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Inflation In India

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Yves Maroni

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Yves Maroni

Recent press reports indicate that India is seeking a $500 to $600 million loan from the United States to help fill a foreign exchange gap estimated as high as $2 billion over the next three and a half years. This help is said to be needed to implement India's second five-year plan which got underway April 1, 1956.

When put this way, it appears that Indian financial problems will all be solved if only $2 billion in foreign resources can be secured. However, the fact is that India's foreign exchange difficulties reflect very largely an internal financial crisis, the solution to which must come in the first instance from within India itself. The internal problem is one of inflation brought about by the attempt to carry out an ambitious public and private investment program calling for expenditures well in excess of current domestic savings and available foreign resources.

In the last 18 months, wholesale prices, bank credit, and imports have risen sharply and foreign exchange reserves have dropped precipitously as the deterioration spread from the internal position to the balance of international payments.

The inflationary gap, which has resulted from the investment program, is so large that it would be unreasonable to expect that it can be closed entirely by additional foreign assistance. There simply is no source or combination of sources from which external assistance of the magnitude indicated could be found. Even if the sum which India is reportedly seeking from abroad should be forthcoming, there would still remain a sizeable internal gap. Unless this gap is closed, inflationary pressures will continue to stimulate imports and to retard exports so that the external assistance now believed adequate to balance the country's international payments will prove insufficient. Only by stopping internal inflation can the ground be laid for solving the foreign exchange crisis. Once internal financial stability is restored, the foreign exchange gap will no doubt decline and the prospects of raising the large amounts of additional foreign assistance necessary to close the gap will probably improve.

The development program

The Indian second five-year plan originally called for public investment of about $10 billion and private investment of about $5 billion between April 1, 1956, and March 31, 1961.[1] Only about half of the public investment outlay was to be financed from taxes and by borrowing

1/ See my paper, "India's Second Five-Year Plan", May 22, 1956.

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from the public. About $2.5 billion equivalent were to be borrowed from the Reserve Bank of India, about $1.7 billion represented foreign exchange requirements, and the balance was to be raised from the profits of state owned enterprises. Resources available to finance the private investment outlay were only partially indicated and included a substantial dependence on bank credit expansion. Foreign exchange requirements of the private sector were estimated at about $600 million.

It was later estimated that the public investment program would cost $1.5-$2 billion more than originally planned. This was the result of price increases, inclusion of additional projects and correction of certain underestimated items. Chief among the latter was an upward revision of the foreign exchange requirements by $840 million. In spite of this revision, the foreign exchange cost of the public investment program was estimated at only about 21.5 per cent of the total, and probably remained grossly understated.1/

The balance of payments deficit on current account for the five-year period of the plan was originally estimated at about $2.3 billion, but this was later raised to $3.15 billion. It was planned to draw down the foreign exchange holdings by $420 million and to obtain the balance of more than $2.7 billion from abroad as loans or grants from foreign governments or international organizations, and as foreign private investment.

From the outset, there were doubts as to whether the available resources would be adequate to finance the plan. It appeared unlikely that the yield of taxation, borrowing from the public, and profits of state owned enterprises would be as large as assumed. The foreign exchange requirements, even at their apparently underestimated level, seemed well above what might reasonably be expected to be available from abroad. If these doubts should become realized, borrowing from the Reserve Bank would have to be larger than planned. Even the planned amount of such borrowing seemed certain to generate inflation.

At the same time, the objectives which the plan aimed to achieve seemed relatively modest. The proposed overall outlay was expected in five years to raise national income by 25 per cent, to increase per capita income by 16 per cent, and to create only about as many new jobs as there would probably be new entrants to the labor force. No attempt was to be made in this plan to reduce the large amount of unemployment and underemployment which have plagued India for a long time. The relatively modest nature of these objectives was given as a justification for disregarding the warnings about the financial feasibility of the plan.

1/ The import content of development programs of underdeveloped countries has frequently been around 50 per cent of the total cost of the program. In Burma, it was as high as 66 per cent of the total.

While these objectives might have been sought with a somewhat smaller outlay, the Indian authorities desired to lay the basis for future development by making a special effort to expand heavy industry. Since this did not involve the creation of much additional employment in relation to the outlay involved, it was decided to stress handicraft and small scale production of consumer goods, at the expense of factory production of these goods, in the belief that this would make up the deficiency in job creation. Both of these decisions had the effect of raising the outlay needed to bring forth the desired addition in total output.

Internal inflationary pressures

As had been feared, the attempt to carry out this plan and the resulting boom in private investment and consumption brought on a sharp increase in inflationary pressures. The public investment program extended and intensified the public investment activities of the first five year plan. It continued and magnified the budget deficits which had begun to grow in the latter part of the first five year plan and which were increasingly financed by borrowing from the Reserve Bank of India. As shown in table 1 below, the inflationary impact of Government

Table 1

Inflationary Impact of Government Operations in India since 1953 1/
(In million dollars equivalent)

	1953	1954	1955	1956	1957 2/
Reserve Bank credit to Government	-81.5	- 2.9	+228.5	+566.2	2/
Scheduled bank holdings of Government securities	+26.9	+ 25.0	+ 78.1	- 42.8	2/
Other bank claims on Government	+ 1.9	+ 4.6	+ 12.2	+ 3.6	2/
Government currency circulation	- 6.3	- 4.2	+ 12.6	- 4.8	2/
Government rupee balances 3/	+97.4	+122.6	+ 14.7	- 6.5	2/
Net inflationary impact	+38.4	+145.1	+346.1	+515.5	+910.0 2/

Source: Reserve Bank India Bulletin (various issues)

1/ Change measured from figures as of last friday of year.
2/ Estimated annual rate for the first half, derived by applying to the level of December 1956 the percentage increase actually incurred between June 1956 and June 1957. No estimate made of components, but Reserve Bank credit to the Government was probably increasing at a rate of $950-$1,000 million.
3/ Increase: - ; decrease : + .

activities, which was negligible in 1953, grew sharply each year thereafter until, in the first half of 1957, it was at an annual rate of $910 million equivalent, about 75 per cent larger than the 1956 rate, more than two and a half times the 1955 rate, and more than six times the 1954 rate.

The resulting increase in money incomes generated a rise in effective demand on the part of the private sector, which added fuel to the fire. While time deposits increased, there was an even greater rise in private bank credit, particularly since the end of 1955. Wholesale prices, which had been declining moderately in 1954 and the first half of 1955, turned up in June of that year and rose 23 per cent in the ensuing 18 months. After levelling off in the first four months of 1957, they resumed their rise in May. Industrial production, which had risen about 40 per cent in the first five year plan, continued to rise and, in the second quarter of 1957, averaged about 58 per cent more than in 1951.

External strains

The most spectacular manifestation of the rise in effective demand was the sharp increase in imports shown in table 2. In the first

Table 2

Indian Foreign Trade 1954-57

Quarters	Exports		Imports		Trade balance (In millions of rupees)
	Value (In millions of rupees)	Percentage change from same quarter of previous year	Value (In millions of rupees)	Percentage change from same quarter of previous year	
1954 - I	1,319	- .5	1,321	- 1.0	- 2
II	1,134	- 5.2	1,520	- 7.9	- 386
III	1,434	+10.0	1,595	+ 7.3	- 161
IV	1,740	+16.9	1,740	+40.2	0
1955 - I	1,628	+23.4	1,709	+29.4	- 81
II	1,325	+16.8	1,624	+ 6.8	- 299
III	1,611	+12.3	1,581	- .9	+ 30
IV	1,513	-13.0	1,815	+ 4.3	- 302
1956 - I	1,645	+ 1.0	2,028	+18.7	- 383
II	1,316	- .7	1,917	+18.0	- 601
III	1,423	-11.7	2,101	+32.9	- 677
IV	1,658	+ 9.6	2,101	+15.7	- 443
1957 - I	1,617	- 1.7	2,358	+16.3	- 741
II	1,490	+13.2	2,614	+36.3	-1,124

Source: International Financial Statistics

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half of 1957, the annual rate of imports was about 47 per cent higher than in the first half of 1955. At the same time, exports showed almost no gain above the levels of 1955. The result was a severe deterioration of the balance of payments position which had been one of approximate equilibrium in 1953, 1954, and 1955.

Between April 1, 1956 and June 30, 1957, India's foreign exchange reserves were in fact drawn down by about $614 million, nearly 50 per cent more than the amount which was to have been drawn in 5 years.1/ In addition, India drew $200 million from the International Monetary Fund. Other assistance from abroad in this 15 month period totalled about $350 million, including about $52 million drawn on International Bank loans, about $92 million in the form of U. S. aid, and an estimated $180 million representing the value of shipments of U. S. agricultural commodities under a PL 480 agreement.2/ While the PL 480 shipments were intended to build up stocks, it is reported that they were in fact in large measure put on the market to fight rising food prices, indicating that imports of this amount might well have had to be made against payment in foreign exchange, had there been no PL 480 agreement.

A small part of the $1,165 million which these resources represent was used to repurchase rupees drawn from the IMF in 1948 and 1949 and to make repayments on IBRD loans. Figures concerning movements of private capital and of banking funds are lacking and the past record is a poor indicator of the direction in which these funds may have been flowing in 1956 and 1957. However, these movements have been rather small in the past and even if they increased in 1956-57, they could not have accounted for more than a small part of the foreign resources listed above.

As shown in table 3 on the following page, these figures suggest that the balance of payments deficit on current account for the 15 months involved may have been as high as about $1,150 million but probably was somewhat smaller. However, it is likely that it was at least $1,050 million. At this rate, the deficit over the five-year period of the plan would total between $4.2 billion and $4.6 billion, nearly twice the original estimate of the deficit of $2.3 billion and nearly 50 per cent more than the revised estimate of $3.15 billion.

1/ Another $213 million was drawn down in July, August, and September 1957.
2/ PL 480 provides for the disposal of U. S. surplus agricultural commodities. Under Title I of this law, these commodities may be sold for foreign currencies. The United States reserves some of the proceeds of such sales for its own uses and makes the rest available to the foreign country partly as a loan and partly as a grant. Under a Title I agreement signed in August 1956, the U. S. is providing India with agricultural commodities valued at $360.1 million over a three year period. Of the rupees paid by India, $72 million equivalent is reserved for U. S. uses, $234 million equivalent is to be loaned to India and the balance given to India as a grant for development.

Table 3

Means of Financing Indian Balance of Payments
Deficit on Current Account
April 1956 - June 1957
(In million dollars equivalent)

Use of reserves		$ 614.0
IMF drawing		200.0
Other foreign assistance		
Drawings on IBRD loans	51.8	
US aid	91.8	
PL 480 shipments (estimated)	180.0	
Colombo Plan aid	11.4	
Norwegian aid	.2	
Drawings on Soviet steel plant loan	15.6	
		350.8
		1,164.8
Less: Repurchase of rupees from IMF	12.5	
Repayments of IBRD loans	4.8	
		17.3
Net official financing		1,147.5
Less: Net movement of private capital and banking funds[1]		n.a.
Net current account deficit (upper limit)		1,147.5[2]

1/ Direction varies from year to year. Net outflow indicated in 1956-57. Its magnitude is unlikely to have exceeded $100 million.
2/ Using estimate made in above footnote, net deficit would be $1,047.5 million.

The bulk of the increase in imports represented sharply stepped up deliveries of machinery, metals, and metal products. In 1956, these amounted to $650 million, or 38 per cent of total imports, compared to $393 million, or 28 per cent of total imports in 1955. Imports of all other manufactured goods were $85 million larger in 1956 than in 1955, but food, beverage, and tobacco imports were $76 million lower,[1] and raw material imports showed only a small increase.

Nearly 80 per cent of India's payments for imports in 1956 and the first half of 1957 were on private account, and payments for private imports accounted for more than half of the increase in import payments between 1955 and 1956. However, many products which were privately imported were used for public investment, so that these figures exaggerate the importance of purely private activity in initiating the import boom. Nevertheless, the role of private investment was probably significant. In part, it took the form of inventory accumulation which is known to have occurred on a large scale.

The rise of private imports, whether for public or private use or for inventory accumulation, was aided greatly by bank credit expansion. Bank advances secured by iron, steel and engineering products rose from 509 million rupees ($107 million) in June 1956 to 874 million rupees ($184 million) a year later. However, the increase in demand for credit was not limited to the capital goods field. Advances against cotton textiles, other manufactured products, and industrial raw materials also recorded large increases.

Monetary policy

In the face of mounting inflationary pressures and particularly the growing demand for bank credit, the Reserve Bank of India increased its lending rates four times between March 1956 and May 1957. In addition, it adopted measures of selective credit restraint aimed at discouraging speculation in foodgrains, sugar, and, for a short time, cotton textiles. Specifically, with respect to advances against these commodities, it undertook to regulate the maximum percentage of the value of the collateral which banks would be allowed to lend and fixed ceilings on the total of such loans as well as on individual advances. The first regulation of this nature, applying to advances against rice and paddy, was issued in May 1956. A similar measure, applying to advances against other foodgrains and against cotton textiles, was adopted in September 1956. The May regulation was cancelled in November, but was introduced again in February 1957 with a lower ceiling provision. Cotton textiles were exempted from the regulation in February 1957, but the restrictions applying to advances against foodgrains were tightened in June and advances against sugar were brought under regulation shortly thereafter.

1/ PL 480 shipments did not begin to arrive until November 1956.

At the present time, each bank is directed not to lend against foodgrains more than 60 per cent of the value of the collateral. Against sugar, banks may not lend more than 65 per cent of the value of the collateral. In addition, each bank must hold its advances against paddy and rice each week to not more than 66 2/3 per cent of the level of the corresponding week of 1956. For advances against other foodgrains, the ceiling is 75 per cent of such level and for advances against sugar it is 110 per cent of such level.

At the end of August 1957, loans and advances of scheduled banks were 17 per cent higher than a year earlier, 41 per cent higher than two years earlier. Advances against foodgrains remained above the levels to which banks have been instructed to reduce them. To bring about a greater degree of compliance with the regulations, the Governor of the Reserve Bank asked the banks on August 22 to reduce the overall level of advances by 10 per cent by mid-October from the level of early August. The summer is normally a period of seasonal contraction of bank credit and a decline of about 5 per cent was about all that appeared likely to occur in these two months. However, the number of banks in India is large and many banks may decide that they are too small to have an appreciable influence over the overall level of credit outstanding and can therefore safely ignore the Governor's request. If this attitude is widespread, the desired reduction in advances will fail to materialize.

Further, the banks have not been urged to reduce those advances which have risen the most, such as advances against capital goods, industrial raw materials, and manufactured products. They have been told, rather, that excessive bank credit against foodgrains has made possible speculative activity in food articles, and that this has brought about increased food prices. They have been advised not to interfere with the growth of production which advances against capital goods are facilitating.

The weakness of this approach lies in the fact that rising food prices may be explained not only by speculation aided by excessive advances against foodgrains but also, and more importantly, by increased consumption stimulated by the rise in investment spending, both public and private. Advances against foodgrains represent only about 5 per cent of total bank credit, whereas advances against capital goods, industrial raw materials, and manufactured products account for nearly 60 per cent of the total. Moreover, it is the last named group of advances which accounts for the bulk of the increase in bank credit. The growth of public and private investment spending financed by this expansion of credit and by the rise in Reserve Bank advances to the Government has boosted consumers' incomes and stimulated consumption. Under the circumstances, selective credit restraints intended to curb speculation in foodgrains fail to get at the root of the problem. Since the consumers cannot be prevented from attempting to spend their increased incomes, a policy of preventing the growth of such incomes from outstripping the rise in production would seem to have been appropriate.

The Reserve Bank's four successive increases in its lending rates in 1956 and 1957 were to some extent intended to accomplish this purpose. They did bring about some tightening of the money markets. However, the liquidity of banks was never so strained as to retard significantly the growth of advances. In part, this is because the growing recourse by the Government to borrowing from the Reserve Bank bolstered bank liquidity at an increasing rate. But in addition, the Reserve Bank extended credit to the banks. From a seasonal peak of 463 million rupees at the end of March 1955, the Reserve Bank's advances to banks rose to 767 million rupees in March 1956 and 1,268 million rupees in March 1957. It may be calculated that this 805 million rupee increase in two years provided the basis for an expansion of credit of 1,187 million rupees,1/ more than 40 per cent of the 2,839 million rupee increase which actually occurred in these two years. While the Reserve Bank may have been unable to prevent its advances to the Government from rising by more than 4.7 billion rupees in this period, it had the power to be less liberal in its policy toward banks.

1/ The calculation is based on these facts: for several years, about two-thirds of additions to money supply each year have taken the form of currency, and about a third has been in bank deposits. For scheduled banks each year in the last several years, about 60 per cent of additions to bank deposits have been in demand deposits and about 40 per cent in time deposits. Scheduled banks are required to maintain balances at the Reserve Bank equal to 5 per cent of demand liabilities and 2 per cent of time liabilities. Given the 60-40 ratio of demand and time deposits, this means that the effective overall reserve ratio for scheduled banks is about 3.8 per cent. For cooperative banks, the effective overall reserve ratio works out at about 1.7 per cent. The rise in Reserve Bank credit of 805 million rupees in two years may be broken down into a 661 million rise in credit to scheduled banks and a 144 million rise in credit to cooperative banks. Given these facts, the expansion coefficient, A, is calculated as follows:

$$A = \frac{1}{1-(1-R)x(1-C)}$$

where R is the applicable reserve ratio and C is the percentage of leakage through increased currency circulation. On this basis, the expansion coefficient for scheduled banks is 1.465. For cooperative banks it is 1.48. The expansion works out at 1.465 x 661 + 1.48 x 144 = 1187 million rupees.

The budget for 1957-58

The 1957-58 budget of the Central and State Governments combined, shown in table 4 on the following page, calls for total expenditures of nearly 19.9 billion rupees (about $4,168 million) and total revenues of about 12.8 billion rupees (about $2,680 million). Expenditures are more than 21 per cent higher than in the previous year, while revenues are about 20 per cent higher. The deficit, at about 7.1 billion rupees (about $1,487 million), is more than 22 per cent larger than last year.

The bulk of the increase in expenditures represents a 23 per cent increase in outlays on the public investment program. These outlays account for about 62 per cent of total budgeted expenditures. National defense expenditures also show a rise of 23 per cent above the level of last year, while other expenditures are nearly 15 per cent higher.

The budget of the Central Government makes a courageous attempt to find new resources to finance these expenditures. It raises a number of excise and import duties, increases the corporate income tax rate, cuts sharply the exemption level on the personal income tax, and introduces a new super tax on incomes, a wealth tax, and a personal expenditure tax. Several of the state budgets also raise a variety of taxes. The yield of this additional taxation is estimated at 1,022.8 million rupees (about $214.8 million) in the current year. In spite of this, revenues are budgeted at only about 64 per cent of total expenditures, roughly the same as last year.

Funds are required not only to finance the deficit but also to finance the lending activities of the Central and State Governments. The total amount required is nearly 18 per cent larger than last year. It is planned to raise about 58 per cent of it by non-inflationary means, i.e., by borrowing from the public and from foreign countries and international organizations, through foreign grants, and by utilizing the net receipts of miscellaneous funds and accounts. The balance is to be raised mainly by borrowing from the Reserve Bank of India, but also by utilizing cash balances and issuing a small amount of government currency. The amount to be obtained by these inflationary means of financing is more than 22 per cent greater than last year, while the amount of non-inflationary financing is more than 14 per cent larger.

About half of the inflationary financing planned for the fiscal year which began April 1 had already occurred by the end of June, somewhat more than the seasonal pattern of recent years seems to call for. Indications are that the July-September quarter showed only a moderate use of inflationary financing, but this is in accordance with the usual seasonal pattern. The next two quarters are normally those when the bulk of the inflationary financing occurs and it remains to be seen whether reliance on this type of financing can be held within the limit set in the budget.

Table 4

Combined Budgets of the Central and State Governments
1956-57 and 1957-58

	1956-57 1/		1957-58		Percentage change
	(In millions of rupees)	% of total	(In millions of rupees)	% of total	
Revenue					
Taxes 2/	8,485.1	80	9,986.8	78	+ 17.7
Net profits of public enterprises	650.5	6	774.5	6	+ 19.1
Administrative receipts	848.7	8	1,348.7	11	+ 58.9
Other revenue	623.1	6	652.5	5	+ 4.7
	10,607.4	100	12,762.5	100	+ 20.3
Expenditure					
Economic development 3/	10,029.5	61	12,358.8	62	+ 23.2
Defense	2,243.1	14	2,762.6	14	+ 23.1
Other	4,120.3	25	4,724.5	24	+ 14.7
	16,392.9	100	19,845.9	100	+ 21.1
Financing requirements					
Deficit (per above)	5,785.5	83	7,083.4	87	+ 22.4
Loans to others (net) 4/	1,167.6	17	1,091.5	13	- 6.5
	6,953.1	100	8,174.9	100	+ 17.6
Means of financing					
Borrowing from public (net)	2,442.1	35	2,520.2	31	+ 3.2
Foreign borrowing (net) 5/	278.1	4	1,030.4	12	+270.5
Foreign grants	348.4	5	396.7	5	+ 13.9
Net receipts of miscellaneous funds and accounts	1,098.5	16	815.0	10	- 25.8
Total non-inflationary financing	4,167.1	60	4,762.3	58	+ 14.3
Inflationary financing 6/	2,786.0	40	3,412.6	42	+ 22.5
	6,953.1	100	8,174.9	100	+ 17.6

Sources: Reserve Bank of India, Report on Currency and Finance, 1956-57, pp. 169-173; Reserve Bank of India Bulletin, August 1957, pp. 732-750.

1/ Revised estimates for Central Government combined with budget estimates for State Governments.

2/ Adjusted to reflect the effect of tax proposals.

3/ Adjusted to eliminate the discrepancy between "assistance from Central Government" as claimed by the States and "assistance to State Governments" as acknowledged by the Central Government.

4/ Loans to port trusts, municipalities, private and public enterprises, and foreign countries, much of it for economic development.

5/ Includes borrowings from the USSR of 74.5 million rupees in 1956-57 and 360 million rupees in 1957-58. The amount shown in the table for 1957-58 also includes 550 million rupees to be borrowed in rupees from the United States under PL 480.

6/ Borrowing from the Reserve Bank of India, utilization of cash balances, and issue of government currency, the total being adjusted to take account of the effect of tax proposals.

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This analysis suggests that inflationary pressures generated by the budgets of the Central and State Governments are continuing to increase. The resulting additions to bank liquidity will make possible a continuation of the expansion of bank credit, unless monetary restraints are tightened considerably. Reserve requirements for commercial banks currently are 5 per cent of demand liabilities and 2 per cent of time liabilities. Excess reserves of banks, which showed a tendency to increase in the last six months, were about 3 per cent of deposits at the end of September. The Reserve Bank has the power to raise minimum reserve requirements up to 20 per cent of demand liabilities and 5 per cent of time liabilities and it may impose still higher reserve requirements on weekly increases in such liabilities. It has also a varied arsenal of selective credit instruments. Whether it acts to curb the expansion of credit would seem to depend on whether it is decided to slow down the private investment boom which has so far apparently been allowed to develop without interference.

Balance of payments prospects

While much of the inflationary pressures generated by the budget and by the expansion of bank credit during the last 18 months have been absorbed by the deterioration of the balance of payments, this cannot continue much longer, at least not to the extent of the last 18 months. The country's foreign exchange reserves fell below the statutory requirement of 4 billion rupees ($840 million) in early August 1957 and an act of Parliament would be necessary to allow them to fall below 3 billion rupees ($630 million). The danger of shaking public confidence through Parliamentary debates and the need to maintain minimum working balances close to this level are strong deterrents to further use of reserves to finance the balance of payments deficit. In recent months, import restrictions have been tightened drastically in the hope of avoiding the question, or at least of postponing the issue. However, this will merely increase the impact of the inflationary pressures on the domestic economy, with such delay as the existence of large inventories and a swollen pipeline of imports may make possible.

As indicated earlier, the overall balance of payments deficit for the five year period of the plan was estimated by the Indian authorities at about $3.15 billion. At this rate, the balance of payments deficit for the last 45 months of the plan would amount to about $2.4 billion. However, the deficit likely to be incurred in this period if the plan remains substantially unchanged should be expected to be larger than this, to the extent to which internal inflationary pressures continue to add to the balance of payments strains resulting from the foreign exchange costs inherent in the plan itself. The recent tightening of import restrictions should repress this impact somewhat, but it cannot completely eliminate it, partly because of the pipeline of imports which remain to be delivered against licenses issued prior to the announcement of the new restrictions and partly because of the impossibility of devising restrictive measures which will completely and exactly accomplish this objective without error. As a rough guess, it may be assumed that the secondary impact of inflation on the balance of payments will add $400 million to the planned deficit in the last 45 months of the plan. On this basis, the balance of payments deficit of India in this period may be about $2.8 billion.

In addition, foreign exchange will be required for the repayment of international debts previously incurred and newly created and to finance other movements of capital. In the last 45 months of the plan period, India will have to provide for rising repayments of IBRD loans, amortization of the 1951 United States wheat loan of $190 million (due to begin this year) as well as servicing of special credits currently being extended to India to expand its steel industry. The $200 million drawing from the International Monetary Fund which took place this year is to be repaid in three to five years. Even if no repayment to the Fund occurs in these 45 months, debt repayment may require about $100 million in this period. Account must also be taken of an Indian loan of $42 million to Burma. Half of it was disbursed in August 1957 and the balance is due to be disbursed next year. Net movements of private capital are likely to remain small, as liquidation of foreign investments continues to be roughly offset by new foreign investments in kind.

This suggests that India's total foreign exchange requirements in the last 45 months of the plan may be as large as $3 billion. Against this, India may count on about $900 million, representing the unutilized balance as of June 30 of grant and loan assistance already allocated to India by foreign governments, international organizations, and other foreign sources, as shown in table 5 on the following page. Thirty-five per cent of this aid has been promised by the United States, 30 per cent by the Soviet bloc countries, 22 per cent by the IBRD, 8 per cent by the United Kingdom, and 4 per cent by Canada, Australia, New Zealand, Norway, and the United Nations and its agencies. The balance of about $2 billion is the uncovered foreign exchange gap which continued implementation of the plan substantially in the form in which it was drawn would involve.

Conclusion

It would not be appropriate in this paper to discuss in detail India's prospects of raising $2 billion in foreign resources over the next three and a half years or of obtaining the $500-$600 million loan reportedly being sought from the United States. Suffice it to say that the mood of the United States Congress, reflected by its recent cuts of the foreign aid requests of the President, does not give grounds for optimism on this score. In addition, a number of countries which might otherwise help are today fighting inflation and are therefore not likely to look favorably upon a request which would intensify their inflationary problems. Finally, even if $2 billion can be raised abroad over the next three and a half years, the plan will still contain a large internal gap which will have to be covered by borrowing from the Reserve Bank. The inflationary pressures resulting from this financing cast doubt about India's ability to manage its affairs in such a way as to create the means of repayment of any additional external debt.

By cutting back or stretching out the plan, the Indian authorities probably could bring inflationary pressures down to the level where they can be managed, at the same time reducing the need for external assistance.

Table 5

Foreign Assistance to India August 1947 - June 1957
(In millions of dollars)

	Allocations	Receipts	Undisbursed as of June 30, 1957
US aid program	399.7	263.7	136.0
US wheat loan (1951)	190.0	190.0	----
PL 480 - Title I	360.1	180.0 6/	180.1 6/
PL 480 - Title II	5.1	4.7	.4
Total US	954.9	638.4	316.5
IMF drawings 1/	300.0	300.0	----
IBRD loans 2/	323.8	122.8	201.0
UN and its agencies	1.3	1.0	.3
Canada, Australia, New Zealand	100.0	64.8	35.2
Norway	1.4	.5	.9
Germany	5/	5/	5/
United Kingdom 3/	74.2	----	74.2
USSR loans 4/	258.3	15.6	242.7
Other Soviet bloc loans	31.0	----	31.0
Total	2,044.9	1,143.1	901.8

1/ Includes a $100 million drawing which took place in 1948-49 and was fully repaid by April 1956.

2/ Includes a $90 million loan granted in July 1957. Repayments through June 30, 1957, total $23.1 million.

3/ Includes $42 million equivalent to be loaned by the British Government and $32.2 million equivalent to be loaned by a consortium of British banks, as the British contribution to the Durgapur steel plant.

4/ Includes $132.3 million as the Soviet credit toward construction of the Bilhai steel plant.

5/ In 1953, German private investors agreed to invest as much as $20 million equivalent in the capital of the Rourkela steel plant. According to the Indian Government's Explanatory Memorandum on the Budget for 1957-58, p. 147, "in order to make the company an 100 per cent Government concern, it has been decided to purchase the 20 per cent share held by the German firm."

6/ Partly estimated.

If they did this their prospects of raising large sums abroad would no doubt improve, since restoration of internal financial stability would enhance their ability to repay additional external debt.

Such a course would postpone the day when some of the targets embodied in the plan could be reached and require that India resign itself to a slower rate of progress than had been hoped for. This would be a bitter disappointment for the Indian people who have long had an extremely low level of per capita income and who aspire to raise it rapidly. However, internal inflation and the foreign exchange shortage are making it quite unlikely that the desired rate of progress, in real terms, can be reached under the plan as presently drawn. Under these circumstances, the sacrifice involved in cutting back or stretching out the plan may be more imaginary than real and failure to adopt this course may lead to even more painful consequences. By persisting in the attempt to implement the plan and inflicting further doses of inflation on the country, combined perhaps with an intensification of Government controls over the economy, the authorities may fail to reach even the real rate of progress which might be attained under conditions of financial stability. If this should happen it would be more costly than the psychological sacrifice involved in recognizing that the desired rate of progress is unattainable and in accepting a slower but attainable rate.

The experience of other countries with efforts to reduce or stretch out investment plans suggests that it may take a year to enforce program cuts once they are decided on. This is largely because of outstanding commitments which cannot be altered. Even if the Indian authorities decide soon to make the necessary readjustments, the foreign exchange crisis is likely to deepen before equilibrium can be restored.