 2/

Source: — Reserve Bank of India, Census of India's Foreign Liabilities and Assets as on June 30, 1948, Bombay, 1950.

1/ The market value of Indian assets abroad by countries is not available, so that the net position at market value cannot be computed for individual countries.

2/ The Reserve Bank states that the total book value of Indian assets abroad approximates the total market value, as market values in some countries exceed book values but fall short of them in others.

Conversion rate: $.30225 per rupee.

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TABLE 6

Indian Balance of Payments, 1948 – 53
(In millions of dollars)

	1948 1/	1949 1/	1950 1/	1951	1952	1953 2/	Total
Exports (f.o.b.)	1,320	1,165	1,168	1,574	1,363	1,115	7,704
Imports (c.i.f.)	1,492	1,801	1,103	1,811	1,559	1,189	8,955
Trade balance	– 172	– 636	+ 65	– 237	– 196	– 74	–1,251
Investment income (net)	– 54	– 49	– 50	– 51	– 23	– 25	– 252
Other invisibles (Excluding official donations)	+ 146	+ 161	+ 127	+ 164	+ 198	+ 181	+ 977
Net goods and services and private donations	– 80	–524	+143	– 124	– 21	+ 82	– 524
Official donations	–	–	+ 4	+ 3	+ 25	+ 37	+ 70
Net current account	– 80	–524	+147	– 121	+ 4	+ 119	– 454
Private capital (business and individuals)	– 47	– 65	– 18	– 5	– 4	– 17	– 156
Long term official capital and banking funds 3/	+ 24	+ 8	+ 18	+ 81	+ 111	– 3	+ 239
Short term foreign official and bank balances in India (net)	+ 36	+ 9	– 19	+ 52	– 82	– 9	– 13
IMF drawings	+ 69	+ 31	–	–	–		+ 100
Barter agreement balances (net)	– 30	+ 28	+ 4	+ 2	– 7	–	– 3
Special transactions	– 858 4/	– 36 5/	–	– 6 6/	– 7 6/	–	– 907
Official foreign exchange and short term Indian bank balances abroad (increase: –)	+1,067	+504	– 43	+ 101	+ 134	– 60	+1,704
Net errors and omissions	– 183	+ 45	– 90	– 104	– 149	– 31	– 510

Source: — International Monetary Fund, Balance of Payments Yearbooks, and International Financial Statistics, June 1954, page 194; Reserve Bank of India, India's Balance of Payments, 1948-51, Bombay 1953.

Conversion rates: 1948 and first three quarters of 1949, $.30225 per rupee; fourth quarter of 1949 and 1950-53, $.21 per rupee. Figures may not add up to totals due to rounding.

1/ Excluding transactions with Pakistan.
2/ Preliminary.
3/ Excludes Indian official holdings of long term securities.
4/ Includes $677 million for purchase of pension annuity from the United Kingdom and $181 million toward acquisition of British Military installations and supplies.
5/ To complete payment on acquisition of British military installations and supplies.
6/ Demonetized Indian currency withdrawn from Aden.

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TABLE 7

Indian Balance of Payments 1948 - 53, by Regions 1/

(In millions of dollars)

	U. S., Canada IMF and IBRD 2/	Sterling area 3/	Rest of World 4/	Total
Exports (f.o.b.)	1,709	4,019	1,976	7,704
Imports (c.i.f.)	2,316 5/	4,232	2,407	8,955
Trade balance	-607	-213	-431	-1,251
Investment income (net)	- 78	-157	- 15	- 252
Other invisibles (excluding official donations)	+ 78	+941	- 42	+ 977
Net goods and services and private donations	-607	+571	-488	- 524
Official donations	+ 58	+ 9	+ 3	+ 70
Net current account	-549	+580	-485	- 454

Sources: — International Monetary Fund, Balance of Payments Yearbooks, and International Financial Statistics, June 1954, page 194; Reserve Bank of India, India's Balance of Payments, 1948-51, Bombay, 1953.

Conversion rates: — 1948 and first three quarters of 1949, $.30225 per rupee; fourth quarter of 1949 and 1950-53, $.21 per rupee.

1/ Data for 1953 are preliminary.
2/ Data for 1948 estimated as follows: Exports assumed at 72 per cent of total hard currency exports (this compares with 69 per cent in 1949 and 75 per cent in 1950); imports assumed at 73 per cent of total hard currency imports (this compares with 70 per cent in 1949 and 77 per cent in 1950); invisibles assumed at 90 per cent of total hard currency invisibles (this compares with 92 per cent in 1949 and 36 per cent in 1950). Data for 1949 derived, using the actual percentages, 69 per cent for exports, 70 per cent for imports, 92 per cent for invisibles.
3/ Data for 1948, 1949, and 1950 do not include transactions with Pakistan.
4/ Derived figures, being the difference between the last column of Table 6 and the first two columns of Table 7.
5/ Includes emergency wheat imports of $190 million under the 1951 U. S. loan.

TABLE 8

Indian Contributions to and Drawings from Sterling Area Dollar Pool 1948-53

(In millions of dollars)

January - December 1948	- 96 1/
January - December 1949	- 69 1/
January - December 1950	+ 71 2/
January - June 1951	+ 18 3/
July - December 1951	- 30 4/
January - June 1952	- 188 4/ 5/
July - December 1952	+ 70 5/
January - June 1953	- 14 5/
July - December 1953	+ 27 6/
Total	- 211

1/ Finance Minister's statement in Parliament, February 5, 1951.
2/ Government of India, White Paper on Budget, 1952 - 53, page 6.
3/ Derived. According to the Eastern Economist, August 21, 1953, page 334, a net drawing of $12 million was recorded for the whole of 1951.
4/ Finance Minister's Budget Speech, February 27, 1953.
5/ Finance Minister's Budget Speech, February 27, 1954.
6/ Finance Ministry press note, March 15, 1954.

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Table 9

Indian Balance of Payments in 1953, by Regions 1/

(In millions of dollars)

	U.S. Canada IMF & IBRD	U.K. and Ireland	Other Sterling area	Total Sterling area	Continental OEEC Countries	Latin American Republics	Rest of world and Unallocated	Total 2/
Exports (f.o.b.)	237	303	288	590	94	48	145	1,115
Imports (c.i.f.)	227	446	205	650	205	1	106	1,189
Trade Balance	+ 10	- 143	+ 83	- 60	- 111	+ 47	+ 39	- 74
Investment income	- 15 3/	- 9	4/	- 9	4/	--	4/	- 25
Other invisibles (excluding official donations)	+ 17	+ 37	+ 115	+ 152	- 5	+ 3	+ 14	+ 181
Net goods and services and private donations	+ 12	- 115	+ 198	+ 83	- 116	+ 50	+ 53	+ 82
Official donations	+ 37	---	4/	4/	4/	—	—	+ 37
Net current account	+ 49	- 115	+ 198	+ 83	- 116	+ 50	+ 53	+ 119

Sources: International Monetary Fund, Balance of Payments Yearbook; Reserve Bank of India Bulletin, May 1954, pages 423 - 424.

1/ Preliminary
2/ Figures may not add up to totals due to rounding.
3/ Includes payment of $3.6 million to the IMF and/or IBRD
4/ Less than $500,000.

Conversion rate: $.21 per rupee.

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