THE THIRD FIVE YEAR PLAN,—
TARGETS, RESOURCES AND DIFFICULTIES

Planning is a continuous process. Each plan prepares a base for the next plan and is therefore to be treated as a link in the chain of plans — one following another. The First Five Year Plan in the U.S.S.R. was implemented during 1929 - 32. That country has now undertaken a seven year development plan which commenced in 1959 and would be completed in 1965. The First Five Year Plan outlined the long term aims of planning in India. It was stated in the draft outline of the Plan that the rate of saving as a portion of the total national income will go up from 5 per cent during the base year 1950 - 51 and 6½ per cent in 1955 - 56 to about 11 per cent by 1960 - 61 and to 20 per cent by 1967 - 68. On these assumptions, it was expected that per capita income could be doubled by about 1977 i.e. in about twenty seven years and consumption standard raised by a little over 70 per cent over 1950 - 51 level during the same period.¹

An outline of the Third Five Year Plan was prepared two years before the Second Five Year Plan was completed and before finalising it, public opinion was elicited on the Plan. But as pointed out by the Indian Finance, publication of the Third Plan draft distracted public interest from the Second Plan and diverted it to the Third Plan. Thus the last two years of the Second Plan worked without much of public interest in it and it was thus the official machinery that salvaged it.

The Third Five Year Plan assessed the achievement of the two plans and on the basis of their working made out an attempt to reach the long term objective of planning in India. The total expenditure contemplated in public and private sectors during the Third Five Year Plan has been estimated at Rs.10,400 crores, as against Rs. 6,750 crores spent during the Second Plan. It is interesting to note that the plans in India have been swinging from moderate to ambitious alternately. We learn from Planning Commission reports that in the Fourth Plan, the total Plan expenditure would be about Rs.22,500 crores. "Thus, at present the total outlay in the Fourth Plan has to be envisaged as ranging between Rs.21,500 crores and Rs.22,500 crores and outlay in the public sector as ranging between Rs.14,500 crores and Rs.15,500 crores".  

There was practically no change in the basic approach to the economy in the Third Five Year Plan. The Plan aimed at increasing production, create more employment opportunities and attaining economic equality and social justice. The ideal to achieve was the establishment of a socialistic pattern of society in the country.

A reference was made in the Third Five Year Plan to the long term aims of economic planning in India. It was reckoned that at 1960-61 prices, the national income should rise from about ₹14,500 crores at the end of the Second Plan to about ₹19,000 crores at the end of the Third Plan, to about ₹25,000 crores at the end of the Fourth Plan and to ₹33,000 to ₹34,000 crores at the end of the Fifth Plan. Allowing for the increases in population, on these estimates, income per head was to go up from about ₹330 at the end of 1960-61, to about ₹385, ₹450 and ₹530 in 1966, 1971 and 1976 respectively.

It was further stated in the Plan that in order to achieve the targets of National Income and per capita income, the rate of investments in the country had to be raised. The rate of investment as part of the National Income was to be raised from 11 per cent at the end of 1960-61 to 14 - 15, 17 - 18 and 19 - 20 per cent per annum by the end of the Third, Fourth and Fifth Plans respectively.

The Third Five Year Plan aimed at increasing the National Income by about 30 per cent and the per capita income
by 17 per cent. The Plan laid emphasis on the development of agriculture and large scale industries. The expenditure on agriculture and community development in the Third Plan was to be 14 per cent of the total expenditure as against 11 per cent in the Second Plan. The proportion of expenditure on organised industry and minerals in the Third Plan is to be 20 per cent of the total expenditure - the same as in the Second Plan.

It was realised by the planners that agricultural development for a country like India is as important as industrial development. The Third and fourth years of the Second Five Year Plan had run into considerable difficulties owing to a fall in agricultural production, due to unfavourable conditions. This had brought about a rise in prices particularly in those of food-grains and had therefore upset all the estimates of Plan expenditure.

The planners had also in their mind the fact that the development of the country is only possible through industrialisation. The Indian agriculture cannot gainfully engage, 70 per cent of the country's population that is dependent on it. Even for any development in agriculture, industrial development is necessary.
FINANCIAL RESOURCES FOR THE THIRD FIVE YEAR PLAN

The physical targets in the public sector during the Third Plan estimated an outlay of Rs. 8,000 crores. The financial outlay estimated is Rs. 7,500 crores. Out of this amount of financial outlay of Rs. 7,500 crores in the public sector, Rs. 6,300 crores were to be by way of investment and Rs. 1,200 crores by way of current outlays on social services and other developmental but recurring items. The Planning Commission had reasonable doubts about the resources, outlays and achievements of the Plan. Such doubts are very natural for a developing economy. The Plan itself acknowledged "There are, however, uncertainties to be reckoned with -" about the targets and physical and financial resources of the Plan.¹

Private sector investment during the Third Plan was estimated to be Rs. 4,300 crores, out of which the private sector itself has to find out Rs. 4,100 crores, and the rest of Rs. 200 crores is to be given by the Government as assistance. Here financial outlay signifies nothing about any economic development plan unless it is looked from the point of view of physical inputs that such outlay may bring forth. The two approaches to any development plan - physical and financial - should be inseparably kept in view. The Plan,

therefore, stated, "The financial and physical possibilities have to be assessed together. The question ultimately is whether there are physical resources corresponding to financial outlays. This aspect has to be taken care of by providing in the Plan adequate increases in output in key sectors and by ensuring that certain types of resources are obtained from abroad."  

The financial means for the Third Plan are to be obtained from the following resources. For the sake of comparison, the financial means obtained from the various resources during the Second Plan are also noted along with the estimates for the Third Plan.
## Table 34

**Public Sector Expenditure: Estimates for the Second and Third Five Year Plans**

(Rupees crores)

<table>
<thead>
<tr>
<th>Items</th>
<th>Second Plan as initially estimated</th>
<th>Actuals</th>
<th>Third Plan estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Balance from current revenues. (excluding additional taxation)</td>
<td>350</td>
<td>- 50</td>
<td>550</td>
</tr>
<tr>
<td>2) Contribution of Railways</td>
<td>150</td>
<td>150(a)</td>
<td>100</td>
</tr>
<tr>
<td>3) Surpluses of other public enterprises</td>
<td>(b)</td>
<td>(b)</td>
<td>450</td>
</tr>
<tr>
<td>4) Loans from the public (net)</td>
<td>700</td>
<td>780(c)</td>
<td>800</td>
</tr>
<tr>
<td>5) Small savings (net)</td>
<td>500</td>
<td>400</td>
<td>600</td>
</tr>
<tr>
<td>6) Provident Fund (net)</td>
<td>-</td>
<td>170</td>
<td>265</td>
</tr>
<tr>
<td>7) Steel equalisation Fund (net)</td>
<td>-</td>
<td>38</td>
<td>105</td>
</tr>
<tr>
<td>8) Balance of misc. capital receipts over non-plan disbursements</td>
<td>250</td>
<td>22</td>
<td>170</td>
</tr>
<tr>
<td>9) Total of 1 to 8</td>
<td>1,950</td>
<td>1,510</td>
<td>3,040</td>
</tr>
<tr>
<td>10) Additional taxation including measures to increase the surpluses of public enterprises.</td>
<td>450(d)</td>
<td>1,052</td>
<td>1,710</td>
</tr>
<tr>
<td>11) Budgetary receipts corresponding to external assistance.</td>
<td>800</td>
<td>1,090</td>
<td>2,200</td>
</tr>
<tr>
<td>12) Deficit Financing</td>
<td>1,200</td>
<td>948</td>
<td>550</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>4,800</td>
<td>4,600</td>
<td><strong>7,500</strong></td>
</tr>
</tbody>
</table>

(a) = Inclusive of increased fares and freights; (b) = Included in items 1 & 8 in the table. (c) = Includes investment by the State Bank out of R.L. 480 funds. (d) = In addition there was a gap of Rs. 400 crores to be covered by additional domestic effort. (e) = This includes investment of R.L. 480 funds by the Reserve Bank in special securities in 1960-61.
The total revenue receipts of the Central and the State Governments during the Third Plan period are estimated to be ₹9,250 crores. The aggregate expenditures, non-developmental and developmental including those on the maintenance of schemes completed by the end of Second Plan period, were estimated to add up to ₹8,700 crores. Thus, the surplus available for financing the Third Plan outlay is estimated to be ₹550 crores. When we compare this figure with the estimated and the actual surplus of revenue available during the Second Five Year Plan, it is very doubtful that a revenue surplus of ₹550 crores would be available during the Third Plan. The Second Plan estimated revenue surplus of ₹350 crores, but ultimately there was an actual overall deficit of ₹50 crores.

Revenue surplus to finance the Third Five Year Plan to the extent expected can only be available if the Governments make all out effort to tap fully the existing resources, promptly detect tax evasion, put a check on wasteful expenditure and minimise expenditure on non-developmental items.

The expected contribution of Railways to Plan finance is quite moderate considering their income.

It has now been accepted as a practical policy that the State enterprises cannot be run on a no-profit no-loss basis nor at a loss on philanthropic grounds. Such enterprises must earn profits, otherwise they are sure to run at
a loss due to inefficient working. The profits, thus earned from them can be ultimately used for further developmental investments. "There is no place in India for the 'hoary myth' that the public enterprises should be run on 'no profit no loss basis'". Of the total estimated surplus of ₹450 crores, from public enterprises, ₹300 crores is to obtained from Central Government enterprises and ₹150 crores from the State Governments' enterprises.

Market borrowings over the Second Plan amounted to ₹780 crores. The target for the Third Plan is ₹800 crores. The estimate of ₹800 crores for the Third Plan period envisages considerable increase in the absorption of Government securities by the I.I.C., various Provident Funds and other investors. It has been expected that the commercial banks would also subscribe such loans. In order to raise money through loans, the Government was asked to raise the rate of interest on its loans. Small savings in the Third Plan were estimated to be about ₹600 crores as against the actual receipts of ₹400 crores under this head during the Second Plan. The Third Plan has to mostly depend on internal resources other than deficit financing, export earnings and foreign assistance, as the scope of deficit financing is now very limited. When we started the Third Plan, we had no

foreign exchange reserves. Considering all these factors, it can be said that plan should depend more on small savings. It has been, therefore, necessary to intensify small savings drive in the country.

For financing the Third Plan an amount of ₹265 crores is to be realised from the Provident Funds, Steel equalisation Fund and balance of miscellaneous capital receipts over non-plan disbursements.

The scope for deficit financing during the Third Plan was extremely limited, because of the high level of prices already reached by the end of the Second Plan. We had no foreign exchange reserve worth the name, which could be used for importing consumers' goods. The amount of deficit financing was, therefore, limited to ₹550 crores. Though there is no scientific method to measure the safe limits for deficit financing, while undertaking such a method of developmental financing, the following view of the Planning Commission was to be kept into consideration. "The amount of deficit financing that can be undertaken has, however, to be judged from year to year in the light of the emerging economic trends".¹

Though the final plan estimated an expenditure of ₹250 crores more than that envisaged in the draft outline, the amount of deficit financing in both the cases remained the same.

¹ Third Five Year Plan : Planning Commission, p. 100.
The resources available from additional taxes during the Third Plan are estimated to be ₹1,710 crores. It was expected that with the increase in national income owing to planning, it should not be difficult to raise this much through additional taxes — direct and indirect. There was a greater scope for raising indirect taxes than for direct taxes, "because the number of assesses paying direct taxes in India is very small".  

The problem of mobilisation of resources through taxation plays a crucial role in the Indian economy. Taxes divert the additional resources generated through the plans towards savings. Taxes in India not only help in mobilising resources but also provide the Government with an instrument for diverting the resources to the desired channels. Taxes help in the redistribution of income and wealth and can help the country in achieving the goal of establishing a socialistic pattern of society. Finally, taxes can keep inflation under control. "The various taxes on personal income, such as capital gains tax, wealth tax, and gift tax are designed (in India) to curtail consumption; similarly, the tax incentives and concessions in respect of corporate taxation are designed to contribute to increased private investment in the priority sectors".  

The Draft outline of the Third Plan published in May, 1960, estimated the receipts from exports at Rs. 3,450 crores over the five year period. The net receipts from invisibles were estimated at Rs. 120 crores. These total receipts would, it was estimated, be matched by payments in respect of maintenance imports also totalling to Rs. 3,570 crores. On this basis the Planning Commission estimated that the external assistance required during the Third Plan would be about Rs. 2,600 crores. The details of this estimate are as follows:

<table>
<thead>
<tr>
<th>Rupees crores.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Payments for imports of capital goods and equipment required for Plan projects . . . . . . . . . . 1,900</td>
</tr>
<tr>
<td>2) Components, balancing equipment etc. for increasing the production of capital goods . . . . 200</td>
</tr>
<tr>
<td>3) Refinancing of maturing obligations . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 500</td>
</tr>
<tr>
<td>================</td>
</tr>
<tr>
<td><strong>Total</strong> . . . . 2,600</td>
</tr>
</tbody>
</table>

Taking into account the Rs. 480 imports worth Rs. 600 crores, the balance of payments gap for the Plan period was estimated to be Rs. 3,200 crores.

Formulating the price policy for the Plan, the
Planning Commission stated that a certain monetary and fiscal policy has to be undertaken for this end. The Third Five Year Plan, for the first time laid down a specific policy for fiscal and monetary measures to be undertaken during the Plan period. No such policy was laid down for the First and Second Plans. As we are mainly concerned with monetary policy which covers the policy relating to currency and exchange, we extensively quote from the Plan documents about the monetary policies that are to be undertaken during the plan period. The Plan stated, "Monetary policy has to go hand in hand with fiscal policy. Just as the latter has to avoid the creation of excess purchasing power through government operations, the former has to regulate the pace of credit creation through banks. The credit needs of a developing economy are continually on the increase and have to be provided for. Care must, however, be taken to see that the scale and pace of developments in the private sector do not go out of line with those envisaged in the Plan and thereby exert undue pressure on the limited resources available for investment. Speculative holding of commodities and accumulation of inventories need particularly to be discouraged. The fact has to be recognised that capital in India is very scarce relatively to the demands for it, and that in the long run interest of the economy, the price to be paid for it should, save in special cases, reflect real costs. This is important both for assessing the priority to be accorded
to various projects in the plan and for determining the prices of the products or services emanating from the projects.

"Without adequate fiscal and monetary discipline, other regulatory measures cannot have the desired effect. But fiscal and monetary policies by themselves may also not suffice to secure the right relationship between various prices or prevent undue hardship to low and fixed income groups. It may be necessary, then, to have physical allocations and direct control in certain sectors."

In short, the plan provides for adequate increases in the output of essential commodities to permit reasonable increase in essential consumption. The primary task is to achieve these targets. Inefficiencies in this respect can be overcome only with difficulty. Fiscal and monetary policies have continuously to be oriented towards restraint in consumption and maximization of savings.¹

The Reserve Bank of India which implements the monetary policies of the Government set forth for itself the following task during the Third Plan period. "In the task of maintaining stability and discipline during development, the role of monetary policy with which the bank is intimately concerned

¹. Third Five Year Plan, Planning Commission, p. 130.
will be important. With continuing investment and rising output, the demand for bank credit in the Third Plan would rise continuously; so, too, would pressure on prices. The Reserve Bank's monetary policy would therefore have to continue to be two-pronged one viz., of ensuring an adequate flow of credit to meet the genuine requirements of agriculture, industry and trade and checking speculative excesses with their inflationary overtones.  

The Third Plan expected an increase in prices for the following reasons: (i) increased governmental spending would create additional purchasing power in the hands of the people; (ii) production would not increase as fast as the income of the people and (iii) increased food grain prices may help farmers to withhold their products for sometime.

The Plan, therefore, aimed at keeping watch on prices and control it from rising by monetary and fiscal measures and by direct controls.

With full knowledge about developmental planning, the Planning Commission expected some reasonable increase in prices. It is hardly possible to finance any development plan without price increases. "The formulation of a suitable price policy" the Commission stated "does not mean that the price level should be maintained at an inflexibly

uniform level". 1

The financial aspect of the Third Plan was severely criticised by some people and their main grounds of attack were that the resources for the Plan were inadequate to reach the physical targets and that the resources as estimated in the Plan cannot be raised. Regarding the amount of Deficit Financing and foreign assistance, the critics had their own views. It was generally felt that the actual amount of Deficit Financing and need for foreign assistance were likely to be much higher than that envisaged. The rest of the criticism of the Plan centred mostly over details. 2

According to Prof. B.R. Shenoy - a firm and determined critic of the Financial resources of the Plan - the rate of savings out of national income during the Plan period cannot go above 8.5 per cent of the National Income. He further calculates that there would be a rise in national income to Rs.14,800 crores in 1965 - 66 at 1948 - 49 prices. And therefore the savings for investments in Developmental work would be only Rs. 5,650 crores.

The Third Plan contemplates an outlay of Rs.11,600 crores, Rs.7,300 crores in public sector and Rs.4,300 crores

in private sector. To this be added ₹. 550 crores on account of repayments of past loans and ₹. 200 crores for building up a buffer stock of food grains, so that the deficit in resources is likely to be ₹. 12,350 crores minus ₹. 5,650 crores, i.e. ₹. 6,700 crores. He even expects that the deficit may be still larger.

Even if we take into consideration the external assistance of ₹. 3,200 crores expected by the Planning Commission, according Prof. Shenoy, there will still remain a deficit of ₹. 3,500 crores. This will have to be made good either by further foreign assistance or by deficit financing. In that case, the deficit financing of ₹. 550 crores contemplated in the Plan seems to be a gross underestimation.

There are many people who have doubts about the actual amount of Deficit Financing in the Plan. The Plan also not stated that ₹. 550 crores would be the absolute amount of deficit financing. In the words of the Governor of the Reserve Bank of India, "The Economic Department of the Reserve Bank estimated, 'on certain assumptions that deficit financing during the Third Plan period should not exceed ₹. 550 crores; this is now a major policy decision written into the Plan. It is not a rigid position that would hold irrespective of other developments". The last

sentence of Mr. Iyengar should be carefully noted.

Prof. Shenoy has not been able to give an alternate modest Plan. What he could at the most predict is that if resources are raised to the extent as calculated by him through deficit financing, it would land the country to a severely inflationary condition. The merit of his thesis centres round some honest suggestions like that the planners should give greater emphasis on agriculture, more money be spent on education and that investments be made in such projects which can give quick results. He also feels that more liberty and concessions be given to private enterprises particularly he pleads for relief in taxation.

He also feels that there should be more check on the leakage in foreign exchange resources, through better fiscal and administrative measures.

The Indian Merchants Chamber had its own view about the Third Plan Finance. According to the Chamber, capital formation from domestic resources during the past few years beginning from the inception of the Second Plan has shown a definite declining trend and in the public sector, forced savings and external assistance have accounted for about 44 per cent of the investment in that sector in the first two years of the Second Plan. It has, therefore, been concluded that there has virtually been no savings in the Government or the corporate sector.
The income the government derives by way of revenues is mostly drawn from small business class and the fear of nationalisation has discouraged foreign investments in India. It was also felt that during the Third Plan, population would increase faster than the rise in agricultural production. It has also been predicted by the Merchants Chamber, that there will be higher consumption and hoarding capacity of the agriculturists, on account of an increase in their income and as such it may cause increase in prices of agricultural commodities and mobilisation of lesser savings. The Chamber did not express its doubts about the capacity of the government to acquire the estimated amount of foreign assistance; though the World Bank Mission which studied India's Third Plan expressed doubts about our capacity to acquire the estimated amount of foreign assistance. "In fact it (the World Bank) is believed to hint that the proposed size of the Third Plan is rather "too big" and reflects an overestimation of the probable resources both internal and external".1

The Chamber's estimate was that foreign exchange requirements during the Plan would be Rs.3,600 crores and not Rs.3,200 crores as envisaged in the Plan. The Chamber thought that Rs.1,650 crores cannot be obtained from the general pool of savings for public sector investment during the Third Plan.

The Chamber therefore gave an alternate plan of an outlay of Rs. 5,400 crores in the public sector. This Plan had no provision for Deficit Financing nor for additional taxation. The views of the Chamber were moderate and sensible. But their views were definitely timid and were advanced mainly keeping in view the interests of private capitalists. It would have been no doubt much better if we had made no provision for Deficit Financing, and this can be the only basis for valid criticism of the Plan.

A Plan to raise the standard of living of 44 crores of people with hardly Rs. 300 per capita annual income cannot be moderate. The first two Plans were the beginnings for bigger Plans. We could not go back to a moderate Plan as suggested by the Chamber after we had already undertaken an investment of Rs. 4,600 crores in the public sector in the Second Plan.

We are again reminded of the remarks of Mrs. Robinson regarding Indian Planning that the menace of poverty and over-population is more acute than the failures of ambitious Plans. And it is therefore more judicious to make bigger Plans — requiring bigger financial outlays and aiming at achieving higher physical output — even if they fail to a certain extent, rather than to let the country languish. A big pull and courage is needed to finance the Plan and to achieve the physical targets. However, care has to be taken to see that stability of prices is maintained — which has in fact not been
done. We have put too much reliance on foreign assistance, and therefore in case of our failure to acquire funds from foreign resources, the whole Plan may be upset.

Monetary policy in the Plan period has very important role to play but as we have already marked, its efficacy depends on various other measures also. The Reserve Bank of India's power for monetary management to control the economy has also its limitations. As the Bank is ultimately guided by the government, the Reserve Bank's liberty is, therefore, restricted to the Government's general policy and particularly in regard to Deficit Financing. "The Reserve Bank has no power to restrict deficit financing, for which the decision is taken solely by the Government. It can, with the economic indicators and statistical material at its disposal, of course, advise. But that is all"."1

AN APPRAISAL OF THE THIRD PLAN PROBLEMS

India's Third Five Year Plan of Rs. 11,600 crores was launched on the 1st April, 1961. The World Bank called it an ambitious Plan and expressed its doubts about our capacity to mobilise internal and external resources to finance the Plan. There were people, who advocated curtailment in the

size and financial implications of the Plan. Some like Prof. Shenoy stated that to implement the Plan, financial outlay required would be much more than that envisaged in the Plan. It was generally felt that the amount of Deficit Financing would not be limited to ₹550 crores. The actual would far exceed this amount. The Planning Commission itself was doubtful about it but it was the implicit policy of the Planners to limit the Deficit Financing to near about this amount. It was also generally felt - and the Planners too had realised that prices would increase on account of Plan investments. It was the policy of the Planners to permit the prices to rise but subject to their control. They had not agreed to the recommendations of the Bernstein Mission, that the Indian economic development should move with price stability. Faith in development with stability has been reaffirmed by Mr. F.P. Schweitzer the I.M.F. Chief.

During the last year of the working of the Second Plan, there was better production of agricultural commodities and as a consequence of this in the first year of the Third Plan, prices declined. The Plan had placed equal emphasis on agriculture and industries. The Plan included within its scope, the objective of the establishment of a socialistic pattern of society.

When the Third Plan commenced, we had a foreign exchange reserve of ₹304 crores, as against a reserve of
Rs. 363 crores a year back. In June, 1961, it went down to Rs. 282 crores. The carry over of total assistance available from the authorisations during the Second Plan was Rs. 365 crores. The Aid India Consortium, which held its meetings from May 31 to June 2, 1961, assured India of the assistance totalling to Rs.1,089 crores, in order both to provide immediate support to our balance of payments and to cover the import orders to be placed during 1961 - 62 and 1962 - 63.

The Plan has been in progress for more than four years now. During this period it had to face three major difficulties — (1) The emergency arising in October, 1962, on account of Chinese attack on India; (2) The soaring prices of food grains during 1963 - 64. The rising trend of prices of food grains is still continuing and (3) The acute shortage of foreign exchange during the recent months. Mr. M.R. Masani, addressing Swatantra Party workers at Hyderabad on the 25th June, said, "That the country was leading towards bankruptcy, was clear from the fall in its sterling balances from Rs.947 crores in 1949 to all time low of Rs.3.54 crores early this month". 1

The emergency situation arising out of the Chinese attack on India did not bring about any major changes in the plan as it was felt that the programme of development of

agriculture and capital goods industries in the plan was even more essential for increasing the defence potential of the country.

The Plan years have been years of bad harvests and this has caused a pressure on prices during all these years excepting the first year of the Third Plan when there was a fall of 3.6 per cent in prices.

The Plan progress has not been upto the mark. Rather it has been disappointing. The mid term appraisal of the Third Plan taken in November, 1963, revealed that the progress during the first two years of the Plan was very slow. The growth in national income was 2.6 per cent in 1961 - 62 and 2.4 per cent in 1962 - 63. According to our Prime Minister Mr. Shastri, "Some of the reasons for it were undoubtedly outside our control. But we would be less than honest, if we did not face up to the fact that our performance was in many respects poor".¹ The performance of the Plan during the third and fourth year has been better than that in the preceding two years. There has been an increase of 4.5 per cent in our national income in the third year and the rate of growth in 1964 - 65 should on all accounts be better.

¹. The Address of the Prime Minister, Mr. Lal Bahadur Shastri at the 21st Meeting of the National Development Council. Reported in the Hindustan Times, October 29, 1964.
THIRD PLAN - MONETARY POLICY AND FOREIGN EXCHANGE

INFLATIONARY TRENDS

As we have already stated the general index of prices declined by 3.6 per cent in 1961 - 62. But prices started rising from April, 1962. We may note that till 1962 - 63, price index of food articles was lower than the General Index but, now the position has been reversed.

TABLE - 35

INDEX NUMBER OF WHOLESALE PRICES (1952-53 = 100)

(1961-62 to October, 1964)

<table>
<thead>
<tr>
<th>Average monthly week ended Saturday</th>
<th>General Index</th>
<th>Food Articles</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961 - 62</td>
<td>125.1</td>
<td>120.1</td>
</tr>
<tr>
<td>1962 - 63</td>
<td>127.9</td>
<td>126.1</td>
</tr>
<tr>
<td>1963 - 64</td>
<td>135.3</td>
<td>136.8(^1)</td>
</tr>
<tr>
<td>April '64</td>
<td>141.0</td>
<td>144.3</td>
</tr>
<tr>
<td>May '64</td>
<td>144.1</td>
<td>149.5</td>
</tr>
<tr>
<td>June '64</td>
<td>147.7</td>
<td>155.1</td>
</tr>
<tr>
<td>July '64</td>
<td>152.3</td>
<td>161.7</td>
</tr>
<tr>
<td>August '64</td>
<td>156.8</td>
<td>166.0</td>
</tr>
<tr>
<td>Sept. '64</td>
<td>159.7</td>
<td>171.4(^2)</td>
</tr>
<tr>
<td>October '64</td>
<td>155.8</td>
<td>165.8</td>
</tr>
</tbody>
</table>

The prices started rising from the middle of 1962 and the most sharp rise was between April, 1964 and September, 1964. According to our Finance Minister, Mr. T.T. Krishnamachari, "The wholesale prices had risen by about 15 per cent over last year and there had been a particularly sharp increase in prices of food grains, edible oils and other food articles".¹

The rise in price has been on account of slow progress in increasing agricultural production, and some other consumers' goods, coupled with an increase in their demand, due to an increase in the incomes of the people. This increase in the incomes of the people has been caused by huge expenditure on long term projects.

The index of agricultural production declined from 141.4 in 1961 - 62 to 136.8 in 1962 - 63. Agricultural production in 1963 - 64 declined further. According to the Reserve Bank of India Report for 1964, "There has been virtual stagnation in food grains production around the level 81 million tonnes in the past three years".²

Industrial production in 1963 - 64 expanded by 9.1 per cent and this increase was higher than that of the previous two years. However, the rate of increase achieved in

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1963 - 64 is still below the Plan target of 11 per cent.

Another cause of price increases was the sudden increase in defence expenditure on account of Chinese invasion in October, 1962. The Government gave equal importance to defence and economic development. The 1962 - 63 Budget had originally provided for a defence outlay of Rs. 376 crores. The actuals for the year came to Rs. 505 crores. This represented an increase of Rs. 129 crores in expenditure on defence over the budgeted amount. Defence expenditure was raised without curtailing Plan outlays. The Budget estimate of Defence expenditure in 1963 - 64 was Rs. 867 crores. Addressing the Lok Sabha on the 17th September, 1964, the Finance Mr. T.T. Krishnamachari said, "It was idle to think, that a country could be strong militarily without being strong economically. The decision to go ahead with defence and development, was one, which could not be reversed merely because there had been failures of supplies causing hardships in short run".¹

The recent increase in wages has also added to the cost of industrial production and has pushed up prices in general.

Although official action was constantly focussed on holding down the prices of essential articles of mass consumption through a variety of measures, such as increased imports,

¹ Reported in 'The Hindustan Times' dated the 19th September, 1964.
larger internal procurement of food grains as well as their
distribution through a net work of fair-price shops and co-
operative stores, but even all these measures have failed to
keep the prices under check.

THE SUPPLY OF MONEY DURING THE THIRD PLAN YEARS

There has been a constant increase in the supply of
money during the plan years and naturally this had also
affected prices. The rate of increase in money supply with
the public was as under:

TABLE - 36

MONEY SUPPLY WITH THE PUBLIC*

(Rupees crores)

<table>
<thead>
<tr>
<th>Last Friday</th>
<th>Currency with the public</th>
<th>Deposit money with the public</th>
<th>Money supply with the public</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961 - 62</td>
<td>2,201.16</td>
<td>884.66</td>
<td>3,045.82</td>
</tr>
<tr>
<td>1962 - 63</td>
<td>2,379.49</td>
<td>930.51</td>
<td>3,309.98</td>
</tr>
<tr>
<td>1963 - 64</td>
<td>2,602.05</td>
<td>1,147.15</td>
<td>3,749.20</td>
</tr>
</tbody>
</table>

March 31, 1964
to
January 15, 1965 x x 4,003.68

* Reserve Bank of India : Annual Report on
  Currency and Exchange, 1963 - 64, Statement
No. 9 and Government of India : Economic Survey,

It has been the view of the Reserve Bank of India
that monetary factors were equally responsible for the constant increase in prices during the past few years of the working of the Third Plan. Money supply increased rapidly but production was virtually stagnant. "Viewed from the purely monetary angle, an important factor contributing to the deterioration in prices was the rapid increase in liquidity which outstripped the sluggish growth of output in the economy".¹ Money supply in 1961 - 62 increased by Rs.177.21 crores to Rs.3,045.82 crores. It increased by Rs.264.16 crores and Rs.439.22 crores in 1962 - 63 and 1963 - 64 respectively. Between the 31st March, 1964 and 15th January, 1965, there was an increase of Rs.254.48 crores in money supply.

The faster rate of increase in money supply was mainly induced by the more rapid credit creation by the banking system for private trade and industries, Governmental indebtedness to the banking system, comprising investments in Government securities by the Reserve Bank and other banks and ways and means advances adjusted for Government's cash balances with the Bank.

The increased money supply which was responsible for the rise in prices combined in itself an increased supply of currency and credit. The increase in the supply of currency during the past few years of the working of the Third Plan

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has been considerably high on account of increasing rate of Deficit Financing. The aggregate rate of Deficit Financing during the past three years has been much higher than that contemplated in the Plan. This has been due to simultaneous spending on Defence and Development. As against an estimated deficit financing of Rs. 550 crores in the whole plan period, the deficit financing during the first three years of the Plan itself exceeded this amount. The amount of Deficit Financing in 1961 - 62 was Rs. 168 crores in the revised estimate for 1962 - 63 it was Rs. 171 crores and the estimated amount for 1963 - 64 was Rs. 330 crores. In 1964 - 65, the estimated amount of deficit financing was suddenly lowered in view of the steep inflationary rise in prices. The budget estimate of deficit financing for 1964 - 65 was only Rs. 97 crores but the actuals have been Rs. 80 crores. The budget for the year 1965 - 66 estimates on overall surplus of Rs. 10 crores. The Government was deterred from proposing any deficit financing in the current year on account of the steep rise in prices in 1964 - 65 and particularly in that of food articles which worked out about 30 per cent in 1964 - 65.

As we have already marked, it has not been the policy of our planners to maintain rigid price stability. They have believed in the theory that price increase is inevitable during the process of our economic development. It is for this reason that the Government made no serious attempts to keep the prices fixed or develop an apparatus which can be
used against any undesirable rise in prices, with hundred per cent success. The Government made feeble attempts from time to time to check price rises without much success. The Reserve Bank which is capable of influencing the Government's opinion about rising prices, has favoured the idea that there should be development with stability in the country. But it has not emphatically stated the same and at times have given vague opinions, as it would be obvious from the following quotation from the Reserve Banks of India's Annual Report which states: "If conflict between development and stability is to be resolved satisfactorily, it is essential to maintain a continuous watch on the pace and direction of development". 1

Although the World Bank has been of the view that inflation in India is not so acute as in Brazil and Chile but this should not make us feel complacent specially in view of the recent abnormal rise in general price index and in that of food articles in particular. Mr. George Wood the World Bank President at a Press Conference at Delhi on August 26, 1964 said, that there are many other countries in the world like Brazil and Chile, where prices had been much higher than in India. 2 While drawing some consolation from Mr. Wood's statement, we should not forget the remark of the I.M.F.

Chief, which was virtually a repetition of the Bernstein Mission's view on stability and economic development. He said, "that monetary and financial stability is the essential pre-requisite of sustained economic growth".¹

Price situation during the past few months has been extremely critical and while the Planning Commission is busy in preparing the Fourth Plan of over Rs 21,000 crores, the people are speaking of a run away inflation in the country in the near future. About the recent price increases, the Reserve Bank has to say the following: "The price level as measured by Economic Adviser's Weekly General Index of wholesale prices (base 1952 = 53 = 100) at the end of November, 1964 at 155.6 showed only a nominal decline of 0.17 over the month as compared to a decline of 1.8 per cent in the corresponding month of 1963. Over the year, the general price index showed a rise of as much as 16.6 per cent. The all-India consumer price index (base 1949 = 100) for October, 1964 which is the latest available, at 163.0 - an all time record - was higher by 18.1 per cent over the year as compared to a rise of 3.0 per cent in the preceding year".²

If the price rise in the country continues at this speed, it is quite possible that we may have to face inflationary conditions similar to those in Brazil and Chile.

¹ Address by Mr. Pierre Paul Schweitzer, Managing Director, I.M.F. before the Indian Institute of Public Administration, New Delhi, October 5, 1964.
We have already marked that people are preferring to hold more in durable goods than in money during the past few years and if the rate of price increases continues uncontrolled, the day is not too far when the people may generally avoid to deal in money and prefer commodity exchanges.

BLACK MONEY

We have discussed the various so far known reasons which have caused the present steep price rises. But another factor, which has drawn attention recently, has also been responsible for the rise in prices. And that is currently called "Black money" or "Unaccounted money".

'Unaccounted money' or 'Black money' is real money; it is a part of the currency in circulation which has been created by the Reserve Bank of India or the Government of India's Finance Ministry. When it is called unaccounted money, we imply that it has not been brought within the ambit of our normal tax laws, and that it is not amenable to fiscal and monetary control. It has been called 'Black money' because the methods by which it has been earned by traders, contractors, or administrative officials are not fair in the eyes of law. It has been earned through black-marketing, speculation, bribery, smuggling or through some such other means.

This unaccounted or 'Black money' remains hidden in the lockers of the banks and remains in that form of hard cash
or in near liquid assets. Thus in a nutshell we can say that it remains in highly liquid form and moves about most freely.

The amount of black money has been any body's guess. Various people have given their own estimates of black money. The amount of 'black money' has been calculated to be ranging from ₹3,000 crores to ₹6,000 crores at a time when the total note circulation was about ₹2,400 crores. As it is 'black money' i.e. 'unaccounted money', no exact estimate of it can possibly be made.

The economic effects of black money or unaccounted money have been mainly three. As this money is outside the ambit of tax authorities, it has not been possible for the fiscal authorities to control it through fiscal means. The use of black money pushes up the demand and hence also the prices of certain types of things such as land, houses, durable consumers' goods and luxury goods. It thus puts the honest citizens and particularly the fixed income group at a disadvantage as compared to the possessor of ill-gotten money.

As we have already stated this money is always kept in highly liquid form and it not attached to any particular trade or business. It is used for hoarding of any commodity that for the time being is in supply. Thus it artificially

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makes the commodity more scarce and encourages black-marketing. The recent price increase of food grains has been partly on account of 'Black money', which has made the existing scarcity more acute.

The way to tackle 'Black money' should be found through both social and economic measures. The people concerned, should be made to realise that 'Black money' acts against the interests of the society. This task has to be fulfilled mainly by the social reformers. Simplification of tax structure would also go a long way in overcoming the menace of 'Black money'. The Finance Minister has already taken some measures in this direction but a lot more still remains to be done regarding it. It has also been said that if the taxes are reasonably reduced, the incentive for evasion of taxes will be much less and thus a major source of creation of 'Black money' will gradually vanish. However, under the present circumstances when the country has to provide for big outlays on defence and economic development, there is little chance of taxes being reduced. Greater efficiency and integrity in the administration specially in that of income-tax are also essential for successfully tackling the problem of 'Black money'. Demonetization of notes of denominations of rupees hundred and above is also a suggested measure which finds quite a good number of supporters in the country. This suggestion has also been given by some members of the Parliament. But the Finance Minister Mr. T.T. Krishnamachari, has
rejected any such action and has categorically denied all
rumours about the demonetization of high denomination notes.
According to Mr. Krishnamachari such a step would create a
State of near standstill in the country. It would create a
condition of standstill in the wholesale trade and jeopardise
our economy.

The best way to make the 'Black money' or what we
call 'Unaccounted money', sterile is to increase production
and end the scarcity of all essential commodities. Under such
circumstances, even if there is 'Black money' in the country,
it would not be in a position to interrupt in the smooth
working of the price mechanism.

THE RESERVE BANK'S MONETARY MEASURES
DURING THE THIRD PLAN

There have been two opposite monetary forces working
in the country during the past four years of the working of
the Third Plan. As already stated earlier, there was an
expansion of money supply - cash and credit both - during
the past four years. On the other hand, the Reserve Bank
followed a number of regulatory and anti-inflationary measures.

The three-tier system of slab rates, which was intro-
duced on October 1, 1960 was the chief instrument of credit
control employed by the Reserve Bank in the first year of the
Third Plan. Selective credit controls, however, were
liberalised in view of the improvement in the supply and prices of the commodities subject to such controls.

During the year 1961 - 62, the banks had progressively raised their lending rates, with the result that at the end of December, 1961, nearly 50 per cent of the advances were at interest rates higher than 6 per cent against an average rate of about 4 per cent at the end of 1960.

The pressure on prices and the slow pace of seasonal credit contraction during 1962, slack season led the Bank to tighten access to its accommodation. Effective from July 2, 1962, the basic quota for borrowing at the Bank rate was reduced by one-half to 25 per cent of the average statutory reserves of each scheduled bank for the preceding quarter. Borrowing in excess of the quota up to 200 per cent bore a rate of 1 per cent above Bank rate, the excess over 200 per cent and up to 400 per cent of the quota, a rate 2 per cent above Bank rate; and the amount exceeding 400 per cent of the quota, a rate 2.5 per cent above the Bank rate.

The position of the banks' borrowing rates from the Reserve Bank as it stood on March 16, 1962, was that 42 banks had borrowed at the maximum rate of 6 percent, 15 banks borrowed at 5 per cent and 7 banks at 4 per cent. The average rate of interest on the banks borrowing from the Reserve Bank on that date was 5.09 per cent.
The effective cost of borrowing of the banks was somewhat higher as on their borrowing against usance bills (which constituted nearly 3/4th of their borrowings) a stamp duty of 0.2 per cent - the incidence of which on actual borrowing was somewhat higher - was chargeable.

While the slab system of lending rates was intended to induce banks to be cautious in advancing loans, it was considered desirable to prevent its operation from having an adverse effect on the flow of institutional credit to specially deserving sections. ¹

The year 1962 - 63, witnessed two very important events - the Chinese aggression and the pressure on prices from mid-1962.

The possibility of a further pressure on prices owing to emergency caused by Chinese attack on India led to a more stringent policy of credit control by the Bank. Accordingly from October 31, 1962, the Bank revised the structure of its lending rates and for the first time regulated the availability of credit to banks by fixing a ceiling on such accommodation equal to a bank's average statutory reserves during the previous quarter. Borrowing up to 25 per cent of the statutory reserves were to be permitted at the Bank rate.

viz., 4 per cent another 25 per cent of it at 5 per cent and
the balance at 6 per cent. Borrowing in excess of the basic
quota was charged at a higher rate which in effect worked out
to 6½ per cent. In order to ensure that the genuine needs of
industry and trade were adequately met, the revised policy was
operated with a large measure of flexibility.

The Bank Rate was revised in May, 1957, when it was
raised from 3½ per cent to 4 per cent. Effective from the
close of business of January 2, 1963, the Bank Rate was further
raised by ½ per cent to 4½ per cent. The dear money policy
of the Reserve Bank is justified on the following grounds.
Firstly, dear money policy is anti-inflationary. Secondly,
it would help in the economical use of scarce capital in an
underdeveloped country like India where capital is scarce.
In his presidential address to the Indian Economic Association,
Prof. S.K. Basu suggested that the Bank rate be raised further
and should not be pegged at 4½ per cent. His argument for
an increase in Bank Rate is that in a capital scarce economy,
the maintenance of a low and stable interest rate policy is
likely to hamper, rather than stimulate economic growth and
capital formation. A relatively high interest rate struc-
ture will help in economising the use of capital and bring
about a desirable change in the allocation of resources. In
certain circumstances, low interest rate may tend to encour-
age substitution of capital for labour and provide an
incentive to wastage rather than economy, of scarce capital
resources. It may also tend to stimulate unhealthy practices in company financing by placing too much reliance on loan capital, rather than on equity, as is already being witnessed in India. Post-war Japan offers a good example of a country achieving a high rate of economic growth and capital formation with a high interest rate structure. ¹

In order to curb the constant increase in prices since the end of November, 1963, the Reserve Bank's Rate was further raised from 4½ per cent to 5 per cent on September 25, 1964. Simultaneously, with the increase in Bank Rate to 4½ per cent in January, 1963, the lending rates were simplified into a two-tier system by merging the first two slabs. Banks were permitted to borrow in each quarter, a sum equal to 50 per cent of their average statutory reserves during the previous quarter at the Bank Rate and the remaining 50 per cent at 6 per cent; and borrowing beyond that level was to be charged at a higher rate which was fixed at 6.5 per cent.

In line with the general physical controls, selective credit controls were also tightened. The Bank withdrew its exemption in respect of advances against warehouse receipts for wheat and paddy. Margin for such advances was imposed for the first time between January and March, 1963.

¹ Dr. S.K. Basu's Presidential Address to the forty-sixth Annual Conference; Reported in 'Commerce', 4th January, 1964, p.2.
There was no great change or innovation in monetary policy in 1963 - 64. In the field of selective credit controls, the main developments were the (i) relaxation of control on advances against shares; (ii) tightening up of control on advances against paddy, rice and ground-nuts and (iii) reimposition of the control on advances against wheat.

With renewed pressure on commodity prices, the Reserve Bank reduced on March 11, 1964, the borrowing quotas and lending rates to the levels prevailing before the end of October, 1963. Banks were permitted to borrow a sum equal to 50 per cent of the statutory reserves at the Bank Rate of 4½ per cent and the remaining 50 per cent at 6 per cent; any borrowing beyond this limit was to be in the nature of especial accommodation.

The overall aim of Reserve Bank’s credit policy has been to maintain both a general and selective restraint on credit and a pruning down of less essential demands through the combination of quantitative and selective credit control measures.

As we have already stated the aim of the Indian planners has never been to maintain rigid price stability and they have never thought that it should be maintained at all costs through monetary and fiscal measures. Some rise in prices was thought to be inevitable. Possibly it has been thought that at the time of any abnormal rise in prices, it
would be possible for them to control it though monetary fiscal and other non-monetary devices. But in a country like India, where dealings are generally made in cash and as much as one-third of the dealings are made without the use of money, the Reserve Bank's capacity to check inflationary rise in prices through monetary measures gets somewhat restricted. The Reserve Bank's capacity to check inflationary price rise is further limited on account of the fact that it has no power to limit the amount of deficit financing, which has been taken to be the easiest method to fill up the gap in the plan's financial resources. Due to administrative failures the Government has not been able to implement the non-monetary and non-fiscal measures to check the rising prices. Its utter helplessness in this respect is obvious from its appeal to the people that they should not hoard food grains and should disclose hidden incomes of those who might have concealed it from the tax authorities. The Government of India has also increased the reward for such disclosures from 5 per cent to 10 per cent of the Income tax gained. The Reserve Bank's own policy about monetary management has been that of "flexibility with reference to changing overall requirement of the economy".¹ This flexibility is meant to fall in line with the changes in the Government's fiscal and monetary policies.

If the present trend of rising prices is to be checked the Reserve Bank's views and advice should carry greater weight with the government and it should not be forced into following certain monetary policies. It is now recognised both by the government and the Reserve Bank that there should not be any more Deficit Financing. As we have stated the budget for 1965 - 66 anticipates an overall surplus of Rs.10 crores and in the year 1964 - 65, the actual Deficit Financing was less than that anticipated. Further the Draft on the Fourth Plan clearly states that there should be no Deficit Financing in the Fourth Plan. An all-out effort has to be made to increase production in the country particularly that of food grains. And finally we can say that an all out effort should be made to check inflation too, because, "The penalty we have to pay for inflation is not merely the sacrifice of future development; it is the threat to current economic social and even political stability".¹

FOREIGN EXCHANGE DURING THE THIRD PLAN

The Third Five Year Plan expected foreign assistance of Rs.2,600 crores. At the inception of the Plan we were assured of an assistance amounting to Rs.1,089 crores by the Aid-India Club for the first two years of the plan. The

carry over of the assistance promised in the Second Plan was Rs. 365 crores. The total amount of foreign exchange reserve with the Reserve Bank was Rs. 282 crores.

In August 1963, the members of the Aid-India Consortium again met and pledged aid amounting to £ 1,052 millions for the third year of the Third Plan. The consortium of governments and institutions interested in development assistance to India held its tenth meeting on May 26, 1964 under the Chairmanship of the World Bank. At this meeting they promised aid for the fourth year of the Plan amounting to £ 1,028 millions.

The consortium at its twelfth meeting on April 21, 1965 discussed aid to India during the final year of the Third Plan. The additional aid pledged for the final year as agreed to in this meeting is £ 1,027 millions.

Members of the consortium considered it important that a substantial part of the aid to be extended to India during the coming year should be in the form of non-project aid which could be used to finance imports required for the maintenance of the Indian economy. According to them up to one-half of the aid pledged at the meeting should be in this form. Two-thirds of the aid pledged for 1965 - 66 will consist of grants and low interest loans repayable in 25 years or more.
TABLE - 37

AID PLEDGED BY THE AID INDIA CONSORTIUM FOR THE
THIRD PLAN (YEARWISE)*

(£ millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Aid (£ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961 - 62</td>
<td>1,295</td>
</tr>
<tr>
<td>1962 - 63</td>
<td>1,070</td>
</tr>
<tr>
<td>1963 - 64</td>
<td>1,052</td>
</tr>
<tr>
<td>1964 - 65</td>
<td>1,028</td>
</tr>
<tr>
<td>1965 - 66</td>
<td>1,027</td>
</tr>
</tbody>
</table>

Total for 5 years .... 5,472

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Before we enter into a detailed discussion about the foreign exchange problems that we had to face during the working of the Third Plan, it would be proper for us to keep in our view the position regarding India's foreign trade during the past four years. A glance at the figures will give us an idea about the magnitude of the problem.
TABLE - 38

INDIA'S FOREIGN TRADE (MERCHANTISE)
(1959-60 TO 1964-65)
(Rupees lakhs)

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
<th>Balance of trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>1959 - 60</td>
<td>961,45</td>
<td>639,65</td>
<td>- 321,80</td>
</tr>
<tr>
<td>1960 - 61</td>
<td>1,122,48</td>
<td>642,07</td>
<td>- 480,41</td>
</tr>
<tr>
<td>1961 - 62</td>
<td>1,093,08</td>
<td>660,58</td>
<td>- 432,50</td>
</tr>
<tr>
<td>1962 - 63</td>
<td>1,133,15</td>
<td>685,32</td>
<td>- 447,83</td>
</tr>
<tr>
<td>1963 - 64</td>
<td>1,221,19</td>
<td>793,24</td>
<td>- 427,95</td>
</tr>
<tr>
<td>1964 - 65</td>
<td>1,210,27</td>
<td>838,43</td>
<td>- 371,84</td>
</tr>
</tbody>
</table>

There was a sharper fall in foreign exchange reserve in 1961 - 62 than that in 1960 - 61 despite the improvement in the trade balance. During the year 1961 - 62, there was a net drawing from the I.M.F. amounting to Rs. 58 crores, in addition, our own foreign exchange reserves were drawn down by Rs. 41 crores. Thus, the total draft on reserves was Rs. 99 crores as against a draft of Rs. 45 crores in 1960 - 61. The sharper fall in our foreign exchange reserves inspite of an improvement in the balance of trade position was on account of the net outgo on banking capital account, higher amortization payments and reduced inflow of capital on private account.
With a view to plug the leakage in our foreign exchange earnings, on account of foreign travel, certain steps were taken in 1961 - 62.

The year 1962 - 63 opened with our foreign exchange reserve under a severe strain. During 1961 - 62, as we have already noted foreign exchange reserve had fallen by Rs. 41 crores despite our drawing from the I.M.F. to the extent of Rs. 58 crores. The greatest pressure was felt at the end of 1961 - 62. A standby agreement with the I.M.F. was therefore entered into for U.S. $ 100 millions and the equivalent of U.S. $ 25 millions (about Rs. 12 crores) was drawn in July, 1962. During the year 1962 - 63 not only the I.M.F. drawings were repaid but the reserves also rose by Rs. 48 crores. There was thus a favourable swing of the order of Rs. 147 crores.

The main reason for this was the quicker pace of reimbursement received from U.S. Agency for International Development loans amounting to Rs. 90 crores. The improvement in exports, partly attributable to transactions relating to Goa, Daman and Diu, was itself of the order of Rs. 35 crores.

Allowing for net drawings of Rs. 58 crores from the I.M.F. in the financial year 1961 - 62 as against Rs. 12 crores in 1962 - 63, the draft on reserves in 1962 - 63 was only
Rs. 14 crores as against Rs. 64 crores in 1961 - 62.

In 1962 - 63, the measures, like the imposition of restrictions on foreign travel, the steps taken to check smuggling, the amendment of the Sea Customs Act and the Gold Control Order, as well as large untied foreign assistance seem to have contributed to the favourable turn.

The Board of Trade was established in May, 1962 in order to promote Indian exports. Various other export promotion measures were taken in 1962 - 63, but even then the Reserve Bank of India in its annual report for the year ending June, 1963 stated, "The average annual increase in exports necessary to attain the Third Plan target yet remains to be achieved". ¹

In the year 1963 - 64, the scarcity of foreign exchange continued to cause a severe strain on the developmental programme, though there was a better performance on the export front and a sizeable inflow of external assistance. The foreign exchange reserves which had risen by Rs. 48 crores in 1962 - 63 fell by Rs. 10 crores in 1963 - 64 to Rs. 279 crores. The draft on the foreign exchange reserves during 1963 - 64 was mainly attributable to the repayment of Rs. 24 crores of the outstanding indebtedness to I.M.F.

which together with the increased payments for imports offset the considerable increase in receipts from exports and foreign aid. The deficit on current account had narrowed down from Rs. 345 crores in 1962 - 63 to Rs. 335 crores in 1963 - 64 as a result of record earnings and improvement in invisibles.

On account of general stringency of foreign exchange, the import policy for the year 1964 - 65 as announced on March 31, 1964 was basically restrictive.

The year 1964 - 65 turned out to be a difficult year for our balance of payments. We have imported large quantities of food and fertilisers during the year on account of food shortages in the country. Our outlay of foreign exchange on defence account was also on the increase.

Keeping in view the urgency of increasing industrial production and taking into account the rise in prices abroad, the Government had to allocate a significantly larger amount for imports of raw materials and components in 1964 - 65. As stated by Sri T.T. Krishnamachari, the Government expected, "That the rising trend in exports would continue during 1964-65 and would offset the outgo under larger import commitments".1

Actually our export earnings in free foreign exchange did not increase in 1964 - 65. The world price of some of our exports such as sugar fell sharply and we had to reduce the quantity of some of our exports in view of domestic

shortages.

The net result was that our foreign exchange reserves declined from Rs. 188 crores at the end of March, 1964 to Rs. 116 crores by the end of March, 1965 i.e., by about Rs. 72 crores in 1964 - 65.

At the beginning of the Third Plan, our foreign exchange reserves were hardly sufficient - already exhausted the war time accumulation of Sterling Balance, - to help us tide over the normal fluctuations in our trade balances. The Third Plan, therefore, did not envisage any drawing down of the reserves over the five year period. At the end of the three years of the Plan, our reserves were at virtually the same level as at the beginning of the Plan, but this became possible only through increased indebtedness to the I.M.F. during this period.

In view of the decline in our foreign exchange reserve during 1964 - 65, we entered into a standby agreement with the I.M.F. for $200 millions in March, 1965.

As against this standby agreement for $200 millions with the I.M.F. in March, 1965, our repayment obligations to the Fund itself amounted to $175 millions between March, 1965 to March, 1966. "Over the current year, therefore", stated Shri Krishnamachari, "we have to live within our own export earnings and such foreign aid as is already in
sight and as may be forthcoming". ¹

For all these years of the Planning, we were mostly concerned with the problem of acquiring foreign aid, but now the problem of repayments has also to be tackled. According to a recent study made by the National Council of Applied Economic Research, it has been found that India's foreign debt obligations rose from ₹49.80 crores in 1951 to ₹1,800 crores in 1964.² Since many of the early foreign loans were acquired on hard terms, this has cast on us a heavy burden of debt servicing leading to an exacerbation of our already acute balance of payment position. On account of some repayments of debts currently falling due and the heavy interest payments to be made, the benefit to be derived from fresh foreign aid is likely to be minimised. Two ways of getting out of this crisis of foreign exchange shortages have been recently suggested — (i) A moratorium on debt repayments and (ii) The devaluation of the Rupee. These two have been suggested over and above the measures for severely restricting imports and stimulating exports that have been recently taken by the Government. The Government of India does not agree, and rightly too, with the above two suggestions. Declaration of moratorium will mean that the country is not

creditworthy and this will jeopardise any future foreign aid and even foreign trade. In the words of the Finance Minister, "It has been said that in our present (foreign exchange) difficulties, we propose to declare a moratorium on our debt payments. I would like to make it clear that Government have no such intention. We shall meet our debt obligations as indeed all our obligations". About devaluation we shall make a detailed discussion later on. The foreign exchange crisis, balance of payments problems and the problems of debt repayment are interrelated and ultimately these problems are closely connected with the economic development of the country. As pointed out by the World Bank's recent study, the performance of the Indian economy has been persistently poor. It was pointed out that there has been a setback in industrial production in recent years, particularly in 1964 - 65. The Bank expressed its anxiety over the virtual stagnation in agriculture. The Bank is believed to have emphasised that all development programmes will be meaningless unless we achieve self-sufficiency in food. The World Bank study has, it is learnt, suggested a nine point programme to accelerate the growth rate in Indian economy. Some of the points suggested are —

1) Higher rate of industrial production through a policy of liberal import of raw materials and spare parts for those industrial plants which are idle.

2) Higher internal production of fertilisers for increasing food production.

3) Adoption of a selective scheme of subsidy, if necessary for promoting exports.

4) Priority be given to investment in those public sector undertakings which can acquire adequate return for financing their expansion and development.

5) The Bank is believed to have favoured some modifications in the fiscal and monetary policies in order to encounter inflation and bring about orderly economic growth.

THE POSITION OF PORTUGUESE ESCUDO NOTES AND COINS CONSEQUENT ON THE LIBERATION OF THE FORMER PORTUGUESE OCCUPIED TERRITORIES IN INDIA

In the former Portuguese territories in the India, the currency circulation was known as Escudo and consisted of notes and coins. Soon after the liberation of Goa, Daman and Diu in December, 1961, Military Governor of these territories issued a proclamation on December 29, 1961 whereby both the Indian currency and the Escudos were declared legal tender in Goa, Daman and Diu. The proclamation fixed the rate of exchange at six Escudos to the Rupee. The value of the Escudo notes and coins exchanged for Indian currency up to the 31st March, 1962 amounted to ₹6.10 crores.
With the promulgation by the President of the Goa, Daman and Diu (currency and coinage) Regulation 1962, Escudo notes and coins circulating in the former Portuguese territories were demonetized with effect from May 15, 1962. Section 5 of this Regulation, which provided that Central Government might, at its discretion, accept Escudo currency for exchange for such further period after its demonetization, as might be considered necessary. Exchange facilities were given up to the 14th July, 1962 in the case of Escudo/Portuguese Rupee notes and up to the 14th August, 1962 in the case of Escudo/Portuguese Rupee coins.

These facilities were provided at the branches of the State Bank of India in Goa and Daman and the State Bank of Saurashtra in Diu. Arrangements were also made for their conversion in the various treasuries of Goa, Daman and Diu. The total exchange value paid up to the above dates amounted to Rs. 9,48 crores.

With the demonetization of Half Rupee of Hyderabad, the French currencies in Pondicherry and last of all the Portuguese Escudos, the Indian Rupee is now the only legal tender currency for the whole of the Indian Union.

GOLD CONTROL

It is a generally known fact that a large portion of our foreign exchange earnings is drained out through
gold smuggling. The technique adopted in the case of gold is the same as that for smuggling of other commodities. This is done through under invoicing of the exports and over invoicing of the imports. When the value of a commodity is under invoiced, the amount of foreign exchange received as per invoice is surrendered to the Reserve Bank. But through a secret understanding, the balance not included in the invoice is retained with the foreign importer of Indian goods. This enables purchase of commodities in foreign countries for being smuggled into our country. Suppose a firm A sends $5 lakhs worth of goods to U.S.A. and underinvoices it at $3 lakhs. The firm A surrenders only $3 lakhs to the Reserve Bank. The remaining $2 lakhs is used for payment for the goods that are to be smuggled into India. The same amount may very well be used for the purchase of gold to be smuggled into the country.

Conversely, over invoicing of imports helps the importer to retain a portion of the foreign exchange sanctioned by Reserve Bank, in foreign countries. And this money is used for purchasing gold smuggled inside the country.

Thus smuggling of gold and goods were causing a drain on our foreign exchange resources, Gold Control Ordinance was promulgated mainly to prevent this drain. It cannot be said that the ordinance which has now become an Act, has totally checked gold smuggling, but according to our
Finance Minister, it has at least lessened the amount of gold smuggling.

Mr. Vinod Prakash in his paper, "An estimate of the stock of precious metals in India" had estimated that at least Rs. 30 crores worth of gold was smuggled in India in 1952. Taking this as a rough annual average, he calculated that gold worth Rs. 340 crores has been smuggled into India since 1947. His paper was submitted about five years before the Gold Control Ordinance was promulgated. If the figures for these years are taken into account, the amount of gold smuggled since 1947 and up to the 31st March, 1963 would be worth about Rs. 500 crores.¹

The forward markets commission in its report stated that the value of gold smuggled into India was roughly Rs. 30 to Rs. 40 crores per annum, before the Gold Control Ordinance was promulgated. This figure has also been quoted by our Finance Minister. Whatever may be the basis of calculation of different authors, one thing is certain, that they had no means to make an exact calculation of the amount of gold that has been smuggled in India during the past several years, before the Ordinance was issued. However, the sum and substance of their calculations is that gold of considerable value was being smuggled into India every year and

was causing considerable pilferage of our foreign exchange resources. Thus, foreign exchange which India needs for more useful purposes has been wasted on gold smuggling. It was stated by the Reserve Bank, that, "A factor affecting the balance of payments of the country has been the continued smuggling of gold". ¹

Efforts were made before 1963 to stop such leakage of our foreign exchange. But the results were not very encouraging. In September, 1962, further steps were taken and an Act was passed which brought gold within the perview of the Industries (Development and Regulation) Act, 1951. This enabled the Central Government to take steps to regulate the production, supply and distribution of gold. This was followed by a ban on forward trading of gold effective from November 13, 1962. On January 9, 1963, the Government promulgated the Gold Control ordinance providing inter alia for the declaration of holdings of non-ornament gold, registration of dealers in gold, a ban on sale and purchase of gold except on permits and prohibition of manufacture of ornaments of more than 14 carat purity. To administer the Gold Control, a Gold Control Board was also established. These developments caused the stoppage of official trading in gold. But dealer to dealer transactions in declared gold commenced

from February, 1963. As many cases of evasion of the Rules came to the notice of the Government it amended the Rules in June, 1963. The amended Rules prohibit the production by any refinery of primary gold of a purity of more than 14 carats and provide for compulsory hall-marking of all primary gold produced by refineries. These measures were intended — (i) to check the smuggling of gold in the country effectively, through the regulation of gold transactions in the country and (ii) to reduce the demand of gold in the country — a measure which was under consideration of the Government for a long time.

As a result of various measures taken by the Government before promulgating Gold Control Order, the price of gold had suffered a setback. After touching the highest at 129.90 per 10 grammes on August 29, 1962, it receded to 115.75 on October 10, 1962. Later on due to continued demand for gold, the price again moved up to 121.65 by November 3, 1962. Thereafter, as a cumulative result of the floatation of gold bonds and a ban on forward trading in gold, the quotation came down sharply to 86 on November 24, 1962. As such a low price for gold there emerged a strong consumers' demand for gold and gold prices again recovered and went up to 115.25 by December 18, 1962.

The price of gold receded again to 102.75 by January 9, 1963 when the Gold Control Rules were announced
and official trading in gold stopped. It started again on February 18, 1963. The initial quotation for dealer to dealer trading went downwards. From ₹102 in February 18, it came down to ₹98 on February 23, 1963. The rate again increased on account of marriage season and by May 9, the rate was ₹118. It again came down to ₹112 by June, 1963.

The initial impact of Gold Control Rules was visible in the easing of the unofficial price quotation of 14 carat. Gold from ₹65 - 67 per 10 grammes in the last week of June, 1963 to ₹61 by the middle of July, 1963. Soon after the first official quotation was available on August 23, 1963 (₹64.50 per 10 grammes), prices moved within narrow range upto August, but tended to decline during the greater part of September touching ₹59.50 on September 17, 1963.

At this stage, the Government made some relaxations in the Gold Control Rules — (i) It permitted the self-employed gold-smiths to be licenced on payment of licence fees. (ii) It permitted the conversion of existing ornaments of more than 14 carat purity into ornaments of equivalent purity and (iii) Keeping of primary gold upto a limit of 100 grammes. The gold price had somehow recovered on account of this amendment, but it again went down and on November 6, 1963, it touched ₹58.50 per 10 grammes of 14 carat gold.
Since the end of November, 1963, the price of gold fluctuated either way and in the process touched a peak of Rs.71.25 on May 27, 1964. The price of gold as at the end of June, 1964 was Rs.69.50 per 10 grammes (14 carat fine). This shows a rise of 6 per cent over the year (July, 1963 to June, 1964).

The recent firmness in the price of gold is, it is thought, on account of a fall in its supply due to a check on smuggling. "The firmness (in the price of gold)" wrote the Reserve Bank of India, "was attributed apart from seasonal influences, to the reported decline in the arrival of smuggled gold". 1

It has been stated by the Finance Minister in Parliament that Gold Control Rules have been able to minimise the smuggling of gold in the country. Even bitterest critics of the Rules have not criticised it on the ground that it did not help the country in checking gold smuggling.

The Gold Control has been criticised on the following grounds:

1) That it has caused hardship to the gold-smiths. To provide relief to gold-smiths, the Government has taken a number of measures. Efforts have been made to find alternative employments for them. Concessions have been granted

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to them in the matter of education of their children and regarding appointments to government posts.

2) The Gold Control Rules have also been attacked on the ground that they have forced people to declare their non-ornamental gold and the value of gold ornaments over the prescribed limit. Fear has been expressed that this may be the first step in the direction of confiscation of private possession of gold. Interest bearing Gold Bonds of long maturity were also issued against subscription in gold at the rate of $62.50 per tola.

It was argued by Shri C. Rajgopalachari, that gold or gold ornaments are safe with the women folk of the country, if they pass into the hands of the Government they are sure to be misused.

For the critics who feel that gold should remain with individuals and families rather than come into the possession of the Government, the only answer is that individual possession of gold is luxury which India can ill-afford at the present juncture. A country, which cannot meet all its foreign exchange requirements for defence and development out of its exchange earnings, has to discharge its international obligations in gold. This is essential for attaining ultimate self-sufficiency. Not only the smuggling of gold into the country is to be prevented but the gold in the country has to flow out to enable the country to acquire the
necessary capital equipment for the country. The policies regarding gold are likely to be formulated with this two-fold objectives in view.

THE RECENT CONTROVERSY ABOUT THE DEVALUATION OF THE RUPEE

In Rajya Sabha in December, 1964, Mr. Daya Shai Patel and Shri Sitaram Jaipuria asked the Finance Minister Mr. T.N. Krishnamachari, whether it was not a fact that the value of the Indian Rupee in 'free market' has gone down. According to these two Members of the Parliament, the value of the Indian Rupee in Hong Kong free market was Rs. 22 or Rs. 23 per pound Sterling against the official rate of Rs. 13.67. According to these gentlemen, the fall in value of Rupee in 'free market' was on account of deficit financing which has caused an excessive price rises in the country. The Finance Minister could not deny that the rate of exchange of the rupee to the pound in Hong Kong had been falling still he refuted the allegation that there was any relationship between the falling of exchange rate of the Rupee and Deficit Financing.

On the 28th December, 1964, an official of the Revenue Intelligence Department of the Government of India

stated that the value of Rupee in 'free market' in U.K. had depreciated and that the official rate of exchange did not work in private transactions. He said, even in Calcutta, the non-official rate of exchange for British pound Sterling was Rs. 22 as against the official rate of Rs. 13.67.

As early as in 1961 in an article in 'Commerce' it was stated that the countries with which we have Rupee payment agreements are selling Indian Rupee to other parties—who want Indian goods at a rate much below the official rate of exchange. Thus, it was concluded that the value of Indian Rupee had gone low. The relevant portion of the article reads as follows: "For example, if Czechoslovakia wants machinery from Germany, it can earn the necessary D-marks by exporting Indian Coffee to Germany. The Indian Coffee can be imported, under the rupee payment agreement by which our rupees are credited into rupee account in India in our favour. As German machinery is much more valuable to Czechoslovakia than imports from India, they are prepared to finance this trade at a value of the rupee which will be less than par so far as western European countries are concerned". ¹

A demand was raised by a section in the country that in view of the fall in the exchange value of the rupee in

'free market', the rupee should be officially devalued. Two additional grounds were also put forth for this demand -

1) That the prices in India have gone much higher than in most of the countries of world, with whom we have close trade relations. In a letter to the editor of 'The Hindustan Times', Mr. M.P. Gandhi, a well known industrialist of India has compared the rate of depreciation of the value of the Indian Rupee with the currencies of some of the important countries of the world. Though he has not explicitly advocated devaluation of the Rupee on the basis of such comparison, but it is implicit, when he says, "some fresh thinking and bold and urgent action is indicated". The comparative figures regarding the depreciation of the value of the Indian rupee and that of other currencies are given below:

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2) Devaluation has also been advocated for curing our balance of payments difficulties. But the Government has turned down this demand. It has been argued by Shri T.T. Krishnamachari that, "First and foremost, devaluation is no answer to our basic and immediate problem which is that of living within our means. Over the long run also, devaluation is not the best means of giving the necessary impetus to export promotion and import. Essentially, our problem here is that of enlarging the base of domestic production and this task may well receive a set-back by a sharp, sudden and indiscriminate increase in the price of even those imports which cannot be produced at home in the immediate future."¹

In conclusion, we can argue that India has been bailed out from foreign exchange crisis by the U.S.A., Western European nations, I.M.F., world bank and the Aid India Club from time to time. If such helps are not forthcoming in future - as they are mostly based on political considerations as well - no finance minister can give a guarantee, with this state of affairs continuing that India would not be forced to devalue its Rupee, under pressure of circumstances.

To prevent any devaluation of the exchange value of the rupee, it is essential that the internal value of the rupee be stabilised.

XI

CONCLUSIONS

The foundation of the present currency system of the country was laid in 1835 when, in an effort to unify the currency system in the country, the East India Company issued the Rupee coin of 180 grains of silver (11/12th fine) as the standard coin.

The evolution of the Indian currency system is a history of the course of events that occurred not as a result of any preconceived plan but as a result of the force of circumstances. Bimetallism was tried to be gradually introduced but the effort failed. The country drifted towards the Gold Exchange Standard purely as a result of the circumstances, which forced its adoption. When Britain went off the gold standard, we found our currency established on the Sterling Exchange Standard.

The Reserve Bank of India Act of 1935 provided for the paper currency based on the proportional Reserve of gold and Sterling securities. After India's membership of the I.M.F., it was provided that the reserve could consist of other foreign currencies also. When in the course of the Second Plan, the country had to face the difficult
foreign exchange situation, the locking up of the foreign exchange in the currency reserve, was considered undesirable and the proportional reserve system was replaced by a minimum reserve system. Thus, foreign exchange was released for use for the plan purposes.

The problem of the stability of the value of the Indian currency has occupied the foremost place amongst the currency problems of the country. Practically every committee and commission, appointed by the British Government was, amongst other things, required to consider the exchange ratio of the Indian Rupee and to suggest measures to stabilise it. Under an exchange standard, stability of the exchange value is a symbol of the stability of its internal value also.

The question of stability again comes in the forefront in the context of Indian economic planning. The problem is now considered in terms of the price level in the country, which is indicative of the value of money. The I.M.F. Mission suggested that we should adopt a policy of development with stability. Here stabilisation represents prevention of inflation that is likely to arise in developing countries, unless precautions are taken to prevent it.

The planners in the country remained complacent about depreciation in the value of money in the early period
of planning. They seemed to be of the view that some rise in prices is not only inevitable but also desirable for development of the country. Some rise in prices in particular sectors of the economy, if carefully planned, can provide a proper incentive necessary for development. But the inflationary rise in prices can do definite harm to the development plans. It has been rightly stated that "if a country embarks on a rapid program without taking steps to restrain inflation, the end result of the program may be progress less rapid than it would have been if the program had not been attempted."1

It was wrong to think that inflationary rise, once allowed to set in, can be checked at will. Once the inflation sets in, the wage-price spiral appears. Another danger signal is the distrust in money. In the olden days, whenever there was a distrust of money and people lost faith in the value of money, it was exhibited in people demanding conversion of currency. This happened during the early period of the First World War, when there was a rush for the conversion of paper currency.

Now, the loss of faith in the currency is reflected in the unwillingness of the people to hold their money savings in bank deposits, government securities or in similar forms. They prefer to buy real estate.

As the tempo of development gained sufficient

momentum, during the Third Plan the danger signals of inflation have become clearly visible. Attempts have been made to combat it by physical control measures and some monetary measures like increasing bank rate and selective credit control. However, one of the principal factors, responsible for the present inflationary price increases is the lack of proper long term programme for restraining inflation from the beginning of the economic planning in the country. But for the foreign aid received by us, specially the wheat under U.S. L 430, the inflationary conditions in India, would have been still more acute.

Under the existing inflationary conditions, it is the duty of the Reserve Bank, as the Central bank of the country, to take measures for contracting credit. But during a development programme, this cannot be done without harming the programme itself. The Reserve Bank of India has, therefore, resorted to selective credit control, to restrict credit to particular trades, particularly to food grain dealers. Selective credit control has not been very effective because it still leaves the way open for obtaining credit for other trades or purposes and for diverting it to the trades, credit for which is restricted.

During the Second World war, India accumulated a huge amount in Sterling securities. Britain made purchase in India through the Government of India and paid for the
same in the form of sterling securities. The Government of India lodged these securities with the Reserve Bank of India and obtained from it Indian paper currency issued on the basis of the sterling securities, lodged with it. This very paper currency was used for making payment for the goods purchased for Britain. As we have noticed, this process enabled Britain to shift its own inflation partly to India. Currency in India expanded, while the goods became scarce because of the purchases by the Government of India for the British and Allied troops stationed in India and for the allied countries.

Presently, we are passing through a foreign exchange crisis, resulting from a continuously adverse balance of payments. At the beginning of the First Five Year Plan, we had our sterling balances and this made us complacent about the foreign exchange problem. Had we carefully preserved our sterling balances and rigidly controlled utilisation of foreign exchange from the very beginning, perhaps, the problem would not have been so acute now. It was only during Second Plan period, that the need for conserving foreign exchange was fully realised.

Our imports are now regulated through a import policy announced every year. Due to the scarcity of imported goods, their prices have gone up and there is a big margin between their import price and market price.
It has been suggested that the import licences should be auctioned so that a greater part of this unearned profit to the importers, comes to the public exchequer.

Big difference between the international price and the Indian market price of certain luxury articles and gold, has encouraged smuggling of these commodities into India. Smuggling consumes our valuable foreign exchange and diverts it from being used for the import of capital and other goods, more urgently required for our development schemes. Strong administrative action is necessary for preventing smuggling of goods and gold.

Foreign assistance and loans received by India have been more than expected. To a extent this aid has been responsible for preventing inflationary conditions, from becoming more acute. Utilisation of foreign assistance has not kept pace with the authorisation and the delay in utilisation, has resulted in carry over of unutilised foreign aid. The reason for delay is that, the assisting countries do not have a long term programme of aid and that, most of the aid, authorized, is tied to particular projects which require a lot of preliminaries to be undertaken. Lately, it has been stressed that a substantial portion of the aid should be untied.

The foreign exchange crisis is closely linked with the inflationary conditions in the country, which encourage
imports and discourages exports. When the imports are restricted the difference between the prices of imported goods and that of goods produced at home, encourages smuggling. Inflation also discourages inflow of foreign capital into the country. One of the reason for the private foreign capital not coming to this country is, the constant rise in the prices. Stability in the internal value of money is thus essential for preventing worsening of a country's international position.

Foreign Assistance comes to our country not because of its natural tendency to flow into the country but because of the political considerations, which motivate the assisting countries to provide aid to particular other countries. It is dangerous for a country to rely too much on such aid.

In the context of the foreign exchange position, an important factor which has not received the attention that it deserves is the Indian currency circulating in foreign countries like Nepal and the Gulf countries. When these countries decide to replace the Indian currency there, by their own local currencies, India will have to discharge the liability, on this account, by paying in Sterling or some other foreign currency. In any overall assessment of our foreign exchange position, this liability should be given a due consideration.
We have entered into rupee payment agreements for our imports from certain countries, specially those of Eastern Europe. Trade agreements with these countries provide that imports from them will be paid for in Indian currency, which they can use for purchasing goods in India. It has been reported that some of such countries have sold Indian currency in free markets at the rates below the official rate. It is, therefore, necessary that in entering into the rupee payment agreements we should exercise the same caution that we exercise in the case of other imports. The imports should not be permitted, simply because we can get them on rupee payment.

On the ground, that Indian currency is available in free market at less than the official rate, a demand has been raised that the rupee be devalued. We have once devalued our currency in 1949 when Britain also did so. However, at that time the circumstances and reasons for doing so were quite different. We were having a continuous adverse balance of trade with hard currency area. Also because of the close links of the rupee with the sterling, when sterling was devalued, it became imperative for India that the rupee should also be devalued. The I.M.F. does not favour devaluation as a measure for correcting temporary imbalances in the economy of a member country. Secondly, devaluation can be useful, only when a country can afford reduction in imports and has a considerable export surplus. Our demand
for import of goods necessary for development cannot be reduced below the present level and, therefore, the devaluation will lead to the increased cost of the imports and will thus add to the inflationary pressure in the country.

There is another aspect of the devaluation. Once the exchange value is altered, the wary owners of foreign capital begin to expect that it will be changed again. The capital begins to flee from the country. Thus, ultimately balance of payments position is not likely to improve much by devaluation.

Private stocks of gold and ornaments in the country have been looked upon, for quite sometime, as a means of meeting the foreign exchange shortages. However, looking to the attachment of the people to the yellow metal, the government has been hesitating to take any drastic measure to take out gold from private possession. The Chinese attack on India in 1962 made it imperative for the country to find foreign exchange for the needs of defence as well as development. Hence, gold control was introduced in India immediately after the Chinese attack. However, even this gold control was a measure against smuggling of gold and not a means of taking out gold, in private possession.

There is no doubt that the gold control of 1963 is an important step in the policies regarding gold in the country. Besides checking smuggling of gold, it also
aimed at discouraging the use of gold in the country. If once the popular attachment to the gold is lessened, it would be easier for the government to take measures to take out private gold for making good the shortage of foreign exchange.

The export of gold from the country in the thirties was greatly resented and caused a lot of dissatisfaction amongst people. However, it should be remembered that export of gold for meeting the foreign exchange shortages caused by adverse balance of payments is a natural process. In recent years, Russia and China have unloaded a huge stock of their gold in the international markets for acquiring foreign exchange for buying food grains from abroad.

After the recent Indo-Pakistan conflict, it has become clear that the foreign assistance that we receive is not free from political strings. It has also been now realised that how dangerous it is to rely on such aid for economic development. Hence, the country should be prepared to export gold for meeting the cost of the capital equipment required for our development. The government has realised this and the Gold Bonds issued, are a step in the right direction. In some years to come, the success of our developmental efforts will depend on our ability to maintain stability in the internal and external value of our money. Internal value, besides other things, will
depend upon quick increase in the production of food grains and the carrying on of our development plan without resort to any further deficit financing. The external value will, of course, depend upon the speed with which we can achieve self sufficiency in the production of capital equipment and defence needs and on our capacity to promote exports. No doubt, this will take sometime and till then the deficit in the balance of payments will have to be made good by export of gold. Hence, the efforts of the government, in near future, are likely to be concentrated on the measures to persuade people to take out their private gold and make it available to the government to meet the shortage of foreign exchange.