CHAPTER VI
CHAPTER VI

CAPITAL FORMATION AND FOREIGN CAPITAL IN INDIA

Capital resources are required to enable a developing nation to use its human and material resources more effectively and to gain access to the benefits of the constant revolution in technology and processes of economic development. But shortage of domestic capital compelled India to bank upon foreign capital which it accepted in the forms of external aid as well as private foreign investments. Consequently foreign capital became a major supplement to the mobilisation of India's domestic capital. It helps to avoid the foreign exchange constraints in the short-run, and to accelerate the growth of the country in the long run. Foreign capital also brings with it technological skill and the latest types of machinery, equipments, instruments and tools and opens new horizons of foreign market through its infra-structural development.
A study of the inflow of foreign capital entails a detailed examination of the volume of the transfer of capital from international organisations and private entrepreneurs, the impact of such capital on domestic capital and the influence of bilateral and multilateral trade agreements, which, when mixed in varying proportions, promote development in a low income country like India. Inflow of aid resources in India has made a very substantial contribution to Indian growth and industrialisation, by permitting higher investment levels and better utilisation of capacity than would otherwise have been possible and also by relieving the foreign exchange constraints and assisting the very rapid build-up of infrastructure.

The capital inflow from international organisations includes donations and long-term loans in cash or in kind. The main exception to this definition is that donations and loans which are specifically related to the defence of the recipient country are excluded. Prof. Rosenstein-Rodan

1. UN, ESCOR, 24th Session, Annexes, Agenda Item 6 (Geneva), 1957, p.24.
appears to be correct in his view:

"The purpose of (external) aid is to accelerate the economic development of these countries up to a point where a satisfactory rate of growth can be achieved on a self-sustaining basis. The overall aim of development aid is not to equalise incomes in different countries, but to provide every country with an opportunity to achieve steady growth." ²

Determination of the Requirements of Foreign Resources

As a matter of general practice, there are two methods for determining the foreign resource requirements of a developing country. They are:

(1) the investment gap approach; and

(2) the balance of payments approach.

The rate of economic growth and the extent of mobilisation and utilisation of resources through the mechanism of savings and investment will determine the internal investment gap. In the initial stage of the process of development, the savings-investment gaps are likely to be greater, but are likely to decline in the later stage of the development. The Planning Commission of India similarly made it clear

in the following words:

"India has a programme of development larger than can be financed from the resources internally available.... There will, however, still remain certain shortages which would tend to restrain the whole pace of development, and it is in meeting these that external resources can be of help."

Thus the pattern of financing the Five Year Plans reveals a growing gap between investment and domestic savings which has necessitated reliance on external assistance. How this investment-saving gap will have to be filled in by foreign capital can be seen by an example. To achieve 6% rate of growth with the population increasing at an annual rate of 2.5% and assuming the average capital-output ratio for the economy as a whole to be 3:1, the rate of investment required shall be 18%, as against the present rate of saving of 10.4% at the end of the Third Plan and about 8% between 1966-67 and 1968-69. The possibility

3. Planning Commission, India, First Plan, p.27.

4. C.N. Vakil and P.R. Brahmananda, Planning for an Expanding Economy: Accumulation, Employment and Technical Progress in Underdeveloped Countries (Bombay), 1956, p.49. Professors Vakil and Brahmanand have evolved their own model thus: Rate of Growth of Income = A X B - P (where A = Average Productivity of Capital or the inverse of the capital-output ratio; B = Ratio of Savings to Income in a particular period or S; P = the modified version of Harrod-Domar model.

5. See for details TABLE 5, Chapter V, p.186.
of mobilising it internally is not altogether impossible if the society prepares to accept rigid discipline of hard living with a view to ensure maximum saving and hence investment as had been done by Soviet Union, Yugoslavia, Japan, etc. In Indian economy, with an unequal distribution of wealth and disguised unemployment and with relatively more individual freedom under democratic constitution, it shall be very difficult, if not impossible, to force savings beyond certain limits. And if the economy is not able to raise its domestic savings to the extent of planned investment to achieve the targets of economic growth, it has to depend upon foreign capital to supplement domestic savings. An alternative to foreign capital will either be slower growth that might prove politically dangerous and economically not enough to meet the 'revolution of rising expectations', or more rigid controls over consumption that might not be feasible under the present situation.

Secondly, a country aspiring for speedier economic growth based on rapid industrialisation will need foreign economic assistance to meet the balance of payment gap which is bound to occur with the increased volume of development-oriented and other imports of machinery, raw materials and technical know-how. The UN Economic and Social Council at
its XXXVII Session observed:

"The experience of the developing countries has shown that import component of capital formation is high and in many countries the ratio of import of capital goods and materials for capital goods to gross capital formation has increased steadily, accounting for over 40% in many countries in recent years. The foreign exchange component of planned outlays shows a tendency to exceed 30% in many countries. These proportions increased substantially when data are confined to capital formation in the industrial sector."

As regards the acquisition of industrial equipment for manufacturing industries, the magnitude of imports was quite large. The domestic production was initially negligible, but was expected to rise with the passage of time. According to the UN Economic and Social Council,

"It has also been estimated that the acquisition of industrial equipment for manufacturing industries by all the developing countries accounted for $3,200 million in 1958. These countries produced $200 million of these requirements and the remainder ($3,000 million) was covered by import of capital goods from the developed countries. The projected needs in 1975 show a rise to the level of $8,000 million a year and it is expected that developing countries will be able to produce domestically about one fourth of the above needs."

It is important to mention that the higher ratio of capital goods imports to their total imports has been emphasised by

6. UN, ESCOR. XXXVII Session, Annexes, Agenda Item 10 (Geneva), 1964, p.7.
the developing countries, which has been primarily attained by a reduction in the importation of consumer goods rather than through an increase in the overall level of imports. Thus slowly but steadily, the developing countries will be able to attain the full stage of industrialisation, for which, initially the role of foreign capital for capital formation is vital and indispensable. In fact, increase in the rate of capital formation in several countries was to a large extent financed by the inflow of such saving from abroad. It has been stated that out of average 8% total net saving in India during the period 1950-59, 1% of it came from foreign sources.

Foreign saving thus not only supplemented saving for capital formation, it also provided much needed foreign exchange to finance the import of capital goods required for industrial development, apart from providing local capital for investment, as in the case of loans and donations from counterpart funds generated by the sale of PL 480 commodities. The rate of fixed capital formation, meagre as it is in comparison with India's needs, would have been still much less but for the transfer of foreign

8. UN, Department of Economic and Social Affairs, World Economic Survey, 1960, p.61.
savings. Capital formation in India and in other developing countries was in a large part financed by their current account deficits, which enabled them to import foreign goods and services to a much greater extent than could be financed from their own earning from exports of goods and services, and these deficits were mostly covered by foreign assistance. Foreign capital provides the channel through which surplus savings can be profitably pumped out, thereby minimising the possibility of a depression or stagnation. It may be further pointed out that foreign aid offered by governments in the form of commodity assistance has also similar effects on the economy of the lending country. Under these circumstances, the UN maintained that without the use of external resources, the government must either restrict its development programme or divert internal resources to development work by cutting down the standard of living. Similarly, the Cairo declaration on the subject of economic aid for development affirmed 'its support for international aid based on mutual respect and economic benefit.' However,


10. UN, ESCOR, 34th Session, Annexes, p.63.
Divergent opinions prevail with regard to the acceptance of the foreign aid which would have to be given a balanced thought. K.M. Kurian's observation is quite apt in this regard:

"Opinions vary between the extreme positions of unconditional welcome to dogmatic opposition to foreign capital in all its forms and manifestations. Some people accept it as a panacea for the chronic ailments of backward economies, while others tolerate it as a palliative."

Thus some regard the international capital movements as the 'prime movers' of economic progress, which appears to be exorbitantly high weightage to the role of foreign capital. The truth of the matter appears to be that while foreign capital has given the external stimuli to internal growth, the 'prime movers' of economic development have always been the capacity of a country to raise its domestic capital resources. Indeed the external and domestic aspects of development financing are closely interrelated.


Uses of Foreign Capital

Foreign capital can ensure the optimal use of the domestic resources so that investments are made into fields of high priority. It will thus facilitate capital formation in the country. As the First Five Year Plan states:

"In view of the fact that the investment of foreign capital necessitates the utilisation of indigenous resources and also that the best use of foreign capital is as a catalytic agent for drawing forth larger resources for domestic investment, it is desirable that such investment should be channelled into fields of high priority."

It has to be borne in mind that inflow of foreign capital involves a recurring foreign exchange drain in the form of profits or interest charges and capital repatriations. It is, therefore, essential that foreign investment, by and large, takes place in those industries which would result either in a direct saving of foreign exchange through import substitution or by enhancement of export receipts. It is essential that in order to import for our development, a surplus of production over consumption has ultimately to be created so that a certain portion of that surplus could be directed into the export channels. The receipt of foreign aid

to ease the imbalances are only a temporary expedients and it is to be obtained in adequate quantity initially only to achieve major object of its own liquidation. Thus development to be enduring should not be exotic but should come from within. In this measure, foreign aid at best can supplement and not supplant national effort.

**Foreign Aid and Five Year Plans**

The role of foreign aid in India’s Five Year Plans has been well recognised. The impressive industrial structure which has been built up needs a large volume of imports which it is not possible to provide out of export earnings in the initial stages.

The First Five Year Plan recognised the role of external assistance that it will 'supplement the real resources of the country with commodities for which additional demands will be generated in the process of development but for which the domestic supplies are limited.'

In the Second Plan, it was significantly stated that 'the foreign exchange requirements of the Second Five

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Year Plan are large, and had also stressed on domestic savings along with external resources. The Third Five Year Plan vividly describes the importance of external assistance in the following words:

"In the transitional period, the effort to develop the basic and heavy industries and machine-building capacity, without which the growth of the national economy would itself be retarded, accentuates the balance of payments problem.... A developing economy, which for its past endeavours to mobilise its own resources to the utmost extent possible, faces the difficulty that its developmental effort may entail a large increase in import requirements for specialised capital equipment and for raw materials and components, for which, for a period, it is unable to pay from its own export earnings. The need for external assistance is implicit in this situation. Such assistance has already done a great deal to hasten India's economic growth and its value can scarcely be overestimated."\[18\]

In the Fourth Five Year Plan, a much greater domestic effort has been emphasised as will be seen from the reduced quantum of aid of the order of ₹1,850 crores in the Fourth Plan period compared to a net inflow of ₹3,500 crores (in post-devaluation rupees) during the Third Plan.\[19\] Thus the volume of foreign aid is expected to decline gradually until the economy reaches the stage of self-generating growth.

18. Planning Commission, India, Third Plan, p.27.
Magnitude of Aid During Plans

During the First Plan, the amount of the required foreign aid was small due to the small size of the Plan. India also mostly depended on its accumulated sterling balance of Rs.858 crores on March 31, 1950, which helped India to finance initial imports. In the Second and the Third Five Year Plans, the quantum of foreign aid substantially increased due to large involvement of foreign exchange requirements with its emphasis on industrialisation. The foreign assistance continued in the later period also but greater emphasis was laid on mobilisation of domestic savings. Again, the quantum of aid received from abroad also in no small measure depended on the rate of savings and investments in the economy. It can be stated that in the First Plan, the bulk of the investment was financed from domestic savings which amounted to 7% of the national income as against the total investment of 8%. The position changed materially in the Second Plan when the ratio of investment to national income rose to 11% while the ratio of domestic savings to national income rose at a slower rate and came up to about 8.5% only.

22. Ibid., p.170.
During the Third Plan period, investment rose further to about 14% of the national income while savings amounted to only 10.5% only. In the Fourth Plan the quantum of foreign aid has been reduced to Rs.1,850.0 crores, against an investment of Rs.15,902 crores in the public sector, which comes to 8.6% as against 21% and 28% of investment in the Second and Third Five Year Plans respectively. The same trend continued between 1966-67 and 1969-70. Estimated utilisation of the foreign aid in the plan period is

23. *Idem*.
shown in TABLE 1.

TABLE 1: EXTERNAL ASSISTANCE UTILISED DURING PLANS**

(U.S. $ million)

<table>
<thead>
<tr>
<th>Period</th>
<th>Loans</th>
<th>Grants</th>
<th>PL 480/665 Aid and Third country Total currency assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Upto Second Plan</td>
<td>1788*</td>
<td>485*</td>
<td>1155*</td>
</tr>
<tr>
<td>2. During Third Plan</td>
<td>4009</td>
<td>223</td>
<td>1793</td>
</tr>
<tr>
<td>3. During 1966-67</td>
<td>903</td>
<td>126</td>
<td>480</td>
</tr>
<tr>
<td>4. During 1967-68</td>
<td>1074</td>
<td>81</td>
<td>415</td>
</tr>
<tr>
<td>5. During 1968-69</td>
<td>888</td>
<td>87</td>
<td>113</td>
</tr>
<tr>
<td>6. During 1969-70</td>
<td>1026</td>
<td>34</td>
<td>143</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>9688</td>
<td>1036</td>
<td>4099</td>
</tr>
</tbody>
</table>

** Excludes (a) grants under US PL 480 and (b) special deposits placed by the IBRD with the RBI during 1967-68.

* Includes assistance of ₹ 201.67 crores provided during First Plan. (See for details Estimates Committee, Fourth Lok Sabha, India, Report No.11 (New Delhi), August 1967, pp. 5-8.


It will be seen from the above TABLE that a large part of this was accounted for by PL 480/665 Aid and Third
Country Currency Assistance upto the year 1967-68 which has declined in the following years. It has been asserted that the share of external aid in the total investment during the three plan periods was 14 % only if food aid is excluded. The share during 1966-67 and 1967-68, however, rose to 24 %. It can further be added that of the total external assistance received between 1950-51 - 1969-70, loans constituted 66 %, grants 7 % and the U.S. assistance under PL 480, PL 665 and Third Country Assistance 27 %. TABLE 2 gives the break-up of the loans and grants in the form of external assistance. It also shows how the percentage of grant element in the external assistance has been declining from plan to plan.

TABLE 2: PERCENTAGE DISTRIBUTION OF LOANS AND GRANTS DURING PLAN PERIODS

<table>
<thead>
<tr>
<th></th>
<th>First Plan</th>
<th>Second Plan</th>
<th>Third Plan</th>
<th>1966-67 to 1969-70</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans</td>
<td>64</td>
<td>82</td>
<td>96</td>
<td>92</td>
</tr>
<tr>
<td>Grants</td>
<td>36</td>
<td>13</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


27. Ibid., p.l.
Sources of Aid

In order to ensure continuity and stability of foreign loan and to put these resources to the most productive use, the traditional system of foreign lending based on the initiative of private investors' needs to be revised or supplemented. In modern times aid can be provided either bilaterally or multilaterally.

Bilateral Aid

Bilateral aid is the agreement arrived at between two countries and includes within the scope of these programmes, bilateral aid provided within the framework of regionally coordinated schemes, such as the Colombo Plan for cooperative economic development in South and South-East Asia. Economic aid to India was provided under the Colombo Plan by the U.K., Canada, Australia, New Zealand and other countries for financing India's Five Year Plans. Bilateral economic aid to the underdeveloped countries continued the steady expansion in the post-war period, the most substantial increase having been recorded for the United States, France and the USSR. Three major developments affected the nature

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29. UN, ESCOR, 36th Session, Annexes, Agenda Item 4 (Geneva), 1958, p.49.
30. Ibid., p.3.
and dimensions of future assistance in 1956-57. These include, firstly, mutual security legislation in the US which was amended with a view to establishing a Development Loan Fund and its successor, the Agency for International Development (AID) to assist projects and programmes for long-term economic growth; secondly, the US and the USSR expanded the area to provide bilateral aid; and thirdly, there was increased demand for external credit to sustain the execution of their development plans.

United States of America has been the major creditor in the field of foreign public capital. Its aid programmes in India started in December, 1950, with the signing of the Point-Four Technical Assistance Agreement between the Indian and the US Governments. Since then the United States has extended support to many aspects of India's development programmes. The aid has been extended through Technical Co-operation Mission, Development Loan Fund and its successor, the Agency for International Development (AID), the Export-Import Bank, Public Loan 480 (Food for Peace) programme and others. Food aid has mainly come from the US under PL 480. Of the total loans amount drawn

31. Ibid., pp. 5, 61.
32. K.M. Kurian, op. cit., p. 113.
(excluding PL 480 and PL 665 imports against rupee payments) the share of USA was 37%. Besides, the share of IDB/IDA 20%, of West Germany 12%, of UK 9% and USSR 9%.

The rest of the aid (about 13%), was received from other donor countries like Japan, Canada, France, Italy, etc.

**Tied and Untied Aid to India**

Now that the magnitude of bilateral aid has been progressively on the increase during the plan period, seemingly to overcome the balance of payments difficulties, most of it has been provided as the 'tied' one, which means that the purchases by the aid-receiving countries shall have to be made from the aid-giving countries for specific purposes although they may be of a very low priority in the aid-receiving countries, or are in fact charged competitively higher prices than those prevailing in other countries. For example, the American aid has been increasingly tied to purchases within the country. The Russian aid too has always been tied, but it is more defensible arrangement that much less rate of

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34. Idem.

35. UN, ESCOR, 41st Session, res. no. 1183 (XLI), 1445th plenary meeting, August 5, 1966, Annexes, Agenda Item 8 (Geneva), 1966, p.39.
interest is charged and the whole arrangements by way of imports and exports of commodities involve a wider network of payment agreements having a considerable reciprocity about it. On the whole, however, tied assistance tends to distort optimum trade patterns in which countries resort to restrictive trade practices. It is, therefore, important to ensure that purchases made with tied aid are nevertheless made on the best possible conditions, either by systematic checks on the price and quality of the goods supplied or by using procedures allowing free competition among domestic suppliers. An ideal situation would be if aid is neither tied to the donor country nor to a particular purpose but is available to the full extent needed. However, such a situation does not exist to-day. The government should make its best endeavour to procure the aid which may be tied to the donor country but not tied to any purpose. It is, however, a matter of concern that assistance of 'untied' nature is available only from the World Bank and the International Development Association and other multilateral agencies. Thus, a probable solution lies in 'internationalising' international capital through multilateral arrangements.

Role of International Financial Organisations

A certain amount of international control and management seems to be necessary if foreign-lending is to yield better results. The UN institutions now participating
in the flow of capital and assistance are the International
Bank for Reconstruction and Development (Hereinafter
mentioned as IBRD) (with its affiliates, the International
Development Association (or IDA) and the International
Finance Corporation; and organising Consortia and
consultative groups) and the International Monetary
Fund (or IMF).

The IBRD group has sought in various ways to
expand and intensify its efforts to provide finance in
increasingly flexible ways, building up local institutions
to mobilise and channelise productive investment. The
IBRD has created new productive opportunities by providing
loans for basic public service facilities and infrastructural
development. It has thus encouraged private investment
both at home and abroad. Besides, the International
Finance Corporation has encouraged the growth of productive
private enterprise in member states. In September 1960,
IDA came into existence as an affiliate of IBRD in order
to provide development finance to countries unable to
borrow on conventional terms of repayment and interest.
The UN General Assembly Resolution has reaffirmed the
appeals made by the Economic and Social Council and Trade
and Development Board to member governments of the IDA

36. UN, ESCOR, 39th Session, Annexes, Agenda item no.2
(Geneva), 1965, p.40.
to treat the question of further increasing the resources of the Association as a matter of high priority.  

The financial terms of the IDA credits are much more easy than those of IBRD. All credits extended by it have been for a term of 50 years without interest. Repayment is due in foreign exchange; amortisation begins after a ten-year period of grace; thereafter 1% of the principal is repayable annually for ten years and 3% is repayable annually for the final thirty years. A service charge of three-fourths of 1% per annum is made for administrative costs. Upto March 31, 1970, the IDA has extended 25 credits totalling $1,127.63 million.

Capital-exporting countries have explored various other methods of coordinating their financial assistance to less developed countries to ensure its most effective use. In order to coordinate the flow of foreign assistance to India, the IBRD convened the Consortium for Aid to India in a situation of emergency in August, 1958. The Consortium (consisting of USA, U.K., West Germany, Canada, Japan, Italy, Netherlands, Belgium, Austria and Denmark which joined

37. UN, GAOR, Session XXII, res. no.2275(XXII), 1618th plenary meeting, December 4, 1967, Supplement no.16 (New York), 1968, p.24.

later in 1968) has been holding periodic meetings to examine the development plans of the country and to agree on the amount of external resources that they are prepared collectively to make available to it. Both the quantum and the quality of aid, in the context of India's present stage of development, have been stressed at the Consortium meetings. The total sum of external assistance committed by the Consortium members for the Third Plan amounted to $4,643.7 million, out of which the USA alone contributed $1,699.0 million, which accounts for 32% of the total amount. The Aid India Consortium met in Washington on May 23 and 24, 1968, to review the recent developments in the Indian economy and to consider India's external aid needs for the fiscal year 1968-69. They agreed that India needed substantial and swift commitment and disbursement of non-project aid if the current development policies and the recovery from the recession were to be sustained. They accepted the Bank's assessment that India needed non-project aid in the order of $1,000 million from Consortium members.

39. UN, ESCOR, 39th Session, Annexes, p.41.


including IDA. Against the commitment of non-project aid for 1968-69 so far, amounting to $642.15 million, the share of the USA amounted to $225.73 million. In addition to the above amount, commitments credit agreements totalling $245.10 million were also signed with the USA, France and U.K., against 1967-68 pledges of non-project aid; and the total value of project agreement signed during 1968-69 amounted to $164.51 million. In order to help India meet the growing debt service burden, the Consortium countries have also been extending a part of their non-project aid in the form of debt relief which amounted to $323.83 million between 1966-67 and 1969-70. Thus the Consortium has become an important lever in the coordination of foreign aid policies and programmes.

Besides the above, the UN General Assembly adopted a resolution No.1240 B(XIII) dated October 14, 1958, envisaging the Special Fund as "a constructive advance in United Nations assistance to the less developed countries which should be of

42. Idem.
43. Idem.
immediate significance in accelerating their economic development by, inter alia, facilitating new capital investments of all types by creating conditions which would make such investments either feasible or more effective. It was reaffirmed by the UN Development Decade that the Expanded Programme of Technical Assistance and the Special Fund can play an increasingly important role in this international effort. The Special Fund component of the United Nations Development Programme assists the governments of some 130 low-income countries required to make capital investment, domestic or foreign, both feasible and effective. Specifically, through surveys and feasibility studies, it assists in uncovering and assessing natural and physical resources and identifying investment opportunities. In 1965, the UN General Assembly took a far-reaching step in merging together two of the UN's largest and most comprehensive technical assistance operations, the Expanded Programme of Technical Assistance (established in 1959) into a new

45. Quoted in UN, ESCOR, 37th Session, Annexes, p.72.
46. UN, GAOR, Session XVI, Supplementary No.17, res. no.1715 (XVI), 1084th plenary meeting, December 19, 1961 (New York), 1962, p.23.
47. UN, GAOR, Session XXI, Supplementary No.1, August 3, 1966 (New York), 1966, p.137.
United Nations Development Programme with project commitments of well over $1 billion. The new United Nations Development Programme (UNDP) consequently came into existence on January 1, 1966. India has been the recipient of largest assistance under the Technical Assistance Programme and Special Fund Assistance of UNDP. The total contribution made by India to the Programme from the inception of the UN Expanded Programme of Technical Assistance and the UN Special Fund till 1969 is equivalent of $32,875,000. Against this contribution made by India the technical assistance allocated under these two components is $89.02 million approximately. The assistance allocated by the UNDP to India during 1969-70 amounted to $5.20 million. It is noteworthy that the General Assembly has accepted in principle to create a United Nations Capital Development Fund transforming the Special Fund. However,

49. Idem.
51. Idem.
52. Idem.
53. UN, GAOR, Session XV, res.no.1521(XV), 948th plenary meeting, December 15, 1960, Supplementary No.16 (New York), 1961, p.12; See also UN, GAOR, Session XX, res. no.2042(XX), 1391st plenary meeting, December 8, 1965, p.771 Supplementary No. 14, pp.21-22.
the delegations of the advanced countries of Canada, France, Japan, the United Kingdom and the United States indicated their inability to support the establishment of the Fund and urged that the existing resources should be expanded. But the majority of nations comprising the UN wanted to set up the Fund early. India favoured the establishment of the Capital Development Fund on the ground that, if the UN Development Programme embarked on investment proper, its pre-investment activities should be correspondingly weakened. It was further maintained that the existing financial institutions, such as IBRD, IDA and International Finance Corporation were too much under the influence of the capital-supplying countries and their membership was not as wide as the UN itself. For that reason, the developing countries sought a truly multilateral organisation in which both developed and underdeveloped countries would have a voice. The UN Capital Development Fund, however, could not be established because of the opposition of the economically developed nations.

Classification of bilateral and multilateral aid utilised up to March 1970 is shown in TABLE 3 showing the magnitude of assistance received from various
TABLE 3: BROAD CLASSIFICATION OF SOURCES PROVIDING EXTERNAL ASSISTANCE UPTO MARCH 1970

( $ Million )

<table>
<thead>
<tr>
<th></th>
<th>Utilised upto March 1970</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Loans Grants P.L.480/665</td>
</tr>
<tr>
<td></td>
<td>Country Currency Assistance</td>
</tr>
<tr>
<td>IBRD/IDA</td>
<td>1,938 - -</td>
</tr>
<tr>
<td>USA</td>
<td>3,589 353 4,099</td>
</tr>
<tr>
<td>USSR</td>
<td>844 14 -</td>
</tr>
<tr>
<td>West Germany</td>
<td>1,042 22 -</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1,024 10 -</td>
</tr>
<tr>
<td>Japan</td>
<td>429 1 -</td>
</tr>
<tr>
<td>Others</td>
<td>822 636 -</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9,688 1,036 4,099</td>
</tr>
</tbody>
</table>


Note: Figures in brackets represent percentages to the total.
The USA accounted for about 54% of the total cumulative utilisation. The IBRD and IDA together accounted for about 13% of utilisation. Other countries that provided sizeable assistance were the USSR, West Germany and the United Kingdom in that order. It will further be seen that about one-half of the total US aid to India has been under PL 480 Title I Programme.

Inflow of Foreign Assistance

It has been generally recognised that to speed the pace of economic development, the volume of foreign economic aid must be raised substantially above its current level. Various formulae have been suggested for this purpose, including the celebrated target of 1% of the national income of the developed world. General Assembly Resolution No.1522 (XV) states:

"The inflow of international assistance and capital should be increased substantially so as to reach as soon as possible approximately 1% of the combined national incomes of the economically advanced countries."\[54\]

It has been found that the aid has more or less levelled off in absolute terms, but it has diminished in terms of the

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percentage of aid provided by them, as their gross national income advances. In any case, with a few exceptions, the transfer of external resources to the developing countries has not only failed to reach the unanimously agreed minimum target of 1% net of the individual national income of the developed countries but that the trend since 1961 has been one of continuous decline. While in 1961, the flow of development financing amounted to 0.87% of gross national product of developed countries, it came down to 0.62% in 1966.

In India’s economic development foreign aid has played a significant role though, in comparison to its need and availability of funds with the advanced countries, they have been rather halting and meagre. TABLE 4 shows quantum of foreign aid in relation to investment in India

55. UN, ESCOR, 41st Session, res. no.1183(XLI), August 5, 1966, p. 38.

FOREIGN AID IN RELATION TO INVESTMENT

<table>
<thead>
<tr>
<th>INVESTMENT</th>
<th>FOREIGN AID</th>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

RUPEES CRORES.

UP TO 2nd PLAN  DURING 3rd. PLAN  ANNUAL PLANS (1966-68)

REF.: CHAPTER VI, TABLE 4.
during the plan periods.

TABLE 4: FOREIGN AID IN RELATION TO INVESTMENT

( Rs. crores )

<table>
<thead>
<tr>
<th>Period</th>
<th>External Assistance* (1)</th>
<th>Total Investment (2)</th>
<th>1 as % of 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to Second Plan</td>
<td>1,542.6</td>
<td>10,110</td>
<td>15.3</td>
</tr>
<tr>
<td>During Third Plan</td>
<td>2,711.2</td>
<td>10,400</td>
<td>26.0</td>
</tr>
<tr>
<td>1966-67 - 1968-69</td>
<td>3,125.3</td>
<td>6,685</td>
<td>46.7</td>
</tr>
</tbody>
</table>

**SOURCE**: For (1) above, see for details TABLE 1; For (2), Planning Commission, India, Third Plan, p.32; and Annual Plans;

* Calculations have been made at pre-devaluation rates upto Third Plan and at post-devaluation rates between 1966-67 - 1968-69.

The percentage of foreign aid to investment has shown an upward trend due to devaluation of the rupee as well as low investment between 1966-67 - 1968-69 due to unusual economic conditions. These figures appear to be somewhat alarming but weighing all the circumstances and the size of population of the country, the quantum of aid could have
been still greater. As Barbara Ward said,

"Let us, therefore, fix the minimum level of aid to India at about £2,000 million for the five years, the optimum figure at £4,000 million. Even the larger figure represents no more than about two-fifths of 1% of the Wests' combined national incomes during the period. It is perhaps not one-sixtieth of what they spend on arms." 57

India's share of two-fifths in such a programme is dictated by its sheer size because 40% of the population in the underdeveloped non-communist countries live in India. Thus considered, it would yield at least £800 million a year in foreign exchange which is enough to fulfil India's ambitious Five Year Plans.

However, foreign aid, besides being inadequate to the development requirements, also involves the repayment liability. An increase in the burden of debt service charges, in recent years, has put considerable strain on India's balance of payments. The debt and amortisation payments are heavy because a large portion of debt consists of medium and short-term maturities. It needs liberalisation.

57. Mrs. Barbara Ward, India and the West (New Delhi), 1961, p.207.
Repayment Problem

The terms and conditions of repayment have greatly varied from donor to donor, loan to loan and time to time. On the one hand, India has received the Russian and other eastern European loans, given for a 12-year period at 2.1/2\% interest to be repaid in rupees and settled through bilateral trade, and on the other hand, the hard commercial loans have been obtained from West Germany and Japan and part of loans from the USA also, involving a high rate of interest. A substantial increase in the external indebtedness in India, especially on public account, has occurred in the last 20 years. The dwindling of India's sterling balances from ₹.858 crores on the 31st March, 1950 to ₹.136 crores at the beginning of the Third Five Year Plan on the one hand, and a sizeable increase in the quantum of foreign aid during the plan period on the other, have put a great burden on the country's foreign exchange earnings due to repayment liabilities. It has been estimated that the servicing charges absorbed about 20\% of export earning in 1965-66, and are likely to claim about 28\% at the end of

The Fourth Plan.

The magnitude of the problem can be understood by showing the debt repayments vis-a-vis the aid received from foreign countries. India's external debt service mounted from $191 million in 1961-62 to $506 million in 1969-70. TABLE 5 shows the inflow of gross foreign assistance as well as the increasing amounts of debt repayments between 1961-62 - 1969-70 resulting into the falling net inflow of foreign aid.

**TABLE 5 : INFLOW OF FOREIGN ASSISTANCE : GROSS AND NET**

( Million $ )

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross aid utilisation</th>
<th>Amortisation payments</th>
<th>Interest payments</th>
<th>Total debt service of aid</th>
<th>Net Inflow</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961-62</td>
<td>711</td>
<td>121</td>
<td>70</td>
<td>191</td>
<td>520</td>
</tr>
<tr>
<td>1962-63</td>
<td>933</td>
<td>101</td>
<td>81</td>
<td>182</td>
<td>751</td>
</tr>
<tr>
<td>1963-64</td>
<td>1,239</td>
<td>113</td>
<td>96</td>
<td>209</td>
<td>1,030</td>
</tr>
<tr>
<td>1964-65</td>
<td>1,520</td>
<td>145</td>
<td>110</td>
<td>255</td>
<td>1,265</td>
</tr>
<tr>
<td>1965-66</td>
<td>1,622</td>
<td>162</td>
<td>141</td>
<td>303</td>
<td>1,319</td>
</tr>
<tr>
<td>1966-67</td>
<td>1,509</td>
<td>210</td>
<td>153</td>
<td>363</td>
<td>1,146</td>
</tr>
<tr>
<td>1967-68</td>
<td>1,570</td>
<td>275</td>
<td>163</td>
<td>438</td>
<td>1,132</td>
</tr>
<tr>
<td>1968-69</td>
<td>1,088</td>
<td>276</td>
<td>182</td>
<td>458</td>
<td>650</td>
</tr>
<tr>
<td>1969-70</td>
<td>1,203</td>
<td>317</td>
<td>189</td>
<td>506</td>
<td>697</td>
</tr>
</tbody>
</table>

**SOURCE :** RBI, Report on Currency and Finance, 1969-70, p.46

61. The Indian Monitor (Bombay), July 1970.
The gross aid utilisation during the Third Plan totalled to $6,025 million, of which $1,140 million had to be paid back as total debt service which came to 18.9%. The proportion of debt service increased still more to 32.8%, despite debt rescheduling totalling to $41 million. These figures clearly give a discouraging trend of the substantial fall of net aid. Further, against $6,025 million gross aid utilisation during the Third Plan, food aid amounted to $1,793 million, thus leaving $4,232 million. Out of this, $1,140 million were debt repayments which meant $3,092 million net foreign aid towards capital formation in India during the Third Plan. The increasing magnitude of food aid also required immediate correction. Due to green revolution in the country the requirements of food aid have gradually diminished. But the same is more or less counterbalanced by the debt repayments which have been substantially increasing with the time, and thus making the contribution of the foreign countries towards capital formation as negligible. Indeed the net inflow of aid fell from

64. See for details TABLE 1.
$1,146 million to $630 million in 1968-69, which again slightly rose to $697 million in 1969-70.

Attention of international organisations is naturally attracted to the serious nature of the problem of debt repayments and service charges which finds the similar trend of an increased outflow of capital in other developing countries as well. The UN General Assembly states:

"Deeply concerned at the statements contained in the annual report of the International Bank for Reconstruction and Development for 1965-66 that the net official assistance from the industrial countries to the developing countries and to the multilateral institutions had remained rather static, at about $6,600 million during the five years from 1961 to 1965, and that the total service payments (interest and amortisation) on public and publicly guaranteed debt of ninety-seven developing countries rose to $3,500 million in 1965, and at the fact that, on the basis of the present trends, the rapid increase in the debt-servicing burden of developing countries would completely offset the inflow in a little more than fifteen years."

Thus the increasing rate of outflow of capital substantially reduces the net volume of external resources available to other countries. Consequently, the UN General Assembly at its 21st Session passed a resolution simultaneously urging the developing countries to make all possible efforts to

increase the mobilisation of their domestic resources to the fullest extent possible as also to make external resources available on easier terms and conditions as follows:

"3 (b) (i). By providing, to the greatest possible extent, an increased flow of aid on a long-term and continuing basis, and by simplifying the procedure for the granting and the effective and expeditious disbursement of aid;

"(ii) by providing not later than by 1968, at least 80% of their assistance in the form of grants and loans at interest rates of 3% or less with a repayment period of twenty-five years or more."66

In another Resolution No.2276 (XXII), the UN urged the developed countries to ease the terms and conditions on which external resources are made available to developing countries so as to minimise the debt-servicing burden on the balance of payments of the developing countries. The Government of India also requested the Aid India Consortium to consider some form of debt re-scheduling in respect of foreign loans, as in the earlier years aid was generally available on relatively hard terms. Consequently, the amount

66. UN, GAOR, Session XXI, res. no.2170 (XXI), 1485th plenary meeting, December 6, 1966, Supplementary No. 16 (New York), 1967, p.31.

67. UN, GAOR, Session XXII, res. no.2276 (XXII), 1618th plenary meeting, December 4, 1967, Supplementary no.16 (New York), 1968, p.25.
of debt relief offered by the various members of the
Consortium for the years 1966-67, 1967-68 and 1968-69
amount to US $ 34.39, 63.20 and 101.41 millions respectively.
All these measures taken are in consonance with the
following recommendations of the UN General Assembly to
all member states:

"To encourage, on a bilateral and a multi-lateral
basis, the extension as appropriate of long-term
loans, grants or credits on favourable terms,
including interest-free loans or loans at the
lowest possible interest rates, the longest
possible repayment periods and repayment in
local currencies or in other beneficial forms,
as well as the influx of other forms of foreign
capital and assistance, which are important factors
in the economic and social progress of the
less developed countries."69

Taking into account all these factors, the UNCTAD,
at its meeting in New Delhi, in the year 1968 made certain
important suggestions for an effective development financing
of the underdeveloped economies, which interalia include:

"1. (a) Each developed country should comply with
the target of a minimum 1 % of its gross national
product for net financial flows, in terms of
actual disbursements, by the end of the
UN Development Decade.

68. Estimates Committee (1968-69), Fourth Lok Sabha,
India, Report No. 89 (New Delhi), 1969, p.28.

69. UN, GAOR, Session XV, res. no.1524 (XV), 948th
plenary meeting, December 15, 1960, Supplementary No.16
(b) Any gaps remaining in the 1% transfer each year should be made good by additional government transfers;

(c) Resources of the International Development Association should be immediately replenished and augmented.

(d) There should be no discrimination by international lending institutions against the public sector in particular in industry. 70

Alternatively, it was suggested that there should be a considerable lowering of interest rates and a considerable increase in maturities and grace periods, as also development finance should be rapidly and progressively untied. 71 Most of these suggestions, however, have not yet been put to actual practice although efforts are being made in this direction. The actual aid, falls far shorter than was so proposed by the UNCTAD and the UN General Assembly. 72 It has now been suggested that aid to developing countries should achieve the target of minimum 1% of the national income by the year 1972. 73

Further, the nations' current earnings must increase

71. Idem.
72. Idem.
at least by the amount of servicing charges along with the availability of foreign loans and grants for development financing. For that appropriate policies should be formulated during the Second UN Development Decade for increasing export earnings.

Foreign Private Investment in India

Foreign private investments have a history behind it. In the pre-independence period, the foreign investment was competitive and not complementary to domestic investment. The impact of foreign investment was to build Indian economy into a producer of primary products and raw materials. It destroyed the indigenous industries and proved a drain on the economy. The investments of some of the British private companies, for example, in the Railways, yielded benefits to the Indian economy only incidentally, although they were primarily meant to strengthen British trade and commerce in India. In fact it is only complementary type of investments which have 'stimulating effect' on the economy.

In the post-independence period, foreign private investments have assumed an entirely new complexion. The foreign capital is not to act as the outpost of the economies

75. Ibid., p.56.
of foreign countries in India, but as a booster for the
domestic economy. An adequate amount of foreign investment,
which includes both foreign aid, as well as foreign private
capital, is required to supplement the domestic resources,
so that India can move ahead economically. 76 Declaring
the Indian Government’s policy in regard to the foreign
private investments in India, the then Prime Minister,
Pt. Jawahar Lal Nehru said in the Parliament on April 6, 1949:

"Indian capital needs to be supplemented by foreign
capital not only because our national savings will
not be enough for the rapid development of the
country on the scale we wish, but also because in
many cases scientific, technical and industrial
knowledge and capital equipment can best be
secured along with foreign capital." 77

Foreign investors, however, would like to have a clear
indication of country’s policy in respect of repatriation
of capital, the remittance of profits as well as payment
of fair compensation in the event of compulsory acquisition
of industrial units by the State. Consequently, the
conditions under which the foreign investors could
participate in Indian industry were carefully regulated in
the national interest. Foreign enterprise was assured

76. RBI, Foreign Collaboration in Indian Industry
(Bombay), 1968, p. 2.

77. Jawaharlal Nehru, Constituent Assembly of India
(Legislative) Debates, Official Reports, Part II, Vol. IV,
No. 1, April 6, 1949, p. 2385.

78. Ibid., pp. 2385-2386.
non-discriminatory treatment on par with domestic enterprise in regard to industrial policy requirements. It was significantly stated that the major interest in ownership and effective control of an undertaking should be in Indian hands.

The significance of effective policy regarding foreign private investment cannot be overemphasised. Private foreign capital has certain important built-in advantages. Equity investments do not involve any pre-ordained repayment liabilities. The investor will receive a return only when his industrial venture has established itself and is making a material contribution to the national wealth. Moreover, participation in the equity capital of new ventures gives the foreigner a continuing interest in the success and efficiency of the project. The absorption of foreign capital has a sort of 'multiplier' effect because it makes it possible to avoid deterioration in terms of trade and to postpone difficult acts of investment.

Foreign companies operate generally through two main forms of organisation viz., the branch and the subsidiary. The branch acts for the parent company which is

79. Ibid., p.2386.
incorporated abroad; it has no local capital (except working capital borrowed from banks). By the end of March, 1965, branches of foreign companies accounted for about ₹.269 crores out of a total of ₹.613 crores of direct foreign investment. Plantations, petroleum and services accounted for 90% of aggregate branch investment. The balance of ₹.344 crores of direct foreign investment was accounted for by subsidiaries and other foreign controlled companies. Subsidiaries and minority participation companies predominated in petroleum, transport equipment, electrical goods and chemicals while purely technical arrangements were relatively more important in textiles, machinery and machine tools and metals and metal products.

TABLE 6 shows that the net direct loans obtained by the subsidiaries in foreign currency increased from ₹.717 lakhs in 1960-61 to ₹.1,148 lakhs in 1963-64. The overall position of repayment of principal sums and interest remittances etc.,

80. RBI, Survey of Foreign Collaboration (Bombay), 1968, p.10.
81. Ibid., p.101.
is also shown in the TABLE.

**TABLE 6: FOREIGN CURRENCY LOANS**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount utilised</td>
<td>234</td>
<td>159</td>
<td>298</td>
<td>282</td>
</tr>
<tr>
<td>Net amount outstanding</td>
<td>717</td>
<td>787</td>
<td>1,037</td>
<td>1,148</td>
</tr>
<tr>
<td>Principal Repaid</td>
<td>17</td>
<td>89</td>
<td>48</td>
<td>171</td>
</tr>
<tr>
<td>Interest Remitted</td>
<td>14</td>
<td>23</td>
<td>30</td>
<td>32</td>
</tr>
</tbody>
</table>


The classification of effective agreements entered into by companies showed that the UK was the leading collaborator so that it accounted for 40% of the agreements while the USA accounted for 19% of agreements and West Germany for 14%.

The growth of private foreign capital has been mainly based on reinvestments of profits and investment in kind. The predominance of non-cash investments in the total gross increase in foreign investments in India is a much less known fact. Such non-cash inflow accounted for about 85% of the gross inflow of foreign capital during 1948-60.

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82. Idem.
It can thus be said that foreign private capital in India has not been on a scale large enough to give rise to a marked and widespread increase in the rate of economic development. It is suggested that a general liberalisation of the economy, that is, lower rates of taxation and hence profitability, security, stability and the right to the reasonable transfer of funds will have to be ensured to induce foreign private capital in the country. The UN General Assembly in a resolution asked the countries concerned to adopt measures which will stimulate the flow of private investment capital for the economic development of the developing countries, on terms that are satisfactory both to the capital-exporting countries and the capital-importing countries. Asking in specific terms to attract private foreign capital, the UN General Assembly recommended in a resolution to re-examine, wherever necessary, domestic policies, legislation and administrative practices with a view to improving the investment climate; avoid unduly burdensome taxation; avoid discrimination against foreign investments; facilitate the import by investors of capital goods, machinery and component materials needed for new investment; make adequate provision for the

84. UN, GAOR, Session XVI, res. no. 1710(XVI), 1084th plenary meeting, December 19, 1961, Supplement no. 17 (New York), 1962, p. 18.
remission of earnings and repatriation of capital.\textsuperscript{85}

India has already taken steps towards attracting the foreign private capital as would appear from the statements made by the government. In fact, the need for expanding the international flow of private capital to the developing countries remains in the forefront of interest both by developed and developing countries. A significant development is the increasing attention given in the developing countries to the establishment or strengthening of institutions concerned with development financing. In the course of the last few years, development banks and finance companies, established with or without government participation, have been designed to provide an effective instrument for mobilising domestic and foreign capital for investment in industrial and other developmental projects. In view of the inadequate growth which has been experienced in the flow of direct foreign private investment, the institutional approach through the mobilisation of joint financing (multilateral aid) and consortia (bilateral aid), has assumed greater significance. All these efforts to mobilise foreign private capital as well as foreign aid through official agencies make a vivid galaxy of instruments in international economic cooperation.

\textsuperscript{85} UN, GAOR, Session IX, res. no.824(IX), 510th plenary meeting, December 11, 1954, Supplement No.21 (New York), 1955, p.12.
Avoidance of Balance of Payments Gap

Generally the underdeveloped countries experience deficit which might be found unavoidable in the process of development in the initial stages, because of the excess of the flow of imports of capital goods over exports. No doubt the inflow of foreign capital is very important to overcome the gaps in foreign exchange, it also involves a recurring foreign exchange drain in the form of profits, capital repatriation and payment of service charges, etc. Hence the inflow of foreign capital should be supplemented by a purposive import policy aimed at ensuring the most beneficial use of available foreign exchange resources in accordance with well-defined priorities which are indispensable for a country engaged in bringing about rapid development in a planned manner with scarce resources. It requires the regulation of international trade which is one of the most important factors in economic development. Policy of import substitution may be clearly laid down to have a direct saving of foreign exchange. Attempts at increasing exports should also be made to correct the current adverse balance of payments situation. That a deliberate and conscious policy has to be adopted to avoid
the basic disequilibrium in the country's balance of payments is clear from the fact that in spite of considerable external assistance, the country's foreign exchange reserves, which amounted to Rs.1,612 crores at the end of March, 1948, had suffered heavy erosion, particularly during the Second Plan period, and had remained at a precariously low level for most of the Third Plan period. At the same time, while exports had ceased to grow and had even shown a declining trend in 1965-66, imports had remained at a high level despite controls. On a review of the balance of payment situation in India during the years 1948-66, it is found that India had an adverse balance of trade throughout these years as shown in TABLE 7.

**TABLE 7 : BALANCE OF TRADE**

<table>
<thead>
<tr>
<th>Period</th>
<th>Trade Balance</th>
<th>Annual Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948-1951</td>
<td>(-) 377</td>
<td>(-) 126</td>
</tr>
<tr>
<td>1951-1956</td>
<td>(-) 542</td>
<td>(-) 108</td>
</tr>
<tr>
<td>1956-61</td>
<td>(-) 2336</td>
<td>(-) 467</td>
</tr>
<tr>
<td>1961-1966</td>
<td>(-) 2384</td>
<td>(-) 477</td>
</tr>
<tr>
<td>1966-1967</td>
<td>(-) 806.3</td>
<td></td>
</tr>
</tbody>
</table>

**SOURCE:**

Thus the basic disequilibrium in India’s balance of payments arose by continuing factors, namely, a growing trade deficit and the mounting burden of servicing the external debt, while exports remained stagnant. Foreign trade was clearly at a very low rung during the Second and the Third Plan period when the annual trade deficit on an average was between ₹ 467 crores and ₹ 477 crores. In fact the foreign exchange position was so difficult that unless aid began to flow soon in adequate quantities, there was every danger of the economy receiving a serious setback. Moreover, the country had reached a stage when it had to incur fresh debts in order to pay off old ones. However, external aid was not readily forthcoming as the lending countries made a sudden pause in fresh authorisations following the outbreak of the Indo-Pak conflict in September, 1965, and seemed to require evidence of the country’s determination and capacity to push exports and improve the external viability of its economy by the devaluation of the currency. Indeed, inflationary trends in the economy meant higher costs for exporting industries, as a result of which Indian exports were priced out in foreign markets as also there was diversion of investment as well as supplies to meet domestic demand.
Thus the chronic and growing deficits in India's trade and invisibles accounts required essentially the devaluation of the Indian currency, upon which aid negotiations and foreign trade conditions very largely depended. Even the finalisation of the Fourth Plan had to be deferred for some time. This time again, it is a big question mark if the objectives and targets of the Fourth Plan can be fulfilled due to the 14-day Indo-Pak War and the economic problems of Bangla Desh.

Various measures have been taken to correct the imbalance of trade. Firstly, devaluation of the rupee on June 6, 1966, has been a shot in the arm for remedying economic malaise. Secondly, efforts have been made to integrate both import and export policies fully with the general programme of investment and production emphasising both export promotion and import substitution. Import of capital and investment goods have to be made because without them real capital formation cannot initiate the development process in the country. However, imports of such goods as can be profitably produced at home will have to be restricted. Similarly, discrimination against luxuries and non-essential goods shall have to be most severe. Again, export policy in industries can also be made profitably flexible and also can be liberalised in which domestic output had expanded, to acquire new markets and to improve by increased exports the foreign exchange position.
It is a good sign that the foreign trade of India has been diversified, both commodity-and-country-wise. A diversified economy will be in a better position to adapt itself flexibly to changing trade conditions. In the long run, the basic problem involves productive capacity and domestic costs and prices, i.e., it is the problem of productivity. Upon productivity will depend not only internal trade but international trade also. An expansion of the trade of developing countries was a pre-requisite for their accelerated economic development. The UN General Assembly at its Sixteenth Session affirmed in its Resolution dated December 19, 1961, that if national economic development efforts were to achieve their objectives more rapidly, "it is essential that countries should ensure the maximum expansion of their trade and an increase in their foreign exchange income as a result of growth in the volume and value of their exports."[87] Lastly, importers of capital goods were advised to explore ways and means of reducing their immediate foreign exchange payments to the minimum by trying to obtain foreign investments or by arranging imports on deferred payment basis. However, despite the utmost effort, it has not been possible to eliminate the

strains in the balance of payments of the economy without a sizable inflow of capital resources from abroad.

**Trends of Exports in India**

That imports exceeded exports during the plan period is too obvious a fact in case of India. Yet there has been some diversification of the export trade of India during 1951-1966, inasmuch as significant increase was achieved in the exports of new manufactures and products like iron ore but they were not enough to offset the decline in the traditional exports of commodities based on agricultural production such as tea, cotton textiles, jute manufactures, spices and tobacco. Further, while it is true to say that in absolute amounts the exports of India during the period 1951-1966 have mostly been stagnant and had shown a rising trend in the remaining years of the Third Five Year Plan, India's share in world exports had declined from 2.1% in 1950 to 1% at the end of the Third Plan. Thus, even during the Third Plan period when Indian exports were appreciably higher than in the preceding two plans, the increase in India's exports during the

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88. Estimates Committee (1968-69), Fourth Lok Sabha, India, Report No. 89 (New Delhi), 1969, p.44.
period 1960-1965 works out to 23.4% as compared to Israel's exports of 94.3%, Thailand's by 53.6%, Uganda's by 49% and Pakistan's by 37%. Again, exports during the year 1966-67 declined to Rs.1,156.53 crores compared to the figure of Rs.1,263.89 crores (in terms of the postdevaluation rupee) during 1965-66, a rather discouraging feature following the devaluation, but was mainly due to the unprecedented droughts in two successive seasons resulting in low agricultural production as well as temporary uncertainties caused by devaluation. The export position has now been looking up. It is imperative that the country makes an all out effort to earn foreign exchange through exports.

Finance of International Trade and Economic Growth

On balance, it can be stated that the majority of developing countries are facing problem for a fairly long period in which they require external resources to finance their savings and foreign exchange gaps. Consequently, their debt service liabilities will also tend to increase over a long period. If most of the capital inflow is contracted on a fixed servicing schedule, i.e., as loan capital, most

89. Idem.
90. Idem.
of the debt-service obligations become contractually fixed. This poses a serious problem to the country's economy as it introduces a serious element of rigidity into the debtor's economy.

**Classification of Factors Affecting Balance of Payments**

Factors affecting the balance of payments and hence a country's capacity to service debt in the short and medium-term can be broadly classified as follows:

(a) **Fluctuating Variables**
(b) **Offsetting Variables**; and
(c) **Rigid Variables**.

(a) **Fluctuating Variables**

The biggest disturbing factor in the balance-of-payments situation arises from the instability of export earnings. Hence these exports have to be diversified and stimulated within the constraint given by the absorptive capacity of the international market. International capital inflows and outflows through international lending agencies and flight of domestic capital due to political factors and inflation and successive devaluations are important fluctuating or disturbing variables in the economies.

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Offsetting Variables

A combination of domestic policies directed at minimizing internally generated disturbances in conjunction with international policies aimed at stabilising receipts from commodity exports and from capital inflow can assure that the development process proceeds smoothly.

Three important methods as a remedying device to fluctuating variables have been suggested in which the impact of export declines and of savings in capital inflow can be offset. These three offsetting variables as a corrective are Reserves, Compensatory and Supplementary Financing and Compressible Imports. The debtor country may build up its foreign exchange reserves in periods of export upswings and use them in periods of decline. Secondly, compensatory and supplementary financing may prove to be an appropriate solution to meet the serious residual problems caused by short-term fluctuations in the prices of and earnings from primary commodity exports and are necessary to offset unforeseen fluctuations in the exports of developing countries as also to minimise the extent to which instability in export markets inhibits

92. *Idem.*
the economic stability and growth of developing economies. Supplementary finance should normally be provided on the same terms as those applicable to basic long-term development finance provided to the country. In this context, it can be mentioned that the IMF compensatory finance facility, inaugurated in 1963, was extended in 1966. In its latest form, "it allows any member country to draw compensatory finance from IMF to offset a short-term loss from a 'norm' measured as a weighted average of exports in the current year and in the two previous years. Such compensatory drawings may not exceed 25 per cent of the country's quota in any one year." 93 Thirdly, import-cuts may be made of non-essential goods in periods of decline.

It is important that these offsetting variables work effectively and the developing countries progress economically more speedily by industrialising themselves so that the adverse movement of their terms of trade, due to restricted demand by the advanced countries of the mostly primary commodities or semi-manufactures of the developing countries, may be checked. The deterioration in terms of trade and the sluggish expansion of the export quantum of developing countries occurred at a time when their need for imported supplies sharply increased.

to speed up the pace of their economic development. Thus the decreasing demand of primary commodities and other semi-manufactured commodities has meant the falling prices and the increased demand of capital goods has led to rise in prices in the world market, thereby making the terms of trade movement against the developing nations. It has been estimated that taking as a base for estimation the average export and import prices ruling in the years 1953-57, the average annual loss amounts nearly to $2.2 billion, which is nearly 20% of the annual net capital flow into developing nations from all sources for the period 1961-1965.

Rigid Variables

In contrast to the fluctuating nature of external receipts of debtor countries, there are certain most rigid variables in the fixed nature of their debt-servicing obligations, e.g., interest repayments, amortisation, etc. The debt and amortisation payments had been heavy because a large portion of debt consisted of medium and short-term maturities, and were supplied on commercial basis at high rates of interest. Thus quantum of relative aid apart, even terms and conditions of loans have been till recently mostly

unfavourable. Most of the Western loans including those of the IBRD, were at a higher rate of interest ranging between 3.5% and 5.75%. Except the Soviet Union which gave loans at a low rate of interest and at softer terms, in the earlier years, aid was generally available on relatively hard terms. Nearly one-third of aid received has been paid back by way of debt payment and service charges thereby depriving India from the benefits it would have otherwise enjoyed, had the external assistance been at cheaper rates of interest, if not altogether interest free, leave alone in the form of grants. Happily, the concept of aid in recent years has been made more favourable to the developing countries and loans have been given on low rates of interest and for a longer period. Of late, the USA, England, Canada and the IDA have started giving cheaper loans at either interest free or at 1% rate of interest or so and rescheduling and postponing debt repayment.

In short, avoidance of the disequilibria in the balance of payments are the heart of the matter. Whether a debtor can overcome the crisis depends on the relative strength of the elements of rigidity (e.g., the contractually fixed external obligations, minimum tolerable level of imports) and countervailing elements of flexibility i.e., the
availability of compensatory finance and compressible or inessential imports.

In the final analysis, therefore, it may be said that external assistance in coordination with effective trade policies will extricate the country from the balance of payments difficulties. The present trend, therefore, is that of 'Aid and Trade', and not, 'Aid, not Trade', for the simple reason that to restrict trade while extending aid is like beating a man with one hand while dressing his wounds with the other. Therefore, international institutions and developed countries should provide an increasing net flow of international financial, technical and economic assistance for supporting and reinforcing industries with an export potential in India. This will enable the country to accelerate its economic growth through making its industrial development programmes by way of diversification, industrialisation and increase of productivity, on the basis of their national policies, plans and programmes of economic development. Further, along with the role of international organisations and official external aid, the importance of private foreign investment cannot be minimised. Private foreign capital not only supplements assistance from foreign governments.
and international institutions but is also a catalyst for the specialised technical know-how for starting new manufacturing industries, besides involving no obligations of debt repayments, etc. It has, however, to be reiterated that the overall economic situation in the country calls for strict economic discipline to make all possible efforts to mobilise domestic resources and to curtail all avoidable non-development expenditure so that the objective of self-reliance as envisaged in the Fourth Plan be achieved and too much dependence on foreign collaboration may be avoided as early as possible. Even the targets of the Fourth Plan stand in need of scrutiny and adaptation due to the recent development in the country and abroad. In any case external aid has only a limited, though vital role to play in a developing country and must be used as a 'walking stick and not a stretcher to lie upon'.

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