CHAPTER III

THE GENESIS, STRUCTURAL PATTERN AND THE SIGNIFICANCE OF INDIA'S BILATERAL TRADE AND PAYMENT AGREEMENTS
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The classical economists were of the opinion that the welfare of world economies was associated with specialization by the various countries in the production of those goods and services in which they enjoy comparative advantages and are well-endowed for their production. They concentrated and emphasized on free trade and free multilateral settlements and were sceptical about the use of trade and exchange restrictions so far as the equilibrium position in the balance of payments is concerned. These trading conditions, ensuring the optimum utilization of the world resources provided for purchase of commodities from the cheapest sources and enabled them to take the sale of their own products to the countries where high prices would facilitate the maximum amount of the profit possible.

This ideal mechanism of international trade and payments failed to revive the world economy during the thirties and the countries facing acute balance of payments difficulties had to resort to restrictive policies of trade and exchange controls motivated mainly by such objectives as "rapid growth, over-full employment and repressed inflation". However, Germany adopted a policy of cleaning agreements whose special feature was that the payments for the imports into Germany were to be made in the German currency—Mark which could be utilized for the purchase of German products alone. In addition to the cleaning agreements,


bilateral trade arrangements were also made by several countries. For instance, Bulgaria and Argentina conducted their trade through the principle of a bilateral trade mechanism.¹

The main factors responsible for the failure of the system of multilateral trade and payments were; (a) the enormous decline in the prices of goods resulting from the general depression of 1930's; and (b) disintegration of the international capital markets that is the cessation of the flow of capital among the countries of the world.² The situation become most serious the post-Second World War period and trade through bilateral trade practices become more popular. These arrangements have been defined as a "logical consequence of inconvertibility"³ and aimed to have some control over volume and the composition of exports and imports. The United Kingdom concluded a number of such agreements with several colonies including India and they continued to operate even during the post-war period.

The deviation towards the conclusion of bilateral trade and payments agreements during the post-war period was on the result (a) the rapid depletion of the dollar stock by the countries at war, and as the dollar was the only convertible currency these countries became unable even to purchase essential goods in the international markets; (b) unwillingness of these countries to spend their remaining stock of gold or dollar for financing intra-European trade; and (c) for the purpose of maintaining

1. Ibid.
2. Ibid; p. 7.
their exports these countries had to negotiate with the non-dollar area countries.

The problems faced by the underdeveloped countries were altogether different from those of the industrially advanced economies. They were unable to earn the required quantum of foreign exchange from their exports and, therefore, the adoption of protective and discriminatory trade policies was considered inevitable. The purpose of these restrictive policies was the promotion of exports from and the curtailments of non-essential imports into the primary producing countries. It was also considered necessary to concentrate on earning more from the more promising items of their exports like engineering and metallurgical products. In particular, "they should seek out for themselves the commodities with rising demand trends and high price and income elasticities."  

The policy of promoting exports particularly of newly manufactured industrial goods combined with certain restrictions on imports has been adopted as the most appropriate trade policy for the planned economic development of underdeveloped countries like India. These countries, apart from an enormous amount of capital goods, also required a more or less similar amount of subsidiary items necessary to meet the expanding demand of the people in the developing economies. As most of the imports coming to these countries were non-essential and, therefore, not helping the maintenance and development of their economies, certain controls over the composition of the imports became necessary. The country entering in trade could discriminate between countries and commodities in numerous ways and the bilateral agreements served to

meet the requirements of the countries suffering from an unfavourable balance of payments position and willing to expand their exports. The bilateral transaction helped the underdeveloped countries by strengthening their bargaining power with the contracting partners which were in a better position. These arrangements also improved the terms of trade of the underdeveloped countries. It is important to note that the instrument of bilateral trading has mainly been accepted in the trade of the underdeveloped and the State-trading countries.

The reasons for the phenomenal growth of these agreements between these two trading blocs may be listed: (a) the Soviet bloc was found to be a favourable trading centre and the underdeveloped countries wanted to take an increasingly large share of its trade. The bilateral agreements provided adequate opportunities and opened up new avenue for expanding the trade between the two blocs; (b) they strengthened the bargaining power of the underdeveloped countries; and (c) as most of the less developed countries were having wide imbalances in their terms of trade, these agreements reduced the pressure on their balance of payments position by providing certain provisions in regard to the payments in terms of the domestic currencies.

India was able to accumulate an adequate stock of reserve sterling balances during the period of Second World War. These balances were to be utilized either in time of emergencies or otherwise for financing imports of capital goods required for the economic development of the country. The post war problems of reconstruction and development placed greater burdens on
the country's sterling balances\(^1\) and some specific shortage of commodities and dollars occurred. Though the position with the hard(dollar)currency countries\(^2\) continued to deteriorate the sharp decline a dates from the middle of 1948\(^3\). India's exports to these countries declined from Rs. 84 crores in the first half of 1948 to Rs. 56 crores in the second half and Rs. 52 crores in the period from January-June, 1949 and to a still lower amount, approximately about Rs. 20 crores, in the period from June 1, 1949 to September 18, 1949\(^4\). This unfavourable turn in the balance of payments position with the dollar area countries was largely due to the diminution in the value of exports.\(^5\) These abnormal movements in India's terms of trade with the hard currency countries and the inflationary tendencies which were already active in the economy were\(^6\) by the withdrawal from sterling balances up to July, 1949 of over £ 80 million for current transaction in addition to the quotas of £ 80 million left over at the end of June, 1948\(^\text{5}\). This simply meant that the country's stock of reserve sterling balances started to be deplated and the country had to follow a restrictive import policy. Moreover, Indian currency was devalued in September, 1949 but still no favourable turn in the terms of trade was in evidence with the hard currency countries. Therefore, it became imperative to redirect

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2. Hard currency countries includes, for 1948 the United States and other American Account Countries, Portugal and its possessions (excluding those in India), Germany, Japan, Sweden and Switzerland only for the first half of the year and Argentina only for the second half.
4. Ibid; 748.
5. Ibid.
6. Ibid.
exports trade and to restrict imports in a direction that could enable the country to reduce the acute shortages of foreign currencies. ¹

The outbreak of the Korean War in June, 1950 brought certain new opportunities to India and increased her export earning. But, the financial gains in real terms on account of the war hostilities were too low to meet India's import requirements. In October, 1952 a mild depression took place in the Indian economy² and had an adverse impact on India's exports, leading to the adoption of certain necessary export promotion measures accompanied by some import control mechanism. Moreover, as the stock of sterling balances was gradually being depleted the Government of India changes its attitude towards the disbursement of reserve sterling balances and concentrated on devising more effective techniques for controlling trade and payments.

The specific scarcities of commodities, dollars and the prospects of earning more from exports were the main considerations which encouraged India to negotiate bilateral trade and payments agreements with a number of Afro-Asian and European countries.³

2. Ibid; p. 10.
Among the more important considerations relating to the trade policy which increased the popularity of the bilateral agreements were the most pressing requirements for the country to establish direct contracts with the State-controlled economies of Eastern Europe. "The State-trading countries have always insisted upon the inclusion of what they consider to be equal opportunities to trade in the commercial contract."\(^1\) The rational of these agreements was in conformity with the developmental requirements of the Indian economy and they have considerably helped in diversifying the composition and direction of India's trade.\(^2\)

The structure of India's bilateral trade and payments agreements had undergone very important changes from the trade-quota type of arrangements to those involving no quota specifications and from the payments provisions in terms of convertible rupee or pound sterling into non-Convertible Indian rupees. Bilateral agreements specifically included the provisions indicating the promotion of trade between the contracting trade partners and the avoidance of all kinds of trade discriminations against each other. The considerable growth of India's bilateral trade agreements with the centrally planned economies is due to "the general attitude of the bilateral partners towards their common

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2. Sen, Sunanda, op, cit; p. 11.
commercial problems. The contracting partners from this bloc always desired ... to develop and strengthen the economic and trade relations between the two countries on the basis of equality and mutual benefit. The arrangements made also included the provision efforts would be made by the respective Governments for expanding their trade turnover to the maximum possible extent with both the partners.

In the beginning bilateral trade arrangements made with the centrally planned economies involved quota commitments and no provision specified the procedure of payments. The specified quota limits set the permissible value or volume for the goods and service traded and there was an obligation on the part of contracting partners to utilize these quota targets. In a number of cases these quota limits guaranteed the imports of commodities not easily obtained during the post war period. The resources position of the world improved since 1952 and the trend shifted to the conclusion of Non-quota type of agreements. These agreements included an important clause relating to payments arrangements the object of which was to reduce the payments problems of the bilateral trade.

1. Sen, Sunanda, op. cit; p. 35,
3. Sen, Sunanda, op. cit; p. 16.
4. Ibid; p. 16.
5. Ibid.
partners. \(^1\) Under bilateral payments arrangements, the partner countries undertake to effect their reciprocal current settlement in a way that will minimize the use of convertible exchange and gold. \(^2\) The payments arising out of trade between India and the centrally planned economies were to be effected in convertible rupees or sterling. However, if any balance in the rupee account were found, it was to be maintained in the Central or the commercial bank of the country authorised to deal in foreign exchange which were to be converted on demand into sterling at the usual bank selling rate for sterling as fixed from time to time by Indian exchange banks.

The ambitious programme for the country's industrial development launched in the Second Five Year Plan produced certain unforeseen stresses and strains in the Indian economy, and the balance of payments positions became more unfavourable. \(^3\) The shrinking reserve of sterling and the widening deficit in the country's balance of payments made it necessary to enforce some strict control on the settlements provisions in the bilateral payments arrangements. Accordingly the agreements concluded after 1958 specifically included the provision that all the payments relating to both commercial and non-commercial transactions, e.g., exports, imports, foreign insurance, cultural-tours and maintenance of legations etc. were to be made in inconvertible Indian rupees.

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1. Ibid.
3. See Statements II and III.
The general aim was not only to economise on foreign exchange resources but also to increase the sales of India's non-traditional exports and secure some guarantee for a steady inflow of essential imports. The payments arrangements were made through special accounts opened for this purpose by the Central Bank of the bilateral trade partners from the East European countries with the Reserve Bank of India and with an Indian commercial bank authorised to deal in foreign exchange. Balances, if found at the time of termination of the agreements, were used for the purchase of goods either from Indian or the contracting partners as the case may be.

The tenure of these agreements is three to five years. They may be extended from time to time with mutually accepted modifications taking into consideration the changing needs of the economies of the contracting partners. The products to be exchanged between India and her bilateral trade partners are classified under the schedules A and B which show the exports from and imports into India from these countries. The main exports from India to these countries are raw materials and products of newly developed industries as against the imports mostly of capital goods. During recent years, India's exports have consisted of plastic goods, light engineering goods, pharmaceuticals, besides the traditional items such as cotton textiles, tea, coffee, tobacco, jute, manufactures etc.

Under the bilateral agreements, the centrally planned economies also provide other facilities in the form of long-term credit, technical training and know-how which have considerably enhanced India's economic development. Special mention in this
respect should be made of U.S.S.R., Poland and Yugoslavia. The Soviet Union is supplying required machinery and spare parts for the various projects set-up in India with Soviet assistance such as the Heavy Electrical Projects and Heavy Machine Buildings Plant at Ranchi. Provisions in these agreements are also made in regard to shipping. Indian ships carry a considerable proportion of the trade between the two countries. The shipping arrangements have enabled India to save a large amount of foreign exchange on freight and also encouraged her own shipping. India's trade with these countries has taken place at the World prices and the rapid expansion in it did not occur at the cost of her trade with the rest of the world.

The bilateral trade and payments arrangements with the Soviet bloc also specified that there should be no discrimination against the countries or commodities which did not come under the purview of these arrangements. The trading between the state-controlled and the competitive economies included certain additional considerations and in the extension of normal trading relations it was found important to probe into the suitability for the competitive economies of granting unconditional MFN treatment to the countries where the market forces are not permitted to play their roles in the functioning of the economic system. The usually accepted solution in terms of a supplementary set of commercial consideration Clause and purchase commitments made it necessary that the bilateral arrangements between India and her(bilateral)

1. See "India's Trade with East Europe," op, cit; p. 48.
partner should specifically involve certain provisions retaining the element of reciprocity under the MEN Clause.¹ The MFN Clause was included in India’s bilateral agreements with its usual exception i.e.; its in applicability in relation to the preferential treatment accorded by either of the bilateral trading partners in some special cases in order to safeguard the grant² or to continue any:

(i) advantage accorded by either party to contiguous countries for the purpose of facilitating frontier traffic.

(ii) Preferences or advantages accorded by India to any country existing on the 18th April, 1960 (the date of conclusion of Indo-Bulgarian agreements) or in replacement of such preferences or advantages that existing prior to 15th August, 1947.

(iii) Advantages resulting from any agreement for the establishment of any customs Union or free trade area to which the Government of (say) Bulgaria or India may become a party.³

The MFN treatment was some different accorded in the bilateral agreements with the U.S.S.R.; Hungary, Poland and Romania.⁴ These bilateral trade partners besides providing reciprocal acceptance of the privileges relating to customs facilities and other operations were also to follow certain other MFN clauses ensuring

¹. Ibid.
². Ibid.
⁴. Sen, Sunanda, op. cit, p. 36.
that "..... any advantage, favour privilege or immunity granted by either of the contracting partners to any product originating in the territory of a third country or destined for its territory shall be granted immediately and unconditionally to the like product originating in the territory of either of the contracting partners or destined to be imported into its territory." The trade arrangements with the U.S.S.R., Poland and Rumania did not include the preferences in regard to the establishment of customs unions or free trade areas.¹

The MFN treatment was also extended in regard to the reciprocal concession made to the shipping facilities. The clause relating to the applicability of the MFN principle to the shipping between India and her bilateral partners included that "Mercantile ships of both countries while entering, staying in or leaving the ports of either of the countries will enjoy the most favoured facilities granted by either respective laws, rules and regulations to ships under third country's flags. This principle shall not, however, apply to ships engaged in coastal navigation."²

The commercial and financial consideration clause also apart from the general principle of equality and mutual benefit,³ included some other provisions of non-discrimination relating

¹. Ibid; p. 37. See also Agreement with U.S.S.R., January, 1959, Article I, clause 2nd & 3rd
Agreement with Poland, November, 1959, Article I, clause 2.
2. Ibid, See also India's trade Agreements, 1962 and Agreement with U.S.S.R.; November, 1959, Article IX,
Bulgaria, March 1960, Article IX,
Czechoslovakia, November, 1960, Article VII, East Germany, December, 1959 clause II, Hungary, June 1960 Article VIII
Poland, November, 1959, Article IX and Rumania, May, 1959 Article X.
3. Ibid.
to the operation of normal Commercial channels between the contracting partners. A very important commercial considerations clause specifically included the provision "... the import and export of goods stipulated (say) in Article II, will be carried out in accordance with the import, export and foreign exchange regulations in force in either country and on the basis of the contracts to be concluded between (say) the Bulgarian enterprises on the one hand and the Indian physical and juridical parties, including Indian state-owned organizations, on the other." Moreover, they also said that "... the provisions of the (present) agreement do not affect the rights of (say) the Bulgarian and the rights of the Indian physical and juridical parties, subject to the imports, export and foreign exchange regulations in force in both the countries, of concluding commercial transactions concerning the import and export of goods and included Schedule A and B." Therefore, the bilateral trade agreements which may be concluded both for long and short periods aimed at the opening up new channels of trade through bilateral arrangements and have been beneficial to those underdeveloped countries of the world which experience

1. Ibid.
great stresses and strains in their balance of payments position and do not receive adequate foreign exchange in order to finance their capital investment for rapid economic development.

Bilateral trade and payments agreements had been used in the thirties for expanding the trade which was declining due to acute scarcity of gold and convertible currencies. But it is significant to note the distinction between the bilateral trade arrangements at the time of great World depression of the 1930's and those which are being made these days. In the 1930's bilateral arrangements were made in order to reverse the swift decline in exports which was due to the inelastic demand for primary products and further to the depression. The arrangements made in the 1950's and onwards have been in the light of large import requirements of capital goods by the underdeveloped countries and as their imports earning capacity is low they have to seek a shift to those countries which were willing to purchase an equal amount of exports from them. Such negotiations encouraged the underdeveloped countries to have larger imports of capital goods even at higher prices as compared to other sources of supply.

In this way, the bilateral agreements seems to be an instrument of trade diversion rather than trade expansion. However, the significance of the bilateral trade and payments agreements between the underdeveloped countries and the centrally planned

1. See "India's Trade with East Europe," op. cit; p. 16.
3. Ibid.
4. Ibid.
5. Ibid.
economies is somewhat different. In their case, they are being used for meeting the fundamental purpose of generating additional flows of trade through bilateral channels which would otherwise not have place at all.¹ Thus, bilateral trade and payments agreements can easily be used as an instrument for trade expansion provided that instead of diverting trade they stimulate additional trade and that "transactions follow international prices."²

To sum up the bilateral trade mechanism is becoming increasingly flexible and generating more trade. The growth of these arrangements is largely in conformity with the recommendations of the First United Nations Conference on Trade and Development and with its efforts for evolving a more suitable international trade policy. The MFN treatment has been included in most of the agreements concluded recently in accordance with the recommendations made by UNCTAD I. The Soviet Union and the other East European countries have been of considerable help to the development of our economy both as an external market for which contracts have recently been made, particularly from 1953 onwards, and also for extending an increasing quantity of long-term credit necessary for promoting and maintaining the tempo of India's economic development.

¹. Ibid.
². Ibid.