RGICS Paper No. 46
1998

INDIA'S ECONOMIC DEVELOPMENT

SOME VIEWS FROM ABROAD

Papers by
Howard Schaffer, Jean François Giovannini, Jochen Kraske & Jean Baneth

RAJIV GANDHI INSTITUTE FOR CONTEMPORARY STUDIES

The views expressed in this paper are those of the authors and are not necessarily those of the Institute.

Suggested citation: Howard Schaffer, Jean François Giovannini, Jochen Kraske & Jean Baneth, *India's Economic Development, Some Views From Abroad*, RGICS Paper No.46 (New Delhi: Rajiv Gandhi Institute for Contemporary Studies, 1998) [PDF Version: 2010]

Contents

The United States and Indian
Economic Development
Howard Schaffer*

On August 15, 1947, as India met its tryst with destiny, a warm message arrived in New Delhi from Washington. Pledging America's firm friendship and good will, President Harry S. Truman declared: "We welcome India's new and enhanced status in the world community of independent nations and reaffirm our confidence that India will take its place at the forefront of the nations of the world in the struggle to fashion a society founded on mutual trust and respect."

U.S.-Indian ties have gone through a dizzying series of ups and downs since Truman hailed India's freedom a half century ago. The firm friendship and good will the president spoke of have been elusive qualities in the bilateral relationship. Periods of strong and supportive relations, when the two countries seemed to share many foreign policy objectives, have alternated with times of strain and tension that resulted from their sharply differing perceptions of major international and South Asian regional issues. Among the most variable elements in this roller- coaster relationship have been American attitudes toward Indian economic development and the role Washington has played in assisting it and influencing its direction, the subject of this paper.

Like so much else in its approach to India over the last 50 years, the policies the United States has pursued on economic aid were often influenced by Cold War considerations. American concern that an economically faltering India would "go Communist" and its interest in India's outperforming the People's Republic of China in the perceived competition between authoritarian and democratic approaches to economic development have prompted more forthcoming attitudes. Washington's dismay that India's vaunted non-alignment seemed too often to have a pro-Soviet tilt and its disappointment when New Delhi declined to support important U.S. foreign policy aims have had the opposite effect.

But other, non-Cold War elements have also come into play. An interest in helping disadvantaged people help themselves to achieve better, more productive lives in a democratic setting has swayed many U.S. policy makers, who have seen it as an important postwar extension of the liberal-idealistic strand in America's approach to the world. American attitudes have also been influenced over time and in varying degrees by assessments of Indian economic policies and performance; views in American political and academic circles of the development process and the appropriate role of Western developed countries in helping to shape it; reactions to India's independent, non-aligned foreign policy and to the way this affected major U.S. interest; perceptions of South Asian political developments, especially Indo-Pakistan relations; priorities given to other items in America's global agenda; interest in promoting American exports and disposing of agricultural surpluses; the health of the U.S. economy and the shape of the federal budget; and, at times of Indian drought and famine, humanitarian considerations. The personal attitudes and agendas of

---

* Ambassador Howard Schaffer is a retired American diplomat who served extensively in South Asia. He is now Director of Studies at the Institute for the Study of Diplomacy at Georgetown University in Washington, D.C.

American leaders, and their reactions to their Indian opposite numbers, have .also figured prominently, as they have in influencing other aspects of the bilateral relationship.

In 1947, American policy makers paid scant attention to India or the rest of South Asia. The region seemed marginal to U.S. global interest, and Washington's concerns increasingly focused on what the Truman administration saw as an international communist menace to Western and Central Europe, the eastern Mediterranean, and the Far East. In March, the administration had launched the Truman Doctrine, a programme to provide substantial military and economic assistance to Greece and Turkey, both considered immediately threatened by communism. In June, in an even more significant move, Secretary of State George C. Marshall announced t a Harvard University commencement audience a plan to assist European countries to rebuild their war-shattered economies. The far-reaching plan, later to bear Marshall's name, would strengthen Europe's democracies in meeting the communist challenge. Although the Cold War had not yet come to dominate international affairs, it was fast moving to center stage, where it would remain for more than four decades.

Marshall had given his Harvard address only two days after the British announced their decision to partition and quit their Indian empire within a scant ten weeks. Caught up in these historic developments, few Indians are likely to have paid much attention to the distant rumble of Cold War thunder emanating from Cambridge, Massachusetts, let alone foreseen that it would have major significance for them. For although it was specifically tailored for industrialised European countries ravaged by a destructive war, the Marshall Plan, and to a lesser degree the Truman Doctrine that preceded it, arguably helped create the political and policy environment that made possible large-scale American economic assistance under very different circumstances and terms to less developed nations, India most prominent among them.

By the time the United States first began to provide economic aid to India, in 1950, the European beneficiaries of the Marshall Plan were already well on their way to recovery. Although Indian leaders had put out feelers for U.S. economic support in late 1948 and Truman had called for a bold new programme of financial and technical assistance to underdeveloped areas as "Point Four" of his January 1949 inaugural address, nothing had been immediately forthcoming. Visiting the United States for the first time in October 1949 on an official tour that proved a disappointment to both sides, Prime Minister Jawaharlal Nehru hardly touched on the aid issue. Nor did his American interlocutors, who ignored Ambassador to India Loy Henderson's proposal of a five-year, $500 million assistance programme. A National Security Council policy paper, drafted a couple of months later, reported in Cold War language that "it would be unwise for us to regard South Asia, more particularly India, as the bulwark against the extension of Communist control in Asia." While the paper acknowledged that economic aid might help strengthen India as a non-Communist state, it concluded that the external financial support required was so limited that it could be provided by the World Bank and the Export-Import Bank. The latter, a U.S. government institution, failed to oblige.

The languishing Point Four programme was finally brought to life with the appropriation of $26.5 million for Fiscal Year 1951 (July 1950-June 1951). India got

$4.5 million of this modest sum to fund the cost of American technical and economic advisers. In 1951, the United States also provided a wheat loan to India valued at $190 million. Ironically, the loan damaged U.S.-Indian relations rather than bolstering them. Sponsored by the Truman administration as the severe impact of India's 1950-51 drought became evident and promoted vigorously by senior administration spokesmen on both humanitarian and political grounds, the proposed two-million ton shipment quickly ran into heavy weather in the U.S. Congress. Some congressmen faulted it because of its terms (in its initial version it was to have been an outright grant); others objected because of India's foreign policy record, especially its attitude toward the Korean War, which they saw as unacceptably favourable to the Communist side. The proposal was eventually enacted as a loan, though not before congressional debate and foot-dragging had generated enough ill will within India to undercut the favourable political impact such generous U.S. action might otherwise have created there.

Substantial assistance to India on a regular, long-term basis began in Fiscal Year 1952 (July 1951-June 1952). The $54 million appropriation, though about a third of the total U.S. technical assistance programme, that year, was minuscule compared to the military assistance and economic aid sent to countries in Western Europe and the Far East and substantially less than State Department officials had called for. The negative views many influential U.S. congressmen continued to have toward Nehru-led India, and the Truman administration's reluctance to expend political capital in countering them, probably account for the limited figure.

By the time the funding was finally agreed to, Chester Bowles had arrived in New Delhi as the third American ambassador to India. A Democratic Party liberal, Bowles firmly believed that non-alignment was a legitimate expression of resurgent Third World nationalism. He held that a prospering, democratic, non-Communist India could become a firm friend of the United States. He advocated economic assistance to the Nehru government both as an expression of traditional American idealism and as an extension of the central element of U.S. foreign policy, the containment of Communism.

More than any of the other career diplomats, politicians, and academic figures who have headed the U.S. mission in India, Bowles was able to put his personal imprint on the aid program. An admirer of integrated rural community development, he made it the core of the nascent programme. Thanks in important measure to him, the concept became a major focus in India's overall approach to economic development in the 1950s.

Bowles had to sell rural community development to the Truman administration and Prime Minister Nehru. As in almost all significant (and many insignificant) aspects of Indian policy in those days, the prime minister's support was vital. Nehru had been badly nettled by Congressional criticism of the wheat loan, which he regarded as pressure on India to change its domestic and foreign policies, and he had only reluctantly accepted American assurances that the new programme would provide assistance with no strings attached. The prime minister and the ambassador became close friends and collaborators, and under Bowles's leadership economic assistance became a prominent factor in the improvement in U.S. -Indian relations that took place during his brief 17-month tenure.

Using many of the public relations techniques he had mastered in his early days as a highly successful advertising executive, Bowles worked hard to develop support in the United States for India. Like many American advocates of economic assistance in his day and later, he did not scruple to use Cold War scare tactics in his efforts. He stressed that unless the newly launched First Five Year Plan succeeded—which he claimed it could do if the United States provided the high levels of assistance he strenuously called for—the Nehru government might well be swept from power and Communism take over in India and the rest of South Asia. He emphasised the comparative economic performances of democratic India and totalitarian China, predicting (as it happened, incorrectly) that this rivalry could determine the course the rest of the developing world ultimately chose to follow. His arguments had considerable resonance. But they were not fully successful in winning over Washington. In the intensely Cold War atmosphere generated by the prolonged fighting in Korea, the Truman administration continued to give much higher priority to military allies than to nonaligned countries like India despite Bowless dire forecasts and the fresh importance an updated National Security Council policy paper had given to the struggle against communism in South Asia. The figures the administration and Congress accepted were never as generous as the levels he recommended, though they would doubtless have been even lower without his persistent and skillful advocacy.

The Republican administration led by President Dwight D. Eisenhower that took office in 1953 was less sympathetic to India than the Democratic Truman administration had been. Eisenhower's powerful secretary of state, John Foster Dulles, was outspokenly scornful of non-alignment, which he termed immoral and shortsighted. He had little use for Nehru, its leading champion. Preoccupied with the security dimensions of the Cold War, he gave low priority to Third World economic development and was not inclined to battle for substantial funding for it before a skeptical, sometimes hostile Congress. Early in his term as secretary he drastically reduced the level of aid to India recommended by the outgoing Democrats. Not surprisingly in the absence of any genuine effort by the administration, Congress lowered the figure even further.

Aid levels to India remained low during the initial three years of Eisenhower's first term (1953-57). The administration's interest in South Asia focused on Pakistan. Persuaded that it could be an important bulwark against the advance of Communism, Dulles enlisted Pakistan in the western security system, eventually making this unfriendly neighbor of India "America's most-allied ally," as the Pakistanis themselves proclaimed. The security link with Pakistan was one of many the administration forged with Near Eastern and Asian Countries. It reflected the view Dulles strongly promoted that such pacts were the most effective vehicle for containing what seemed then to be a monolithic Sino-Soviet bloc, and represented a further militarisation of American foreign policy begun by the Truman administration following the outbreak of the Korean War in 1950. The outspoken, highly negative Indian reaction to this security link, which Nehru charged had introduced the Cold War into the subcontinent, badly impaired U.S.-Indian relations and further hurt prospects for American economic assistance to New Delhi.

In any event, the worldwide assistance programmes the Eisenhower administration carried through Congress in its first three budgets were largely directed toward the military. Except for a few development programmes, economic aid unrelated to immediate security considerations had been virtually eliminated by Fiscal Year 1955 (July 1955-June 1956). Though assistance to India was the largest in this small programme of "pure" economic aid, funding was substantially smaller than Bowles had advocated from New Delhi and the departing Truman administration had proposed during its final months in office.

Yet the fact that India continued to receive at least a modicum of aid was itself important. Dennis Merrill has pointed out that "once the linkage between Third World development assistance and United States national security had been established [as it was by Truman after 1950], it would be difficult to completely derail the aid process." India was not popular in either the administration or on Capitol Hill in the early Eisenhower years. But nonetheless, Dulles was prepared to testify before Congress that some economic assistance was warranted. He cited in justification Nehru's opposition to the Communist Party of India, the challenge the Indian government faced from destabilising forces, and the economic competition between India and Communist China. So it was no longer a question of whether India should receive any assistance, but how much. If the answer Eisenhower and Dulles gave was less than India's supporters in the United States advocated, at least the administration accepted the concept.

Signs of revival in the U.S.-Indian aid relationship appeared in the final year of Eisenhower's first term. By that time, the administration had begun to reconsider seriously its overall assistance strategy. The greater flexibility in post-Stalin Soviet policy towards the Third World was a major element in this reexamination. Moscow's new approach was highlighted by greatly expanded trade, low interest loans, and technical assistance. The administration saw it as an economic offensive that threatened to tie the developing countries closely to the Communist bloc. The Soviet moves helped prompt Congress, too, to recognise that the character and geography of the Cold War had changed and to take a closer and more sympathetic look at economic assistance for non-aligned Third World countries in consequence.

India was a major focus for Soviet attention, and in the changing atmosphere toward economic assistance policy in Washington the launching of its ambitious Second Five Year Plan in 1956 provided a target of opportunity for advocates of higher aid levels to the Nehru government. Prospects for aid were also heightened by a warming in the overall bilateral relationship. Eisenhower himself had gradually moved to a better appreciation of non-alignment, and Nehru's visit to the United States in December 1956, when contrary to many expectations the two very dissimilar men established remarkably strong rapport, helped solidify his more positive views. (Dulles was somewhat slower in accepting the benefits of non-alignment to the United States, but by early 1957 he, too, was supporting it.) The Indian government, for its part, came to view U.S. policy and intentions with a more benign eye. Indian satisfaction with the U.S. position in the Suez crisis of 1956, its discomfort with the Soviet invasion of Hungary at that time, and the sense that India had drifted too far from its non-aligned moorings in developing friendly ties with the Communist countries contributed to the Nehru government's interest in better relations with Washington.

The new U.S. approach to India was formally spelled out in a National Security Council document approved by Eisenhower in January 1957, a few weeks after Nehru's visit. The NSC paper placed major emphasis on the importance of Indian economic development to U.S. security. It declared that the United States should "provide economic and technical assistance to India, placing emphasis on projects and programme having the maximum potential of support of the goals and aspirations of India's Second Five Year Plan," described as "the best vehicle for action to promote U.S. interest in an independent India." The paper also noted for the first time in a formal U.S. government document the broader significance for the United States of the outcome of India China competition in economic development. This, it said, "will have a profound effect throughout Asia and Africa."

Within this positive policy framework, U.S. economic assistance over the four final Eisenhower years soared well above the amounts advocated earlier by the most outspoken champions of American support, let alone the funding actually appropriated and delivered. India was a major beneficiary of the Development Loan Fund (DLF), whose establishment in 1957 reflected the new prominence Washington gave in its foreign policy to the economic progress of the Third World. By 1961, when Eisenhower left office, it had received 40 per cent of DLF lending. The foreign exchange crisis that India experienced in 1957-5 8 heightened both the importance of American assistance and the U.S. commitment to provide it through the DLF, the Export Import Bank, and, most spectacularly, legislation creating the food aid programme, Public Law 480. This P.L. 480 assistance, begun in 1956, reached unprecedented heights in 1960 with the signing of a four-year agreement to provide sixteen million tons of wheat and one million tons of rice valued at $1,270 million. Washington also increased its contributions to the International Monetary Fund and the World Bank, where a soft-loan window, the International Development Association, was established for Third World countries. From the start and by design, India was IDA's largest borrower. To coordinate its aid programmes with those of other international donors, the United States took the lead in moving the Bank to set up a consortium of western lenders. This "Aid-India Consortium" proved a useful mechanism in maximising the impact of foreign assistance and was soon duplicated in other countries that received aid.

The boosts in aid levels to India and other non-aligned Third World countries were part of major revision in America's containment strategy. Although the initial impetus for Washington's new approach came from Moscow, the administration and Congress also began to recognise that fresh policies were called for by disturbing events taking place within the Third World itself. These included rising domestic turmoil and instability in many developing countries, rampant nationalism, and, contributing to both, a so-called revolution of rising expectations on the part of disadvantaged Third World peoples. If the Soviet Union's aggressive new economic diplomacy had suggested that the character and location of the Cold War was in flux, these developments seemed to confirm that finding.

In these evolving circumstances of the late 1950s, military alliances were no longer considered sufficient guarantors of American interest. As Secretary Dulles, the principal architect of such pacts with Third World nations, warned in 1957: "These people [of the Third World] are determined to move forward.... If they do not succeed there will be increasing discontent which may sweep away their moderate leaders of today and bring to power extremist measures fostered by international communism." Recognising that it faced a changing pattern of international challenges, the Eisenhower administration increasingly focused attention and resources on economic aid to nonaligned countries. At the same time, it maintained the programmes of mutual security assistance and defence related economic support it had established earlier in nations that had joined the Western alliance system. Under this new approach, Washington was able to make both non-aligned India and aligned Pakistan leading recipients of its financial largesse. It was not an arrangement the Pakistanis liked.

India excited unusual interest in influential American political and academic circles in those years. Its size, strategic significance, democratic polity, foreign affairs activism, economic juxtaposition with China, and, especially for academicians, its relatively strong infrastructure, civil service, and sophisticated economic planning progress, were important in winning India a significant American lobby for the first time since its independence. In Congress, important members introduced resolutions that spelled out India s unique importance to the United States and made a strong case for enhanced American and World Bank support for Indian economic development. Among the resolutions' sponsors was John F. Kennedy, then senator from Massachusetts. The support of Kennedy, who had visited India as a young congressman earlier in the decade and had become attracted to Third World causes, was especially significant because he seemed to have a good chance to win the Democratic Party's presidential nomination in 1960 and go on to the White House.

Politically well-connected university professors led by Walt Rostow and Max Millikan of the Massachusetts Institute of Technology encouraged the Eisenhower administration and Congressional leaders in their support for India. Rostow and Millikan had become leading theorists in the new field of development economics. They singled out India for special, positive attention. They stressed the importance of major doses of Western capital and technical assistance in moving nations such as India, already at more advanced stages of economic growth, to "take off" into eventual self-sustained development. The peaceful economic and social transformation such countries could attain with this Western aid would also promote their political stability and enable them to ward off the threat of Communism. The attractive Cold War spin of the Rostow-Millikan theories appealed to both the administration and India's backers on Capitol Hill. Rostow had a major hand in drafting and promoting the pro-India Congressional resolutions Kennedy and others sponsored, and the MIT Center for International Studies he and Millikan established proved a useful think-tank resource in winning support for higher U.S. priorities for India.

The administration and India's congressional and academic backers generally accepted the Nehru government's approach to economic development. They were not unduly concerned about its stated determination to forge a "socialistic pattern of society" in which the commanding heights were to be entrusted to the public sector of India's mixed economy. Nor were they troubled by the stress the Second Five Year Plan placed on rapid industrialisation, especially government-owned heavy industry (which received major support from the Communist countries), or the limited resources it provided for increasing food production. The administration found ways to use its aid program to encourage the growth of private enterprise in India and to raise the very low level of American investment and trade there. But for all its conservative, capitalist credentials, a good deal of the aid it provided India was for large-scale industry and infrastructure in the public sector.

By the end of the Eisenhower administration, both U.S.-Indian relations and American assistance for Indian economic development had reached levels no one would have forecast when the President and his moralising cold warrior Secretary of State had taken office eight years earlier. The remarkable strengthening of ties during Eisenhower's second term—significantly accompanied and boosted by the administration's more forthcoming attitude toward India's economic development—was famously encapsuled in the exuberant welcome he received when he visited Delhi at the end of 1959. No foreign leader who has come to India during its half century of independence has attracted such massive crowds and tumultuous acclaim.

The incoming Democratic administration led by John F. Kennedy was expected to strengthen bilateral relations and the American commitment to India's economic progress even further. The special attention and firm support Kennedy had given India during his senatorial years were well remembered. His appointment to senior government office of men who shared these positions was also much noted. They included Chester Bowles, who became number two in the State Department, as well as both Walt Rostow and Max Millikan. John Kenneth Galbraith, a Harvard economist close to Kennedy, was named ambassador o India. This too was taken as a signal of the President's determination to give India high priority in his administration's foreign political and economic policies.

Kennedy's favorable attitude to India and the Nehru government was correctly regarded as a reflection of his overall approach to the Third World and its role in U.S. containment policy. Both as senator and now as president, Kennedy recognised the importance, the inevitability and the potential usefulness to the United States of Third World nationalism. In his view, the United States needed to come to terms with this nationalism and with the independent, non-aligned foreign policies the burgeoning group of newly decolonised, highly nationalistic Asian and African countries had adopted. Washington should regard nationalism as an important potential counter to communism. Instead of shunning outspokenly nationalist regimes as troublemakers that tilted too much toward the communist powers, it should seek to cultivate them, not least through economic assistance. This aid would be linked to "nation-building" and economic reform measures designed to create stronger and more equitable societies, thus helping reduce the attractiveness of communism. The United States could reasonably expect that its more understanding and forthcoming approach would lead non-aligned Third World countries to adopt more positive attitudes toward American policies and objectives in their regions and beyond.

Despite all the promising signs, U.S.-Indian ties did not flourish during the Kennedy administration as much as many in both countries had hoped and forecast. A number of problems, some new, others longer standing, vexed the relationship. New Delhi's occupation of Goa and other Indian possessions of U.S. NATO ally Portugal, its unwillingness to join with the United States in countering communism in Southeast Asia, and its seemingly uncompromising position on Kashmir annoyed Washington. India, unhappy with U.S. reaction to its position on these issues, was also troubled by America's continuing patronage of Pakistan, especially its supply to the Pakistan Air

Force of advanced fighter planes. Matters were not helped by Nehru's visit to the United States in October 1961, when he and Kennedy signally failed to establish the strong relationship the prime minister had with President Eisenhower. (It is one of the many ironies of U.S.-Indian relations that Nehru developed far better rapport with Eisenhower, a military man and conservative Republican, than he had with the two other American presidents he met, Kennedy and Truman, both liberal Democratic civilian politicians.)

The prompt and generous U.S. response to Indian appeals for help in its border war with China in October-November 1962 brought about a momentarily stunning transformation of bilateral ties. But this gradually faded away. The Indians, for their part, felt uneasy and crowded by their greater dependence on the United States. Washington was troubled by what it regarded as India's intransigence in negotiations with Pakistan over Kashmir sponsored by America and Britain, its refusal to see in Chinese Communist aggression in the Himalayas reason to take a more active role in countering perceived Communist aggression in Southeast Asia, and its continuing relationship with the Soviet Union (now grown more valuable in the Indian view as a counterweight against renewed Chinese aggression). Hopeful that the border conflict would lead to a lasting change in India's approach to non-alignment and make it a strategic partner of the United States in practice if not by treaty, the Kennedy administration was disillusioned when Nehru stuck to his old ways.

As anticipated, U.S. aid commitments to India reached record levels in the first years of the Kennedy administration. In April 1961, the administration pledged an unprecedented one billion dollars in development assistance for the first two years of India's ambitious new Third Five Year Plan. Later in the year, it sent one of the first contingents of its freshly launched Peace Corps to Punjab, where the young volunteers assisted in introducing new methods in agriculture and small-scale industry. Eagerly seeking to publicise U.S. assistance, Ambassador Galbraith toured India in a special train that took him and a flock of journalists to many American-aided projects.

But the unfavourable political developments eventually had a negative impact on the environment in which economic assistance was determined in Washington. Even while aid levels soared, boosted after the Sino-Indian war by assistance for India's military buildup, the early enthusiasm for economic support for New Delhi was waning along with U.S. interest in cultivating the Indians for American political advantage.

Ideological issues contributed to this change in atmosphere. Although the Eisenhower administration had been willing to accept the precepts of Indian economic policy and provide assistance to public sector as well as private sector projects and programmes—an approach Kennedy continued—misgivings about this position had persisted. When the Indian government requested an initial half billion dollar loan from the United States to help finance a public sector steel mill at Bokaro in eastern India, these misgivings surfaced in a major controversy within the administration over the project's ideological implications as well as its technical feasibility. Bokaro opponents cited the recent finding of a presidential commission that assistance should not be provided by government to enterprises that compete with existing private firms. The skepticism of some congressmen about the ideological and technical advisability of funding for Bokaro reinforced the opposition of those who were reluctant for political reasons to make a major loan to the Nehru government. Although President Kennedy supported the measure, it died in Congress in the summer of 1963. The Soviets eventually financed and built the mill.

Congressional consideration of the loan took place against a background of increasing doubt on Capitol Hill and elsewhere about the purpose and usefulness of foreign economic assistance. As a presidential commission observed: "There has been a feeling that we are trying to do too much for too many too soon, that we are overextended in resources and under compensated in results, and that no end of foreign aid is either in sight or in mind." Later termed "aid fatigue," this general dissatisfaction found expression in a drastic congressional reduction in funding for foreign assistance for the fiscal year beginning in mid-1963. The level of aid to India, a major recipient, inevitably suffered a serious cutback.

Aid fatigue was coupled with dissatisfaction with Indian economic policies and performance. Much of this concern was targeted on India's faltering agricultural front. By the early 1960s, the stagnation of grain production and the increasing need for food imports had long since become a well-recognised national problem. But although the Third Five Year Plan gave greater importance than the Second Plan had to agriculture, economic policy continued to emphasise the industrial sector, still seen as key to rapid development. Moreover, for political reasons, pricing policy was designed to make cheap food available to the potentially volatile urban masses at the expense of the farmers. This combination of government inattention and low prices conspired to keep down food grain production. Production was further depressed by the availability of massive supplies of P.L. 480 American grain on easy terms and with minimal and casually observed self-help requirements. This inhibited India from adopting pricing, credit, and input policies that would stimulate domestic food production.

Progress in other sectors of the Indian economy had also been slow. Shortages of electric power, coal, transport, fertiliser, and foreign exchange had led the Indian government to lower some Third Plan targets. Expenditure stemming from the military buildup that had followed the Sino-Indian war contributed to the strains the economy faced. The war led the government to reorder its economic priorities, further reducing hope that the goals set in 1961 could be reached.

By the time President Kennedy was assassinated in November 1963, these discouraging developments on India's economic front had served to take the bloom off the Indian rose both for the administration and for academics who had seen in India a promising model on which their concepts of economic development could be tested. Confidence that India could be moved swiftly to the take-off stage in Rostow's theory of economic growth had largely disappeared along with the hope that it could become a reliable friend of the United States on the international political stage.

Kennedy's successor, President Lyndon B. Johnson, did not share his special interest in India. Johnson was concerned by the evident failings of the Indian economy and by what he saw as wasteful U.S. efforts to pump money and food into a country that was following unsuccessful policies. During his administration, the United States used its aid programs to bring about fundamental changes in the way

India dealt with economic development. Its efforts to persuade them Indian government to adopt major economic reform measures that Washington favoured were the most intensive any American administration has undertaken.

These efforts focused at first on Indian food and agricultural policy. As was often his practice, Johnson took a tough line. Dissatisfied with what he regarded as the failure of the Indian government to adopt reform measures that would increase food grain production, he refused to sanction further long-term P.L. 480 agreements. Instead, he put in place a "short-tether" policy. This allowed only limited food grain shipments. Further grain deliveries from the United States would depend on the administration's assessment of India's progress toward food policy reform. Johnson became deeply involved in this policy, personally monitoring Indian compliance with his self-help requirements.

Neither the Indian government's willingness to accept the reform measures the administration promoted nor a severe famine caused by two consecutive failures of monsoon rains over large parts of northern and eastern India in 1965 and 1966 could persuade Johnson to ease this short-tether, ship-to-mouth policy. He insisted on personally approving every wheat shipment from U.S. ports to India during the massive famine-relief operation that in two years moved 14 million tons of grain, the largest transfer of food from one country to another in history.

Johnson's approach was severely criticised in the United States and much resented in India. Justifying it, the president claimed that unless he had adopted his tough line India would not have adopted self-help measures, nor would other countries have contributed to the famine relief effort, as he had insisted they do because of the reduction in American grain surpluses. He also asserted that Congressional support could only have been assured by evidence both of India's progress in helping itself and of the participation of other foreign donors in the food relief programme.

But many observers, including Johnson's own secretary of agriculture, maintain that the president's approach was significantly influenced by his deep annoyance with the failure of the Indian government, by then headed by Indira Gandhi, to support him on Vietnam. The Vietnam War had become Johnson's paramount foreign policy and domestic political concern. What he and other American policy makers regarded as the Indians' unhelpful attitude "after all we have given them" grew to be a serious irritant in U.S.-Indian relations for the rest of his term and in his White House successor's. (Actually, a strong case can be made that at least until mid-1966, the government of Prime Minister Gandhi and, before her, Lal Bahadur Shastri, had been careful to keep U.S. interests in mind in dealing with the Vietnam issue, largely because of the importance to India of American economic support.)

The short-tether policy was just getting underway when the second India-Pakistan War broke out in September 1965. The war significantly changed the way the United States looked at South Asia. It seemed persuasive evidence that India and Pakistan were too concerned with their hostility toward one another to play major, constructive roles in helping America achieve its foreign policy objectives. Outraged by the use by the two countries of U.S.-supplied military equipment against one another, and painfully aware of American ineffectiveness in dealing with the South Asian antagonists, policy makers in Washington came to believe that the United States should reduce its involvement in the affairs of the subcontinent. Aside from the Nixon administration's diplomatic activity during the 1971 Bangladesh struggle and, in the 1980s, the Reagan administration's renewal of U.S.-Pakistan security ties and its covert support for the *mujahiddin* resistance following the Soviet invasion of Afghanistan, the region has ordinarily been on Washington's political back burner ever since.

The Johnson administration's initial reaction to the outbreak of the 1965 was to cut off military supplies and suspend further economic assistance to both India and Pakistan. When fresh aid to India was resumed early in 1966, Washington sought to use its influence to bring about what Secretary of State Dean Rusk called "an economic bargain." The administration's dissatisfaction with India's lackluster economic performance and its growing concern that its assistance was not being properly used had come to be shared by other donor governments as well by the World Bank. It strongly supported the Bank's call for far-reaching reforms to liberalise the tightly controlled way the Indians managed their economy and move the country to a more pragmatic, market-oriented system. In return, the United States and other members of the Aid-India Consortium were to provide substantially higher levels of assistance.

In the negotiations that followed, both the Bank and the Indian government assumed that a substantial devaluation of the rupee would be a necessary part of the reform package. When the devaluation was announced in June 1966, it was widely denounced in India. Despite the World Bank's lead role in promoting the reform package, many Indian critics of devaluation blamed the Johnson administration for conspiring to force it on the Indian government. The negative political fallout in India was worsened. by the failure of devaluation and other reform measures that accompanied it to bring about the higher levels of foreign assistance and the boost in exports than had been expected and used to justify them. Development assistance from the United States rose in Fiscal Year 1966 (July 1965-June 1966) to the highest level since 1962 despite the suspension of further aid agreements in the latter part of 1965 prompted by the India-Pakistan War. (Total assistance, including the massive P.L. 480 shipments, also rose.) But they were substantially lower during the balance of the Johnson administration.

The Republican administration of Richard M. Nixon, who succeeded Lyndon Johnson in January 1969, at first gave India low priority in its foreign political and economic policies. As Thomas Thornton has pointed out, Nixon "was not interested in promoting India to any broader position of leadership, whether within South Asia, regionally, or globally.... Its politics and economy in shambles, India was hardly much of a model for leadership. ..It was less and less likely that India would play a role that would be supportive of broad U.S. interests in Asia." There was little substance to the bilateral relationship. During the first years of the Nixon administration economic assistance continued at levels roughly comparable to those of the last Johnson years, well below those attained in the Kennedy heyday but still considerable. Although the Indian economy was faltering badly, the administration was not interested in pressing for major structural reform; given the rather parlous state of bilateral relations, it would probably have been unsuccessful had it tried. India's "license-permit- quota" raj of tight, enterprise-inhibiting government regulations remained securely in place.

The administration's indifference to India gave way to enmity in 1971. Moved largely by global concerns unrelated to the situation on the South Asian ground, Nixon and Secretary of State Henry A. Kissinger tilted U.S. policy to favor Pakistan in its losing war with India over Bangladesh. U.S.-Indian relations plunged to unprecedented depths. Among the casualties was the economic assistance programme. The administration cut off almost all economic aid. The only programme that continued during this period, P.L. 480, Title II, was intended to fund the overseas activities of American charitable organisations, and has always been driven primarily by the needs of those organisations rather than by U.S.-Indian bilateral ties. In New Delhi, much of the large American staff of the Agency for International Development was reassigned and AID's grandiose main office building was turned over to the Indians. Washington also instructed its representatives at the World Bank to vote against IDA loans to India, an ineffective gesture since the United States did not have veto power.

Under the circumstances of the early 1970s, neither government was interested in resuming the economic assistance programme. India had become even more suspicious of the motives and intentions of the United States, not least in its use of its assistance programmes, and was in no mood to welcome back what it regarded as an intrusive American presence. The Nixon administration, suffering from an advanced case of the aid fatigue first evidenced in Washington years before, saw no political purpose or economic rationale for assisting an unfriendly India, close to Moscow, that was following what it considered failed economic policies. The U.S. disinclination to restore bilateral assistance was no doubt strengthened with the explosion of a nuclear device in 1974 and imposition of the Emergency in the following year. This made any resumption of aid unthinkable from Washington's viewpoint.

Non-food development aid was restored only in 1977 during the administration of Jimmy Carter, when the Emergency had been lifted and the Congress Party was defeated in national elections. The restoration of democracy was lauded in the United States and set the stage for efforts on both sides to improve relations. A resumption of economic assistance seemed an obvious course to Washington (though some specialists familiar with the past record of U.S. aid programmes in India questioned its political utility). Views in India were mixed. The sums eventually provided were in any event fairly modest and much smaller than before 1971. As Dennis Kux has observed, "the revived assistance effort, while not insubstantial, remained more an expression of good will rather than a major policy commitment to Indian development as it had been during the Eisenhower and Kennedy years."

Bilateral development assistance was reduced even further after Carter was succeeded by President Ronald Reagan. The Reagan administration (1981-1989) cut development aid to half the average of the Carter years as tight budgets led to a shift in funds from India to other countries. Development aid levels dropped even further during the administration of George Bush (1989-93).After Bill Clinton became president they rose somewhat, reportedly as a result of the importuning of successive American ambassadors in New Delhi who persuaded Washington that exceedingly low aid levels made it impossible for the United States to play any meaningful role in Indian development thinking. The bulk of the aid provided in recent years has been for technical assistance and does not represent resource transfers.

It is important to note the context in which aid funding has taken place in these years. In the decade between 1986 and 1996 there was a dramatic 50 per cent fall in the U.S. foreign affairs budget. This budget includes economic assistance, which was cut drastically. But the biggest recipients of aid, Israel and Egypt, were exempted from the cutbacks. The cuts thus fell disproportionately on other traditional recipients, such as India. These recipients were also hurt when, following the fall of the Soviet Union, Washington initiated aid programs in the successor countries of the Commonwealth of Independent States.

At the same time, beginning in the early 1990s and accelerating after Clinton took office in 1993, both the U.S. government and American business began to focus on the potential for trade and investment in big, emerging markets, especially in Asia. The economic policy reforms the Narasimha Rao government undertook following the Indian financial crisis of 1991 made India a much more attractive prospect for American trade and investment. Far more American money is now moving to India in these channels than through official bilateral development assistance.

What limited bilateral funding remains is greatly overshadowed also by the assistance the United States government provides India through its contributions to multilateral lending agencies, especially IDA. For years India received 40 per cent of IDA loans, and though the proportion has fallen as other claimants have been accommodated, the Indian share remains high. (Even so, external assistance constitutes a much smaller proportion of the Indian economy than it does those of most other aid-receiving countries.)

The United States has been in the lead in supporting efforts of the World Bank and other international agencies to persuade India to adopt more market-oriented economic policies. But the context in which this effort has taken place is very different from what it was in the 1960s, when the Bank and the Johnson administration undertook similar exercises. Then, India and many other developing countries were wedded to development policies that called for massive, detailed state involvement in their national economies. By the 1990s, most of the Third World, led by the booming countries of East and Southeast Asia but including the South Asian nations as well, had moved to more liberal approaches. If the World Bank, the United States, and others were not exactly leaning on an open door in their discussions with the Indians, they at least found far more promising terrain than they had a quarter century earlier.

Encouragement of economic development remains one of the stated purposes of Washington’s India policy, as it has for decades. But as India enters its second half-century of independence, trade and investment, along with IDA and other international agency funding, will be the principal way the United States will support that development. Bilateral development assistance to India, for so long a major element in U.S.-Indian relations, is most unlikely ever again to reach significant heights. Nor is either country likely to want it to. Trade and investment will—and already have—brought their own set of problems to U.S.-Indian ties. But one can reasonably hope that they will provide a healthier, more stable contribution to the long-term relationship between the United States and India than did the volatile, controversial, often politically charged economic assistance programmes of the past.

India's Economic and Social Development
Indo-Swiss Cooperation

Jean-François Giovannini*

Indo-Swiss cooperation has a long history. Swiss companies have been important investors in India from the time prior to its independence, especially in the chemical and pharmaceutical industries. They retained their leading position among foreign investors, despite the fact that there was a stagnation of financial flows from abroad in the sixties and seventies. With the recent opening-up of the Indian economy, Switzerland has stepped up its investments and remains, with far higher volumes than before, India's fourth largest bilateral foreign capital source. The value of Swiss exports to India, most of them capital goods, has more than doubled in the last 15 years, crossing the half billion Swiss Franc mark in 1994. The rise of India's exports, helped by a favourable trade regime, has been even more marked, registering an increase of 130 per cent over the same 15 year period.

Official development cooperation between India and Switzerland started in 1961. The goals of Swiss development cooperation are determined by the Swiss federal law of 1976 in the following terms: "Swiss development cooperation supports the efforts of developing countries with a view to improve the living conditions of their populations. It strives to put these countries in a position to achieve development by their own efforts. It aims, in the long term, at a better balance within the international community. It supports, in priority the efforts of the most disadvantaged developing countries, regions and population groups. It encourages in particular the development of rural areas, the increase of agricultural production especially of food crops for local consumption, the promotion of handicraft trades and small scale industry, the creation of job opportunities and the search for and preservation of an ecological and demographic balance." In this endeavour, Swiss development cooperation's priorities have been largely in line with the poverty programmes of the Government of India.

The main sectors in which Indo-Swiss cooperation has taken place over the last 30 years are:

- Technical and vocational training (mechanical, electronics, rural management)
- Cattle breeding and milk processing
- Natural Resource Management: land use, watershed management

* Deputy Director General, Swiss Agency for Development and Cooperation, Department of Foreign Affairs, Berne. From 1968 to 1974 coordinator for the Swiss development cooperation in India. Head of the Swiss delegation for the preparation of the Rio Conference on Environment and Development (1992); and the Social Summit in Copenhagen (1995).

• Small and microenterprises: involvement with rural apex banks, such as NABARD and SIDBI, development of sericulture

• Energy and Environment

A large number of present day cooperation programmes can be connected more or less directly to two forerunners which started in the first-half of the sixties: cattle breeding and fodder development project in Kerala and the assistance in settling Tibetan refugees in different States throughout India. The assistance given to Tibetans has helped to establish cooperation with the state governments of Kerala and Karnataka and to work with a number of Indian voluntary agencies. In addition, Indo-Swiss cooperation gained experience in rural credit with the National Bank for Agricultural and Rural Development (NABARD) as well as in dry land agriculture.

The cattle breeding project in Kerala gave birth to a family of livestock programmes, in Punjab (1971-1979) and in Andhra Pradesh (since 1975). A direct connection with the Kerala project can also be seen in two projects of financial cooperation to support the Institute for Rural Management, Anand (IRMA) and the development of a dairy industry in the northern districts of Kerala.

In the second-half of the seventies, the search for cooperation in vocational training, such as the Centre for Electronic Design in Bangalore was intensified and resulted in collaboration in a milling technology training centre in Mysore and a training centre for mechanics and electronic engineers in Bangalore. At the university level, programmes were also started in the area of applied research in biochemical technology and solar energy.

In the eighties, several projects were initiated which are crucial to the present Indo-Swiss cooperation. These programmes are in the field of rural credit, collaboration with Indian NGOs, sericulture and the optimal use of land in ecologically unstable areas, such as semi-arid zones and mountain areas. In addition, important initiatives were launched to address environmental and energy efficiency challenges.

Lessons Learned

Much has been achieved by India and other developing countries in the last 50 years: the indicators for health, education, longevity, access to safe water show a change for the good. This must be recognised. Unfortunately, these changes are still not sufficient, and poverty remains a reality which should not exist and should not be accepted. Income disparities have increased in most countries. Experience has shown that the poorest fifth of the population in most countries gets almost no benefit from development programmes, even when these programmes are designed for them. The fact is that very poor people suffer from all kinds of discriminations. They do not live in a void. They live with other groups which have more power and which can confiscate to their profit whatever means the government or the donor agencies are spending for development. They also have little or no access to productive resources like land, water or credit. The failure in achieving universal literacy is one major reason why the poorest segments of the population have failed to improve their situation substantially. Literacy creates awareness and capacity to defend one’s rights.

It is interesting to examine success stories in order to understand what works and what does not. As we have seen, Swiss development cooperation was associated with the development of Kerala over a period of more than 30 years, mainly in the field of cattle breeding and milk processing. This gave the Swiss many opportunities to learn from Kerala's experience. It is interesting to note that Kerala has achieved a high degree of success in social development, social justice, education, health and birth rates, even though its GNP per capita is lower than in many other Indian States. These results were achieved mainly through an intense political participation by unions, political parties, cultural groups and churches. The State had to perform because performance was demanded by the people. This demand was often angry, taking even the form of general strikes. But it worked. It must also be noted that the Princes of Travancore gave a high priority to education as early as the end of 19th century, and that women had for a long time a good access to it. To sum it up, it seems that education for men and women as well as a good participation in the democratic process are important elements for social development.

Reasons to be Optimistic

As democracy and education are gaining ground in most countries in the world, including India, one may think that in the future, development will benefit the poorer segments of society more than in the past. There are other reasons for optimism. Major changes are taking place outside of government intervention, and some have a deep influence on the way people take decisions concerning their lives. As a child, I had no access whatsoever to radio or television, and that was not exceptional in Switzerland at that time. In India, 25 years ago, most people in the countryside had only the official radio of the Government as a source of information. Today, in most countries of the world, even villagers have often access to television and to information that is largely free of government control. They can imagine a world different from their own. Women especially can see that women elsewhere have more freedom. They can see other women whose lives are not limited to producing children. This world information is giving ideas; it leads to migrations, but also to changes in attitudes, values, and behaviour.

Another major change over the last 20 years, that will have an important consequence for the future, is the development of nongovernmental activities in most countries. The private sectors, and private initiative, are gaining ground everywhere. By private sector, I mean not only private business, which is very important, but also unions, religious institutions, NGOs, self-help groups, savings associations, newspapers and so on. Women's associations and women's participation in social, economic and political decision making are especially important for social change. Everywhere, people are expecting less from their governments and take more initiatives to improve their economics and social conditions, to defend their interests. This change I n attitude, which is very deep, will sometime lead to conflicts, but also to improvement in the conditions of the poorer segments of society.

New International Strategies

Forty years of development efforts and of development cooperation have brought many positive results. It can be said that never that never in the have brought many positive results. It can be said that never in the history of mankind, so much positive change was achieved over such a short period. It is also evident that the results are far from sufficient: more than a billon people in the world, more than 300 million in India alone, still live under the poverty line, that is they do not have access to sufficient resources to cover their basic needs for nutrition, shelter, clothing and health. Moreover, the increase in population and production has created new problem: pollution and the destruction of the natural resources which are the base of human activity. As the North is consuming ever more natural resources for its own economic growth, the world is reaching the physical limits given by nature without having found a solution to the problem of poverty alleviation. This is not acceptable.

The international community has launched a group of theme conferences in order to find a common strategy which could be the base for an improved international cooperation in the 21st century. The main meetings were the Conference on Environment and Development in Rio de Janeiro (1992), the Conference on Human Rights in Vienna (1993), the Conference on Population and Development in Cairo (1994), the Social Summit in Copenhagen (1995) and the Conference on Women and Development in Beijing (1995).

The new international strategy which emerged from these meetings is a useful tool for the future. It will be a framework for action based on common values and a common appreciation of the failures of the cooperation in the past. One important theme is the recognition that all countries have a common responsibility in the sustainable management of the limited resources of the earth, but that this responsibility is differentiated according to each countries, which are the cause of most of the destruction of natural resources, also have more to do in order to restore a balance between the resource and their use.

Another major conclusion of these international conferences is the fact that poverty is most of all the result of a lack of economic, social and political power. The key word for the future is, therefore, empowerment of the weak social groups, especially women, who in all societies are the victims of discrimination. The improvement of their conditions is best obtained by liberation of own energies, rather than by well-meant programmes of governments or NGOs. In this context, one cannot give too much importance to good governance and respect for human rights.

India and the World Bank

Jochen Kraske*

Introduction

The 50th anniversary of India's independence follows close on the 50th anniversary of the creation of the World Bank. Throughout the past 50 years, India and the Bank have remained closely involved. The twin anniversary provides an opportunity to look at the relationship between them. The World Bank played an important role in India, just as India was an important member of the Bank. The Bank was India's biggest single source of external finance and India, in turn, was the Bank's largest single borrower. The size of its borrowing from the Bank gave rise in India to concern about the Bank's influence, though India probably had a greater influence on the Bank.

The relationship between India and the Bank was not without tension or without ups and downs. There were fundamental differences from the outset. India's attitude towards the Bank was shaped by its colonial experience. At the time of independence, India's new leaders were determined to avoid what they saw as a principal source of exploitation and economic backwardness: the persistent trade surplus which financed a steady transfer of capital out of India. As a result, they rejected export orientation and free trade as suitable strategies to foster the diversification and expansion of production.[1] More generally, they felt the classical capitalist model was unsuitable for developing countries. Instead, India's leaders visualised an activist socialist state that would reform oppressive agrarian relations and help India industrialise rapidly within the framework of a planned economy. As they judged the global economic conditions which led to World War II, capitalism appeared to have failed. Instead, India's Prime Minister Jawaharlal Nehru was greatly impressed by the industrial progress he believed the Soviet Union had achieved through central planning and massive public sector investment, especially in heavy industry. Although the bulk of India's trade and financial dealings were with the West, there was instinctive sympathy among much of the political class and press for the Soviet Union, which was identified with anti-colonialism and socialism. With the outbreak of the cold war, therefore, India refused to take sides, chose to remain non-aligned and indeed sponsored and led an alliance among similarly minded former colonial countries.

---

* The author is the historian of the World Bank Group and a staff member of the World Bank. Work on this paper was supported by the World Bank, however, the views expressed in it are those of the author and do not represent the views of the World Bank. The author is grateful for the assistance of Marie Gallup who assembled the source material used in the paper. The author acknowledges with thanks the helpful comments provided by Swaminathan Aiyer, William Diamond, Benjamin King, Sarwar Lateef, Edwin Lim and Joe Wood on the basis of their reviews of various drafts of the paper.

[1] Rakesh Mohan: *Industrial Policy and Controls in The Indian Economy—Problems and Prospects,* edited by Bimal Jalan, Penguin Books, New Delhi 1992, p.89.

In this context, the World Bank looked suspiciously like a prejudiced and partisan agent. In its early years, the United States obviously dominated the institution. Its predominant role, the location of the Bank in Washington, and the openly expressed concern of the Bank to meet the approval of Wall Street confirmed for many observers in India an identity between the interests of the United States and the Bank, and a capitalist bias in the professional work of the institution. On the other hand, the Bank saw itself as an objective, professional body operating without a political or ideological agenda, as its Articles of Agreement mandated. Its aim was to serve its membership fairly and to become a partner in their struggle for economic progress. It required access to confidential information in order to be able to assess the creditworthiness of its borrowers and the soundness of the projects it would support, and it expected to be taken into its borrowers' confidence in important economic decisions.

Indian decision-makers saw the Bank as a source of capital rather than of advice. The ideological perspective attributed to the Bank made it unlikely that the Bank would be able to offer relevant advice. More importantly, the mere perception that outsiders could have any significant role in the Government's decision-making was anathema to those with -an exaggerated concern about national sovereignty. Indeed, sensitivity about outside interference had been a concern when India decided to join the Bank and the Fund. C.D. Deshmukh, then the Governor of the Reserve Bank and later Finance Minister, stressed the non-political, technical character of these institutions and revealed "that it was only after searching examination of the pros and cons that the Indian Legislature gave its assent to India assuming the responsibilities of membership in the Bank. We in India were particularly anxious to feel assured that the Bank's lending would be carried out on prudent, non-political grounds."[2] Any manifestation of dependence on outside agencies was watched with great suspicion. The communist and socialist parties in particular, but also parts of the governing Congress party, suspected the motives of the Bank. To them the Bank became a convenient target which could be safely attacked to embarass the Government. The media thus paid close attention to the utterances and activities of the Bank, and politicians took a keen interest in the institution. As a result, the Bank assumed an importance in the public perception which was out of proportion to reality.

Despite these inauspicious incongruities between the parties, the relationship between India and the Bank endured and continued close and without interruption from the moment the Bank opened for business. Lending by the Bank to India started in 1949 and proceeded year after year. There was much interaction in the form of reviews and discussions of India's economic problems and development strategy. The early and continuous involvement of India in the Bank as one of its largest shareholders with its own member on the Board of Executive Directors gave India an influential role in the institution. The Bank's understanding of development issues and priorities, its response to development needs and its policies were shaped in important ways by its knowledge of, interaction with, and its activities in India. In this sense, the

[2] Statements by C.D. Deshmukh in the Third Session of the Second Annual Meeting of the Board of Governors in London on September 15, 1947.

relationship between India and the Bank was very much a mutual one, much more akin to a partnership than to a conventional creditor-debtor relationship.

The following sections of this paper sum up the several phases in the uneven evolution of the India-Bank relationship, then discuss key aspects of the Bank's role in India, describe India's impact on the Bank, and conclude with a few thoughts about the significance of this relationship.

Evolution of Relations between India and the World Bank

There were, broadly speaking, five phases in the relationship between India and the Bank. The **first** started with the creation of the Bretton Woods institutions and the modest expectations India initially associated with them.[3] There followed a period of limited interaction and getting acquainted slowly, after India's independence. The Bank and other outside observers were impressed with the way India's leaders approached economic development. Economic planning and a strong leadership role for the government were regarded as essential prerequisites for successful economic development, by the Bank as well as by India. The focus on infrastructure and basic industries in the investment strategy seemed appropriate. The Government's conservative fiscal and monetary policy was praised by Bank economists: "few countries can match India's record in monetary policy."[4] The Bank's President Eugene Black on the conclusion of his first visit to India, said that the First Five Year Plan was "well thought out" and "well within the capacity of the country." He declared he was ready to recommend that the Bank "make a further substantial investment in India."[5] In an address to the University of Minnesota he praised India's policy of using export taxes to stabilise jute, burlap and cotton prices and concluded. "This adjustment to an inflationary situation is evidence of maturity in economic thinking—greater maturity than has been shown in many countries with far more experience in managing their own fiscal affairs."[6]

---

[3] The responsible official in the India Office reacted to the invitation to attend the Bretton Woods Conference, "India's attitude to proposals of this kind [a United Nations bank for reconstruction and development] is likely to be one of general sympathy with the international approach, offset by suspicion of any concrete proposals, particularly from the point of view of their effect upon India's political and economic autonomy." He correctly anticipated Indian sentiments when he complained about the proposal "There is an altogether excessive regard for the susceptibilities of private investors and an almost complete absence of regard of the need to plan on a broad basis. The fact that the controlling power is bound to be vested almost entirely in a few powerful countries will strengthen India's suspicions." Letter by K. Anderson, India Office, addressed to E. Rowe-Dutton, Treasury, dated February 23, 1944.

[4] IBRD: The Five Year Plan of India and India's Creditworthiness, R-564, dated February 19, 1952, p.25.

[5] Statement by Eugene R. Black at a press conference in Bombay on February 22, 1952.

[6] Eugene R. Black: Address to the National Conference on Saving, Inflation and Economic Progress, Minneapolis, May 15, 1952. The Indian Executive Director, B.K. Nehru, confessed that he was 'considerably flattered" by this reference to the economic sophistication of his government. Memorandum from B.K. Nehru to Leonard B. Rist, then the head of the Bank's economic department, dated May 14, 1952.

In 1956, the Industrial Policy resolution prescribed a commanding role for India's public sector, reserving major areas of investment for the government. At the same time, India was making preparations for an ambitious Second Five Year Plan. Black addressed a letter to the Indian Finance Minister which was cautiously critical of the country's policies. Black's advice was attacked furiously by the Indian press and Parliament as an unwarranted attempt to interfere in India's chosen path of economic development. It is an interesting illustration of the fact that critical exchanges between the Government and the Bank were quickly known to, and reported on by India's aggressive press.

This incident did not disturb the harmony that prevailed between the Government and the Bank. But there was less cordiality in the way the Bank was perceived by the press and Parliament. Fears were now more often expressed that the Bank was part of a conspiracy to foist free markets and some form of neo-colonialism on India. At the same time, the leading role India started to play internationally, especially among the non-aligned nations, added to its size and expected need for the Bank's resources, gave weight to India's place in the Bank. Most developing countries were still under colonial rule in the 1950s and India was the first borrowing member country that appeared to exhibit all manifestations and degrees of economic backwardness. The Government provided a persuasive analysis of the country's problems and plans for suitable remedial measures. The Government was confident that the country's economic problems would be quickly overcome, and that India, graduating from the need for external assistance, would soon be able to extend advice and help to others.

The Bank, in this phase, began lending to a number of key sectors. One of the first Bank loans was to the Indian railways, initiating an operational relationship which has extended throughout much of the 50-year period. The Bank financed the expansion and modernisation of the Tata Steel and Indian Iron and Steel Corporations, and helped create major new entities like the Damodar Valley Corporation and ICICI. Lending proceeded on a scale appropriate to the size of the Bank at that time and to the Bank's cautious appraisal of India's creditworthiness. Up to June 1958, the Bank's lending totalled slightly over $400 million, representing roughly 10 per cent of all Bank lending to that point.

The optimistic expectations of the post-independence years started to unravel with the foreign exchange crisis of 1958. The Bank's appraisal of the Second Five Year Plan in 1956 had concluded that the Plan was overambitious, because, among others, of the external financial gap it implied. These concerns were confirmed by an economic mission in early 1957. The planners were reported to have failed to appreciate the magnitude of the foreign exchange problem; there was no proper phasing of projects, and import licenses had been issued rather freely. The country's foreign exchange reserves depleted rapidly as a result. The officials in the Ministry of Finance admitted somewhat sheepishly that they had been taken by surprise.[7] By October 1957, the Prime Minister asked the Finance Minister to explain why India got into these difficulties and why they had not been foreseen.[8]

[7]Memorandum from E.P. Wright to Files: India—Balance of Payments, March 20, 1957.

[8] Letter from Antonin Basch to Eugene R. Black, dated October 30, 1957.

Till then, the Government did not try to mobilise and coordinate external assistance. Whatever program existed was focused on the financing of individual projects. Once the seriousness of the situation became apparent, a more concerted effort to raise long-term external finance looked essential. According to B.K. Nehru, who was put in charge of the fund-raising operation, "it was decided that this...should not be handled through diplomatic channels in order to avoid any political flavour being brought into it but should be regarded as a simple banking operation."[9] The Government then asked the World Bank to organise additional financial support. The U.S., anxious to mternationalise its large aid effort in India, actively supported a gathering of aid donors. Black agreed, and convened the first meeting of what later became known as the Aid India Consortium, on August 25, 1958. At this meeting, the donors managed to cover a short-term gap of $350 million. The meeting not only established a precedent for concerted action by the countries and institutions well-disposed towards India, it also pioneered the concept of formal aid coordination, which became common practice in the 1960s and beyond and became a precedent applied to an increasing number of needy countries.

The U.S. played a key role in this initial effort.[10] A conference in the spring of 1959 by an unofficial American group, the Committee for International Growth, popularised India's need for assistance. The speakers included not only liberals like Senator Hubert Humphrey and Ambassador Chester Bowles, moderates like Senator John F. Kennedy, but also Vice-President Nixon, who proclaimed that "it was the task of the United States and other more fortunately placed countries to give massive aid for Indian economic development."[11] The conference managed to bring together humanitarian concerns about India's poor, concerns about the survival of India's democracy, and concern about the threat of Russian influence and expanding communism in the world's largest non-communist country. The conference succeeded in generating much additional support of India. Earlier, in 1958, Senators Kennedy and Cooper had sponsored a resolution in the U.S. Senate suggesting an international mission of experts to promote joint action in support of India's development plans. In response to this resolution, Black organised a mission to India by Hermann Abs, Chairman of Deutsche Bank, Sir Oliver Franks, Chairman of Lloyd's Bank, and Allan Sproul, former Chairman of the Federal Reserve Bank of New York. Black was guided "by the conviction that visits by prominent members of the business and financial communities of the industrially developed countries would help to achieve a wider understanding of the problems confronting the less developed areas of the world."[12] The "Wise Men," as the three were commonly referred to, submitted a report which I.G. Patel has characterised as "one of the most heartwarming documents in the annals of international relations."[13] It endorsed the Third Five Year Plan and

---

[9] B.K. Nehru: "The Way We Looked for Money Abroad", in *Two Decades of Indo-US Relations,* edited by Vadilal Dagli, Bombay 1969, p.20.

[10]About the U.S. role at this juncture see Dennis Kux: *India and the United States: Estranged Democracies,* National Defence University Press, Washington, D.C., 1992, pp.1 47ff.

[11] William J. Jordan: Nixon calls aid for India vital, *The New York Times,* May 5, 1959.

[12] Bankers Mission to Pakistan and India, February-March 1960: Foreword by Eugene R. Black.

[13] 1.G. Patel: *Foreign Aid,* Allied Publishers Private, Ltd., New Delhi, 1968, p.14.

recommended a substantial increase in external assistance. As a result, the members of the Aid India Consortium pledged over $2 million in 1960 for the first two years of the Third Five Year Plan and assured continuing support for the rest of the Plan period.

A particularly telling event in this first phase of the relationship between India and the Bank was the Bank's role in the solution of the Indus waters problem which was burdening relations with Pakistan and constraining agricultural development in the north of India. Inspired by a proposal published in 1951 by David E. Lilienthal, former chairman of the U.S. Atomic Energy Commission and of the Tennessee Valley Authority, who suggested that the division of water resources was amenable to a technical solution, Black offered the Bank's good offices to assist in negotiations between India and Pakistan. The negotiations were difficult and protracted. Nine years passed between the Bank's initiative and the signing of the Indus Waters Treaty in 1960. The Bank's doggedness and ingenuity kept the negotiations alive. The intensive involvement of the Bank in the negotiations demonstrated the central place India's problems 0C 4ied in the minds of the Bank's management and the willingness of the Government of India to utilize the good offices of the Bank on a very sensitive issue.[14]

The **second** phase in the Bank-India relationship was one of strain, lasting through most of the 1960s. Paradoxically, it was the direct result of the successful engagement of the Bank and the donor community to provide large sums in support of the Third Five Year Plan. The Bank and the donors could observe the economic progress achieved in India with a sense of benevolent detachment as long as their involvement remained peripheral. With the endorsement of the Government's Third Five Year Plan and the commitment to cover the Plan's implied foreign exchange gap, the nature of their involvement had changed: the Bank and the donors had gambled that India with their support would succeed in achieving a level of self-sustaining growth. The notion that ambitious investment programs supported by generous transfers of capital would overcome economic backwardness was at stake. The members of the Consortium therefore watched India's performance much more closely and soon noted with growing distress that things did not seem to work well. Inevitably, there were now questions about the management of the Indian economy and the suitability of the Government's policies. The meeting of the Consortium in April 1963 emphasised the need for greater efforts to expand exports, to stimulate private foreign investments, to relax controls, to liberalise the pricing system, and to raise interest rates.

India was also affected by the change in the views of its supporters. In the early years, the Government had turned to the Bank and to the bilateral donors with self-confidence and in the spirit of offering an opportunity to share in a globally important undertaking. This had now changed. India had become dependent on the support of its friends not only to realise its dreams for the future but to survive and feed its growing population. This hurt India's pride and self-confidence. Suspicions about foreign

---

[14]A full account of the negotiations is provided in Edward S. Mason and Robert E.Asher: *The World Bank since Bretton Woods,* The Brookings Institution, Washington, D.C., pp.6lOff.

interference were enhanced, and any comment on the Government's actions was perceived as a threat to national sovereignty. The sense of insecurity and of is measurement was compounded by the military debacle in the encounter with China in 1962 and by the death of Prime Minister Nehru in 1964. The concluding paragraph in a column of *The Economic Weekly* entitled "Aid and Advice" characterised the mindset at the time:

> "India is truly grateful to the Bank for its direct assistance and its helpful role in arranging the Consortium. It welcomes constructive criticism but it is equally for the Bank to realise that there is a line which divides criticism and advice from interference. It would be better in the interest of fruitful and constructive Indo-Bank relations if we tell the Bank right now before it becomes embarrassingly late to do so, that while we take note of their views the Fourth Plan will be a truly Indian document. What is at stake is the Indianness of our Plans."[15]

The Bank's new president, George Woods, who had previous professional and personal links with India, took a close interest in India's development. He wrote to the Finance Minister and expressed his concern about India's lagging performance and its implications for continued support of the Consortium members and the Bank)[16] The Finance Minister in his reply assured Woods that the Government would give full consideration to his concerns. While he thought "it would be a mistake to read too much meaning into the figures of national income for the last two years (chiefly, because the major problem seemed to be caused by weather-related stagnation of agricultural production), there cannot be any difference of opinion regarding the essential point that the performance of the economy needs to be improved."[17] He indicated that the Government's policies and procedures would be examined in the course of the ongoing mid-term review of the Third Five Year Plan.

The idea that changes in economic policies, if not in development strategy, were necessary to achieve greater efficiency and higher growth now became a central issue. The Bank's department head responsible for India wrote in November 1963: "I am convinced that the Bank must use its best efforts to persuade the Indian Government to take a fresh and honest look at policy. I hope the slowdown in the rate of economic advance in India and in particular the failure of Indian agricultural policy will mean that India will be more open to persuasion than it usually is. Because of our leadership in the consortium, the size of our lending program in India, and our special relations with the Indian Government, we have certain persuasive forces at our disposal."[18]

The Bank's operational managers, on the other hand, while noting that India's economic performance was far from satisfactory, were not certain what the reasons for this poor performance were. "In analysing the causes of the recent slow rate of

---

[15] "Aid and Advice", *The Economic Weekly*, April 4, 1964, p.631.

[16] Letter 6 from George D. Woods to Morarji Desai, dated June 20, 1963.

[17] Letter from Morarji Desai to George D. Woods, dated July 1, 1963.

[18] Letter from Escott Reid to Benjamin B. Ling, dated November 20, 1963.

growth, it is particularly difficult to distinguish between such impermanent factors as the weather, the crisis in political leadership and the Chinese attack on the one hand and the more lasting socio-economic obstacles to development on the other."[19] This sense of uncertainty was attributed to the lack of reliable basic information about the Indian economy. The committee of the Bank's senior economists concluded that "a comprehensive study of the Indian economy was essential to identify the major obstacles to growth, to suggest the lines along which the major problems could be approached, to arrive at a general judgment regarding the economic future of India and, in this context, to appraise the Fourth Five Year Plan."[20]

For this purpose, the Bank mounted a large economic mission in the fall of 1964 which was headed by Bernard Bell, a seasoned professional and highly regarded economic consultant. The Bank's attempt to scrutinise India's economic performance was warmly welcomed by the members of the Consortium. The U.S. as the provider of the largest amount of assistance, especially of vital food aid, was particularly concerned about the Indian Government's economic strategy and, with the active involvement of President Johnson, pressed for changes in agricultural policies.[21] The comprehensive report of the mission turned out to be critical of the Government's policies. Bell admitted that, since the report was written for the President of the Bank, "no pains have been taken to express judgments in the form which would be least bruising and most persuasive to those its actions it criticises and whose ideas it hopes ultimately will change." As Bell wrote, the report was meant to be critical: "Our mandate was not to record successes but to seek opportunities for greater success. Less euphemistically, our task was to find and to understand the failures, the deficiencies, and the obstacles to more rapid progress in order that they might be overcome,, that the achievements might be greater, and that progress might be accelerated. The statement concentrates on these and, therefore, will probably seem to be an unremittingly critical catalogue of failure."[22]

The report was undoctrinaire and matter-of-fact. It started from the principal premises on which the Government's strategy was based, such as the heavy reliance on import substitution and the extended role of the public sector. But it exposed the consequences of this strategic approach, the neglect of exports and pervasive inefficiency. The highly regulated control regime that governed trade and investment, and the drawbacks of the command planning system were the focus of the mission's criticism. Accordingly, the thrust of the mission's recommendations was in the direction of liberalization, relaxation of controls, and greater reliance on market forces

---

[19] Memorandum from Department of Operations, South Asia & Middle East, to the Staff Loan Committee: Bank Policies Toward India, dated April 28, 1964.

[20] Minutes of the Meeting of Economic Advisor: The Economic Problems of India, dated April 27, 1964.

[21] John P. Lewis: *India's Political Economy*, Oxford University Press, Delhi. 1995, pp. 92ff.: Dennis Kux: *India and the United States: Estranged Democracies*, National Defence University Press, Washington D.C., 1992, pp.242ff.

[22] Bernard R. Bell: Report to the President of the International Bank of Reconstruction and Development and the International development Association on India's Economic Development Effort, Volume I: Main Report, October 1. 1965, p. ii.

in the allocative process. Heading the list of specific measures suggested by the mission was a call for a devaluation of the rupee. The report also appealed to the aid donors to increase the level of assistance for the Fourth Plan, especially the level of non-project assistance to permit the increase in imports needed to achieve full use of installed capacities. These recommendations were the logical counterpart to the recommendations addressed to the Government of India: greater liberalisation, especially relaxation of the strict import controls, would at least initially lead to increased foreign exchange requirements which had to be met by increased availability of readily usable external assistance.

Many of the more influential economic officials in the Government found little argument in substance with the findings of the Bank's mission.[23] These officials, who had earlier accepted the need for regulation and control in good faith and with the interest of the country in mind, were stunned by the momentum which the control mentality had developed and concerned about the drag of pervasive red tape on productivity. Even people with strong socialist beliefs like K.N. Raj produced reports which were highly critical of the system of steel and import control. Officials in the Ministry of Finance and in the Reserve Bank had also examined the question of the exchange rate; although an outright devaluation was regarded as not feasible politically, they extended the provision of bonuses and the application of tariffs to achieve some corrective effects.[24]

The Bell report thus recommended what seemed fairly obvious modifications of policies and procedures which had proven to be a drag on the economy. It also appears that the sweep of reforms recommended was fairly modest and in line with the thinking of a significant segment, if not a majority, of Indian officials and planners. Yet, the report and its recommendations became highly contentious. The negotiations which it triggered became confrontational and charged with polemical argument. The episode proved a watershed in the relationship between India and the Bank.

There are a number of reasons why this intervention by the Bank, directed personally by its president, caused estrangement. The sense of vulnerability prevailing in India at the time tended to exaggerate sensitivities about outside interference. This fired up the traditional opponents of the Bank, but it also alarmed more conservative political leader's intent on their alignments with popular sentiments. Politicians generally were less inclined to probe the origins of some of India's economic problems and the rational for policy reforms. Some politicians and the private business interests associated with them may well have derived patronage and rents from the established control regime which they were unwilling to lose. Thus, the only argument that attracted the attention of politicians was the basic but rather simplistic proposition that economic reforms were needed to persuade the Bank to provide the support the country needed, Government officials, even those who understood the

[23] See for instance S. Boothalingans: *Reflections of an Era—Memoirs of a Civil Servant*, East West Press, New Delhi 1993, pp.134ff: also John P. Lewis: *India's Political Economy*, Oxford University Press, Delhi, 1995, p.134.

[24] Interview with I.G. Patel, March 8, 1997.

need for reform, tended to reinforce this sentiment, if not in their briefings then in their sarcastic remarks.[25]

The most prominent recommendation of the bell mission was its call for a significant devaluation. This measure was expected to promote exports and facilitate a relaxation of the stringent import controls; it was also obvious test of the government's openness to policy change. But discussion of a change in the par value of the rupee tended to incite the emotions further. In the days of fixed exchange rates, such an adjustment implied a formal admission of failure and a loss of face. Moreover, nationalistic sentiments were associated with the exchange rate, especially in India, where the value of the Indian rupee was always the suggestion to devalue was bound to be highly unpopular and political controversial. In fact, the 1996 devaluation was widely seen as the main reason for the reverses suffered by the Congress party in the elections in early 1967.

Having accepted the need for reform, the credibility of the reformers in the Government was linked to the arrival of the promised assistance. The Bank's economists and government officials reviewed India's foreign exchange need s and concluded that \$900 million of non-project assistance would be required to support the liberalized import regime. The implication was that this amount of assistance would be sustained over several years

In June 1996, the government's decision to devalue triggered action to mobilize the additional external assistance. But moving the members of the Consortium to come up with the necessary commitments required a protected effort of pressure and persuasion. It was only in November 1996 that the \$900 million package for the first year could be regarded as committed. The difficulties uncounted in that first year provided a foretaste of what was to follow: further delays and significant shortfalls from the targets endorsed by the Bank, which themselves had been scaled back from the original \$900 million to \$750 million. Although Indian Government officials understood that the Bank and bilateral Consortium members could make commitments only one year at a time and that aid flows were necessarily subject to the vagaries of IDA replenishments and of the budgetary process in the donor governments, they regarded the shortfall of aid commitments from the expected level as an act of betrayal. The policy reform measures, in particular the devaluation, had been implemented at considerable political cost. The need for reform had been explained to the political decision-makers in terms which linked them to the essential flow of foreign assistance. The credibility of these officials, not to mention the workability of the liberalized import regime, were now jeopardized. The World Bank and President Woods in particular were blamed for this disappointment. Where earlier the Bank had been regarded as a friend and trusted partner, it now appeared as the purveyor of prescriptions which failed to take account of the country's circumstances.

The disappointment was compounded by the apparent ineffectiveness of the devaluation. The impact of a second severe drought on the economy overwhelmed whatever stimulating effect should have been expected from the liberalization. Nor was the extent of the reforms introduced significant enough to have brought about a

---

[25] L.K. Jha, when asked about the reasons for the devaluation laughed merrily: "Oh, that was what George woods told us we had to do to get aid." As quoted by John P. Lewis: *India's Political Economy*, Oxford University Press, New Delhi, 1995. p.136

major transformation of the economy. The underlying system of directives and controls had been marginally relaxed, but was basically intact. The amount of the devaluation itself, mitigated by tariff surcharges on traditional exports, was not sufficient to bring about the necessary structural shift in production. As soon as there were indications of unexpected problems, the controls were quickly tightened, moving S. Boothalingam, the Economic Secretary at the time, to observe later that "the devaluation was not allowed to work."[26]

The Indian Government emerged from this episode determined to lessen the country's dependence on the World Bank and on the flow of foreign assistance. The often proclaimed objective of self-reliance was now pursued with greater vigor. The trade deficit was brought down sharply between 1968 and 1973. Foreign exchange reserves increased to almost twice their previous level in terms of coverage of months-of- imports.[27] There is some evidence that public investment suffered as a result, which prompted the Bank to criticise the Government's estimates of aid requirements as being too low. The Government's declared objective to reduce the flow of net foreign assistance to zero at the end of the Fifth Five Year Plan in 1978/79 would later cause President Robert McNamara to doubt "that India would be able to continue her development efforts at a reasonable pace without a positive transfer of foreign aid."[28] McNamara was understandably concerned about the impact the Government's declaration might have on the decisions of IDA contributors.

For the Bank, the episode represented "the first significant attempt to use the leverage of its lending to modify macroeconomic policies in a major member country."[29] It was a sobering experience. It illustrated that pressure caused resentment and could defeat the purpose of the decisions recommended. It soured the relationship with its most important borrower. The activist attitude of the Bank which had led it to try to tackle what it correctly perceived as the core of the problem, now gave way in its relations with India to an exaggerated reticence to advocate policy change. Instead, the Bank focused on issues directly related to the success of the operations it financed, even in its non- project lending, the regular annual industrial imports credits.

The **third** phase of the relationship covers the rebuilding of trust and harmony between India and the Bank in the late 1960s and 1970s. Robert McNamara had come to the Bank with plans for greatly expanded lending. Naturally, assistance to India assumed a prominent place in his plans, especially for a steady expansion of IDA resources and credits. McNamara recognised the importance of India's support as a major shareholder and powerful force in the developing world. Like his predecessors, he also looked to India's development experience as a guide in his search for new

[26] Boothalingam: *Reflections of an Era*, 1.c., p.144.

[27] John P. Lewis: *India's Political Economy*, 1.c., p.l55.

[28] Memorandum from Jochen Kraske to Files: India—Mr. McNamara's Meeting with Mr. M.G. Kaul, Secretary, Ministry of Finance, dated August 16, 1973.

[29] Edward S. Mason & Robert E. Asher: *The World Bank Since Bretton Woods*, The Brookings Institution, Washington, D.C. 1973, p.679.

solutions. All this argued for an active dialogue and a close operational relationship with India.

India’s agricultural sector became the focus of the Bank’s operational action. The relative neglect of the country’s huge agricultural sector had been a matter of growing concern even before the calamitous series of bad monsoons in the 1960s. The Bell mission therefore had included a team of agricultural experts whose recommendations expedited the adoption of the new technology that produced the “green revolution.” Their recommendations reinforced the work in this field by USAID and by the Rockefeller and Ford Foundations and found a receptive audience with C. Subramaniam, the Minister of Agriculture. Lending for major irrigation schemes, especially command area development, for agricultural credit supporting groundwater irrigation and agricultural mechanisation, for seed propagation, grain storage, agricultural markets and rural electrification represented an expanding share of the Bank’s activities in India, absorbing close to 40 per cent of total commitments by the mid-1970s.

The most striking aspect of this third phase in the relationship between India and the Bank was the growing harmony of their concerns and objectives. Under McNamara’s direction the Bank expanded its lending in such areas as population, health and nutrition which were particularly relevant to India. Eventually, McNamara focused the Bank’s work on the fight against poverty which mirrored Indira Gandhi’s campaign under the slogan “Garibi Hatao.” Bank research concentrated on the relationship between economic growth and income distribution and the relationship between the size of agricultural holdings and the volume of production, issues which were being debated vigorously in India.

The Bank shared the Government’s efforts to alleviate poverty in the rural areas. Ironically, the Bank’s ambitions to support the Government’s anti-poverty programmes were resisted by Government officials, who were more preoccupied with the speedy transfer of resources and sceptical that the Bank would be able to help in ventures with strong political overtones.

External factors also strengthened relations between India and the Bank. Relations between India and the U.S. had deteriorated and led to a sharp decline in U.S. assistance, while the Bank’s assistance had increased and first matched and soon exceeded U.S. aid. The 1971 conflict with, Pakistan which led to the separation of East Pakistan brought India into sharp conflict with the U.S. Despite U.S. opposition, McNamara extended Bank assistance to the newly independent Bangladesh and continued lending to India. His unstinting support of India at this time reflected both the shared belief in the alleviation of poverty and recognition of the need to build up support among the developing member countries of the Bank if he was to retain the World Bank presidency. There was little doubt that the Republican administration in the U.S. would have liked to see McNamara replaced by a more amenable candidate of their choice. The support of a controversial shipping project in India and the Bank’s continued lending to India over U.S. objections following the explosion of a “nuclear device” similarly demonstrated McNamara’s willingness to use his personal influence to provide IDA assistance up to the 40 per cent ceiling agreed by IDA’s contributors.

McNamara's staunch support during the Bangladesh crisis made a big difference in the perception of the Bank by the Indian public and the press. The fact that the President of the Bank was able to stand up to U.S. pressure countered the belief that the Bank was dominated by U.S. interests. Furthermore, the changing focus of the Bank's work and the recognition of equity and social issues refuted the critics on the left who had opposed the Bank on ideological grounds.[30] McNamara's pragmatic approach to public ownership and the role of private enterprise was also welcomed as evidence that the Bank had overcome its attachment to the principles enunciated by Wall Street.[31]All this made for a Bank which was seen more in tune with India's outlook and formed a basis of renewed trust.

At the same time, India's victory in the 1971 war gave it the much needed confidence and lessened fears about foreign interference. The success of the "green revolution" and the emerging self-sufficiency in foodgrain production were further reassuring and meant progress towards lessening the country's dependence on foreign assistance. Although the oil shock of 1973 led to a painful increase in the country's import bill and renewed dependence on large-scale external finance, the growing inflow of worker's remittances, which started in the mid 1970s' soon offset the increases in the import bill and financed a rapid build up of foreign exchange reserves. At that time exports also started at last to increase; spurred by progressive liberalisation of import controls and the gradual devaluation of the rupee against the U.S. dollar that resulted from the link to the British pound.

At the end of the 1970s, India and the Bank thus found themselves on converging courses. The Bank had adopted the essence of India's outlook on developmental priorities, while India had started to moderate the stifling system of red tape and emphasised agricultural production and exports. This augured well for enhanced and closer cooperation. India's growth rate had at last shown signs of rising above the level of 3.5. per cent which up to then seemed to mark the limits of India's potential for development. There was, in other words, a basis for a promising widening of the relationship.

Phase **four** in the relationship between India and the Bank covered the period up to 1991. A gradual shift in the funding of the Bank's assistance to India from confessional IDA credits to conventional Bank loans took place during this period. This signified a change in the nature of the relationship. The indulgence displayed by the Bank and the bilateral donors in the 1970s gave way to a more hard-nosed, businesslike attitude.

Since the crisis of 1958, India had been regarded as only marginally creditworthy for loans from the Bank. Once IDA was created, the bulk of the Bank Groups' assistance was therefore provided through IDA on concessional terms. India received on average over half of the total IDA resources until the Executive Directors decided in 1968 that there should be a ceiling of 40 per cent of total IDA funds on

[30] The Bank's changing outlook was acknowledged rather deprecatingly by Ashok Mitra in his reviews of the Bank's study "Redistribution with growth." See "The Love Song of J. Alfred Prufrock", *Economic and Political Weekly*, May 3, 1975, p.725.

[31] The World Bank under McNamara, *Economic and Political Weekly*, August 3, 1968, p. 1202.

commitments to India, a limit which remained in effect until the People's Republic of China asserted its claim to a share of IDA in the early 1980s and the crisis in Sub-Saharan Africa demanded a refocusing of IDA's assistance. In line with the successful increases of total IDA resources throughout the 1970s, annual IDA commitments to India had increased from $184 million in 1969 to over SDR 1,535 million in 1980. From this peak, IDA commitments gradually declined to SDR 830 million in 1990.

Bank lending had been kept at relatively modest levels until 1980, essentially maintaining the Bank's exposure in India. This reflected the Bank's cautious assessment of India's creditworthiness, but it also responded to the conservative attitude of the Government of India, which had been careful to limit the amount of debt on commercial or near-commercial terms. It turned out that India had coped with the difficult 1970s far better than most developing countries. While in many other countries the oil shocks and the increase in interest rates led to a sharp increase of indebtedness which eventually culminated in the 1982 debt crisis, India's debt service obligations were at a relatively modest level and the country entered the 1980s in a position which would safely allow further substantial borrowing on conventional terms. India thus showed much scope for expanded Bank lending in support of a promising development effort. While IDA lending to India slowed down considerably, both as a proportion of the total and in absolute terms, Bank lending expanded very rapidly throughout the 1980s. Likewise, IFC investments, which had been at a token level, now began to increase significantly.

The Bank continued to focus its lending on the agricultural sector, mainly in support of the expansion and improved efficiency of surface and groundwater irrigation schemes. Bank and IDA funds were committed during this period for the Sardar Sarovar project on the Narmada River, which was later to become a subject of sharp controversy and embarrassment. The Bank also helped to expand the coverage and the quality of the extension services and the network of agricultural research stations. There were attempts to improve water management in both irrigated and rainfed conditions and continued efforts to reform the agricultural credit delivery system. Following the establishment of NTPC, the National Thermal Power Corporation, the Bank's lending expanded especially in the power sector. The Bank also continued to fund the investment programs of the railways and of the major development banks. An important innovation in the Bank's assistance program was the support of the country's developing oil and gas sector, in particular the opening up of the Bombay high oft-shore oil field. In the meantime, IDA concentrated its assistance on the support of innovative health, family welfare and nutrition programmes and on the development of urban infrastructure.

While the Bank was thus associated with a wide spectrum of activities that were crucial to the functioning and the progress of the country's economy, there was little dialogue on the economic strategy and the policies of the Government. At a time, when the Bank had' become active in promoting policy reform through structural adjustment lending in many of its member countries, the discussion of appropriate policy adjustments, to say nothing of an explicit link between the Bank's lending and policy reform, was largely avoided. The low-conditionality non-project lending initiated in the 1960s had ceased in the mid-1970s. There seemed no further need for this kind of assistance as India's foreign exchange reserves increased and the country had access to private commercial credits.

Instead of turning to the Bank for advice and assistance with policy reform, the Government decided to turn to the IMF. In November 1981, the IMF approved an extended credit arrangement of SDR 5 billion in support of the Government's program of structural adjustment with a view to achieving balance of payments viability. This was the largest IMF credit extended to any country up to that time. It gave a boost to India's morale and standing to be able to access the resources of an institution which served developed as well as developing countries. While India was not in desperate need of the resources, its access to IMF funds was reassuring and encouraged the Government to proceed with further liberalisation measures. The Government, however, was severely criticised by the opposition. Prominent left-wing economists prophesied a repetition of the 1966 debacle, that growth would suffer, poverty deepen and the country slide back into aid dependency. As it turned out, the economy grew rapidly, averaging 5.5 per cent per year in the 1980s against 3.5 per cent in the first three decades of independence. More important, poverty began to decline rapidly at the rate of roughly one percentage point a year. Far from sliding into dependency, India did not draw the full amount of the credit and repaid its obligations without difficulty.

This encouraged and improved the image of liberal thinkers in India who had begun to point out the shortcomings of the prevailing control regime and to advocate market-friendly policies. The example and the apparent success of China further suggested a rethinking of the economic strategy. But while academics, Government officials and even Indira Gandhi and later Rajiv Gandhi appeared convinced of the failure of the earlier approach to the management of the economy and the need for change, the necessary political support for dramatic reforms was judged not to be available.

The Bank, though not directly associated with the reform process, attempted to provide assistance through its project work. Plans to shift the focus of its lending to the industrial sector and to strengthen the expansion of exports did not materialise but they stimulated an active program of economic and sector reports. The Bank's economic reports provided critical analyses of India's economic performance and pointed to the deficiencies of Government policies. The Bank also prepared a large number of detailed sector reviews which identified needed institutional and procedural reforms. While none of this work was linked to specific lending operations or resulted in identifiable policy changes, it helped to identify and clarify the issues which required attention.

Among the changes in India which had a bearing on the functioning of the Government and, in a wider sense, on the effectiveness of the Bank's work was the growing influence of populist pressures. During the first three decades of independence, the Congress Party had a virtual monopoly on power. Although there was need for compromise to reconcile a diverse spectrum of views, a sense of political discipline usually prevailed. When the Congress Party lost its majority in a growing number of States and ultimately at the Federal level, competition among contending political parties greatly increased the temptation to disregard hard economic and financial realities. The most striking manifestation was the growing subsidies, which rose from the equivalent of 8.2 per cent of GDP in 1977-78 to almost

15 per cent by l987-88.[32] This had grave macroeconomic consequences. The growth of Government spending accelerated from 13 per cent annually in the 1970s to almost 19 per cent in the 1980s. The resulting deficits were funded by domestic and foreign borrowing, raising the level of debt service in the budget to alarming levels and quadrupling India's foreign debt from $20 billion in 1980 to $80 billion in 1991. When the Gulf war raised the cost of oil imports and Indian investors overseas began to withdraw their deposits, India's foreign exchange reserves evaporated rapidly and, in June 1991, covered barely a fortnight's imports. The need for dramatic reform had become inevitable.

The Bank was at this point much more heavily exposed in India than during the crises of the 1 950s and 1 960s. Creditworthiness considerations called for a careful reassessment of the level of Bank lending and a link with credible stabilisation and further structural reform. What was much more difficult for the Bank to address, however, was the insidious impact of the lack of financial discipline in the institutions which it supported. Agricultural credit institutions, State Electricity Boards, the railways, even the development banks, IDBI and ICICI, whose portfolio suffered as the result of politically imposed lending decisions, all were affected by the pervasive disregard of sound financial and economic standards. This represented a threat not to the Bank's financial portfolios but to the effectiveness of its lending.

The fifth phase in the relationship between India and the Bank began in 1991 when the Government at last undertook the reforms needed to reduce Government spending, stimulate private investment, and open the economy to foreign competition. The impetus to these reforms was provided by the crisis which ruled out further procrastination and the politicians had to come to terms with the reality of an empty treasury. While the reforms took India in the direction the Bank had long advocated, the Bank had little to do with the decisions which were taken. Once the crisis struck, there was little controversy about the action that needed to be taken. The discussions among academics and Government officials throughout the 1 980s had prepared the ground. The input by outsiders relying on the experience of other countries and, in particular, the analytical work of the Bank had contributed to this debate and helped clarify the issues.

Once the basic decisions had been taken, the Government sought the assistance of the IMP and the Bank. It had become acceptable to involve the Bank and the Fund openly in the reform process and to accept their conditionality. The criticism of outsiders was no longer considered unwarranted interference but was welcomed by the press and by a public opinion whose trust in the integrity of the country's political leadership had been badly shaken. Concerns about foreign domination were fading along with the memories of a colonial era long past. Above all, commercial lending and foreign direct and portfolio investments were providing much larger sums than the World Bank could be expected to contribute. The Bank's profile thus became less threatening and relations more matter-of-fact.

Changes on the side of the Bank also affected the nature of the relationship. With the rapid growth of the Bank's program in China and the expanding activities in

[32] Sudipto Mundle and M. Govinda Rao: "Issues in Fiscal Policy", in *The Indian Economy—Problems and Prospects,* edited by Bimal Jalan, Penguin Books, New Delhi, 1992, p.240.

the Central and Eastern European transition economies, India's role in the Bank as a borrower declined. At the same time, the acceptance of the Bank as a development institution and the performance of the projects it financed were being more thoroughly scrutinised by its critics. The Bank's projects in India became a particular focus of environmental critics. India's lively NGO community, supported by international activists, leaned on the Bank to apply pressure on the Government to pay closer attention to environmental and resettlement issues. The Sardar Sarovar project on the Narmada river attracted particular attention and resulted in severe criticism of the Bank and strong pressure to apply its own standards. More demanding requirements and stricter enforcement of the covenants associated with its lending now led to frequent suspension of disbursements and the outright cancellation of loans.

The more business-like relations which now prevailed between India and the Bank simplified the dialogue. The Bank recognised the importance of a strong commitment by the borrower to the objectives supported by the Bank's lending. At the same time, the Bank became more assertive in specifying and enforcing the conditions attached to its loans. Suspension and cancellation of loans became more frequent, and the Bank curtailed its assistance to projects and sectors when the policy and institutional context did not seem to promise success. The historical significance of the relationship for either India or the Bank has not been affected by that change. The following sections will examine more closely the role of the Bank in India and, in turn, the role India played in the Bank.

The Bank in India

As a Lender

The Bank's lending to India has grown steadily and for the past 30 years India has remained the Bank Group's largest borrower. As of the end of June 1996, Bank/IDA commitments to India reached a cumulative total of over $47 billion in support of 373 individual operations. The Bank has been active in virtually all states and territories of India and in all major sectors of economic activity. It thus touched the lives of many of the people living in India. In the circumstances, it is natural to attribute a significant role to the Bank in India and to expect that it made a measurable contribution to the country's, development. In fact, the Bank's financial contribution has been small in relation to the size of the economy. Bank Group disbursements averaged around 2.5 per cent of gross domestic investment. The Bank's contribution to the financing of India's merchandise imports typically covered between 7 and 8 per cent of the total. The amounts of commitments and disbursements therefore do not provide a telling measure of the significance of the Bank's contribution.

The importance of the Bank's financial contribution was less a function of the total amounts it was lending, than of the context in which its assistance was provided. India's chronic shortage of foreign exchange made the Bank's assistance more valuable than the numbers alone would suggest. In times of acute crises, the funding of marginal imports could make a difference to the functioning of the economy. The implementation of projects benefited from the availability of untied, freely usable foreign exchange funds. The fact that the provision of Bank resources could mitigate the constraints imposed by the control system often proved very beneficial. In general, development is about overcoming bottlenecks, about the return on investments, about improvement at the margin; and it is here that the Bank's money made a real difference.

The Government paid much attention to the Bank's lending program for India. K.C. Roy, the Indian Government's chief negotiator of the first Bank loan to India, commented on the lengthy negotiations but concluded that he and his officers had been "fully trained" in the way the Bank conducted its business and that he and his colleagues, with the benefit of this experience, should be able to conclude future agreements "more quickly and effectively."[33] This proved to be a perceptive observation. Officers assigned to the World Bank desk in the Ministry of Finance were without exception unusually able. They knew how to handle the Bank often better than the Bank's own staff. Bank managers placed much weight on good relations with their counterparts that they were reluctant to offend them, especially since Indian officials enjoyed direct access to the President of the Bank and used it whenever they felt matters were getting out of hand. Their task was to find ways to reconcile the Government's and the Bank's objectives and to integrate the Bank's lending into the complex system of planning and allocation governing the distribution of foreign exchange resources across sectors and states. Whatever impact the Bank's assistance might have had on particular sectors or projects was moderated by the rules and regulations imposed by the Government of India on matters such as the sharing of costs, the procurement of goods and services, and the recruitment of staff.

The Bank's involvement was often resisted because state governments or project agencies felt that the Bank's rules introduced intolerable complications into the normal rules of government administration. The Bank's occasional insistence on special institutional arrangements or the recruitment of extra staff often seemed to make Bank assistance very costly. To entice states to accept the Bank's involvement, the Ministry of Finance and the Planning Commission agreed that Bank resources would be "in addition" to the funds otherwise provided by the Center. This tended to strengthen the relationship between the Bank and the more aggressive and enterprising states, such as Maharashtra, which took advantage of the opportunity to gain access to additional resources. The trend towards more direct and independent contractual relations between foreign lenders, such as the World Bank, and state governments has since continued and moved some state governments to seek the Bank's financial and technical support in reshaping their budgets and investment programmes.

Indian observers commonly attributed much influence to the Bank in the Government's economic and financial matters. The large volume of Bank lending and the Bank's leadership role in the Consortium suggested the presence of considerable leverage. Critics of the Bank did much to raise the profile of the Bank by pointing to the risks associated with outside influence. In fact, the Bank's influence was limited because the sanctions available to the Bank to enforce its views were limited. They were represented ultimately by the threat to suspend disbursements or to cancel a loan or credit, obviously undesirable options for an agency interested in the completion of the ventures it financed. Though covenants attached to the Bank's lending were often

[33] Letter by K.C. Roy to Eugene R. Black, dated October 6, 1949.

violated, the- Bank was reluctant and slow to use the means at its disposal to enforce its conditions. Indeed, it rarely did so before 1991.

The pressure on the Bank to maintain an active lending relationship further limited its leverage. A commercial lender will be guided in his decisions primarily by their impact on the bottom line. But a cooperative institution like the World Bank justifies its existence by providing services to its membership. Reducing lending for breaches of covenants in the absence of conditions which clearly undermined the financial soundness of the Bank was not considered prudent, especially when dealing with the largest borrower. The institutional propensity to maintain active lending relations was further reinforced when the Bank under McNamara aimed for an ambitious expansion of its lending and regarded the volume of resource transfers a major goal of development assistance. The steady increase in the IDA program was directly tied to the build-up of the lending program in India. That this relationship was well understood in India was illustrated by a cartoon in the Indian Express. It showed Indira Gandhi sitting on a throne in imperial splendor and McNamara in front of her on bent knee extending a chest of jewels, with the caption: “Flattery won’t get you very far, Mr. McNamara—but we’ll take the money if you insist.”[34] It was well understood, in other words, that the powerful influence of the Bank on the Government of India was largely a myth.

As Mediator and Advocate

The aspect of the Bank’s role in India most widely appreciated was its work as a mediator and advocate. One of the attractions for India in joining the Bank had been the multinational, independent, technical character of the institution. Though many held to the perception that the Bank was prejudiced in favour of particular economic solutions, they accepted that the Bank was fair, consistent with the principles it enunciated and in that sense a trustworthy arbiter in technical, financial and economic matters. This made the Bank and its experience a reference point in many discussions; in particular, it encouraged India and Pakistan to turn to the Bank to assist in the division of the Indus basin.

The initial exchange of letters between the Bank’s President and the Prime Minister in late 1951 which established the Bank’s role in the dispute bypassed the Indian Government officials who might have opposed the idea in their eagerness to repel “any assault on [India’s] sovereignty or interference in [India’s] internal affairs.” As seen by B.K. Nehru, the Prime Minister considered the dispute amenable to a technical solution: “He did not want any unnecessary tension with Pakistan and he had faith in the impartiality of the World Bank.”[35]

The Bank’s persistence and ingenuity eventually brought the difficult negotiations to a successful conclusion—nine years after they started. The Bank was able to exploit and strengthen the willingness of the parties to settle. The longer the negotiations lasted, the more difficult it became for either side to break from them, and the more effective became the Bank’s intermittent threats to walk away from the

[34] *Sunday Indian Express,* January 30, 1972

[35] B.K.Nehru: *Nice Guys Finish Second,* Viking Penguin India, New Delhi, 1997,p.254.

process. In the end, the Bank's ability to organise the financing of the works needed for dividing the waters helped bring about the agreement.

It is interesting to note that, despite this record, the Bank was not invited again to play a role in the disputes between India and Bangladesh or India and Nepal. Although Bangladesh and Nepal sought the Bank's involvement and the Bank offered its good offices, the Government of India in those instances was unwilling to relinquish its controlling influence and accept outside mediation. The Bank earned much praise in India for the successful agreement of the Indus basin dispute, but there were many observers who felt that India had given away too much and who blamed the Bank for the outcome. There is no doubt that involving the Bank in the settlement of the Indus waters dispute was a decision shaped by the vision and statesmanship of Prime Minister Nehru. Unfortunately, his confidence in his ability to overcome disagreements with India's neighbors did not last.

While the Bank's role as a mediator of conflicts was somewhat outside of its usual line of business—and, incidentally, depended much on the personal reputation of Eugene Black as an international figure—its role as a financial intermediary and advocate came naturally. So, when the foreign exchange crisis in 1958 called for a concerted effort to raise additional resources abroad, the Prime Minister decided to turn to the World Bank as India's international banker, thus avoiding any political flavour in the arrangement.[36] President Black readily agreed to help and the Bank came to coordinate the support of Western donors, not only to overcome the acute crisis of 1958, but also to sustain the Government's development effort in general.

The Bank-led Consortium proved an effective forum for the Government to appeal to the donors. It served not only to increase the volume of assistance flowing to India, but to address issues relating to the form and quality of the assistance. On behalf of the Government, the Bank argued consistently for greater concessionality in the terms on which aid was provided and the need to refrain from burdening the country with inappropriate amounts of suppliers' credits. The Government was able to plead through the Bank for relaxation of procurement rules and push for the untying of aid. The speed with which aid would become available, the flexibility in its use, the appropriate blend of project and non-project assistance, were issues dealt with in the context of the Consortium. This led to an increasing flow of programme and commodity assistance to finance current import requirements and to the provision of debt relief so as to allow India to use its own free foreign exchange resources for other purposes.

The effectiveness of the Consortium mechanism rested on the establishment of commonly accepted norms by the Bank, as an international institution owned jointly by the members of the Consortium and by India, which would guide the decisions of the donors. The deliberations of the Consortium provided a reference point for the bilateral negotiations between the Government of India and the individual donors. They also allowed the members to compare their action with those of the other members, and within the donor governments they supported the arguments of the aid agencies with their respective finance authorities.

[36] B.K. Nehru: "The Way We Looked for Money Abroad", in *Two Decades of Indo-US Relations,* edited by Vadilal Dagli, Bombay, 1969, p.20.

On the other hand, the establishment of the Consortium undoubtedly tended to give weight to the concerns of the donors. The meetings of the aid group provided an opportunity to air grievances and to express critical comments which the standards of international diplomacy would have otherwise suppressed. Indian officials, who might have avoided a response to these concerns expressed in other ways, felt compelled to react and to heed some of the advice offered by the Bank and the donors in this forum. This helped to foster the image of the Consortium as a pressure group.

T.T. Krishnamachari, India's Finance Minister in the early years of the Consortium's functioning, was ready to propose that the Aid India Club be abolished by the time he left the Government at the end of 1965. He perceived the Consortium more as an opportunity for the donors to gang up on India and exert inappropriate pressure for policy change on the Government. A particular reason for opposing the machinery was his belief that the World Bank as its sponsor was peculiarly susceptible to pressures by the U.S. and to the influences of Wall Street.[37] Some Indian politicians and administrators were dismayed by the implication that meetings of the aid group put them in the position of appearing to beg for assistance, which was particularly obvious when aid was urgently needed and when the members of the aid group showed reluctance to respond positively. These isolated reservations did not detract from the general understanding that the aid group was a positive and supportive arrangement and that the Bank's role as advocate of India's interest and catalyst for the support by others was effective and important. As aid levels stagnated or declined in the late 1970s and 1980s the meetings of the aid group were beginning to be treated more as a routine ritual and lost some of their impact. This change in the character of the aid group was reflected in the recent change of its format into a "development forum," which allows for .a more general exchange on India's business prospects with public and private partners.

As a Policy Advisor

The Bank's lending decisions always rested on thorough technical and economic appraisal of the projects it supported. They also presupposed a careful assessment of the borrowing member country's creditworthiness which in turn implied an analysis of the various factors bearing on the country's capacity to service its debt, including the economic and financial policies of the government. The Bank thus acquired much expertise and the capacity to offer policy advice based on the comparative analysis extending across various countries and regions. In due course, the Bank came to regard this role as a clearinghouse for ideas and advice as more important than the money it was providing along with the advice.

At least until 1991, India did not belong to the Bank's borrowing member countries who were openly seeking the Bank's advice. Politicians remained suspicious of anything that could be perceived as outside interference, and many government officials were confident that they did not need advice, which they regarded as unnecessary and inappropriate meddling. The Bank's interlocutors therefore wanted to limit the dialogue with the Bank to project details. This practice

[37] *Times of India* (New Delhi), January 8, 1966.

was firmly established by B.K. Nehru who during the first ten years represented the Government in its dealings with the Bank. He "concentrated on getting as much money out of the Bank as possible with the least possible interference by it in our policies or with our freedom of action."[38] This became the operative mode of the Department of Economic Affairs in its dealings with the Bank and with bilateral aid donors. The challenge was to discourage unwanted advice and the perception of interference without giving offense to the well-meaning intentions of friendly donors.

The Bank recognised India's sensitivities and, while sharing the results of its economic analyses, tended to tone down critical comments and advice. This was important because confidential Bank reports had a way of reaching the Indian press. It was also not difficult since India's economic performance and its creditworthiness generally did not give reason for acute concern. But there were occasions when the management of the Bank felt sufficiently strongly about a subject to express its views with some insistence.

A good illustration of some of the more serious disagreements which developed between the Government of India and the Bank, and the Bank's attempt to persuade the Government to modify its position, occurred in 1956. The mission that reviewed the Government's Second Five Year Plan had expressed the view that "the importance of the private business has not yet been sufficiently recognised and publicised" and recommended "that the private sector be given adequate incentives and resources to enable it to make its requisite contribution."[39] President Black decided to emphasise the point when he wrote to the new Finance Minister: "While I recognise that the Government of India itself must play an important role in India's economic development, I have the distinct impression that the potentialities of private enterprise are commonly underestimated in India and that its operations are subjected to unnecessary restrictions there."[40] This produced uproar. The Financial Times observed that "the World Bank has projected itself right into the center of an explosive political controversy. It is no wonder that some sections of Indian opinion have reacted violently to it."[41] The Finance Minister in his reply tried to tone things down: "I am aware that your views and ours about private and public enterprise do not altogether coincide though the differences are not quite as great as seem to appear in public debate."[42] The Government officials tried to dampen the effect of the controversy and told the Bank's management "that the policies and procedures regarding private foreign investment were now being reviewed and expressed the hope that as a result a more favourable atmosphere would be created."[43] In the event, nothing appears to have happened to encourage private foreign investment.

[38] B.K. Nehru: *Nice Guys Finish Second*, Viking Penguin India, 1997, p.242.

[39] Letter from Thomas H. McKittrick, the leader of the Bank's mission, to CD. Deshmukh. dated June 30, 1956.

[40] Letter by Eugene R. Black to T.T. Krishnamchari, dated September 5, 1956.

[41]*The Financial Times*, Editorial, October 12, 1956.

[42] Letter from T.T. Krishnarmchari' to Eugene R. Black, dated September 16, 1956.

[43] Memorandum of Conversation: IBRD Assistance in Financing India's Second Five Year Plan, dated October 12, 1956.

The episode provided evidence to those in India suspicious of the Bank's motives; for the Bank it demonstrated India's sensitivity to any questioning of the Government's policies, it illustrated the limits which the Bank encountered in offering effective advice which did not coincide with the views of those to whom it was addressed. The Government was unmoved by the Bank's arguments in fact the Bank's advice may have hardened the determination of those who felt that the role of the private sector needed to be limited. In due course, it was not Government which changed its views but the Bank which agreed to support industrial public sector undertakings.

The Bell mission and its recommendations for economic reform provided another example of the Bank's offering advice, On this occasion the advice was leveraged by the assistance which India needed urgently. The Bank applied pressure to introduce reforms not only on its own accord but also because it was in turn pushed by the members of the Consortium to do so. Although the Government accepted the Banks' recommendations, it did so reluctantly in a spirit which undercut the effectiveness of the reforms. The most notable effect of the Bank's intervention was to strengthen the Government's determination to achieve self-sufficiency and to follow its own political imperatives in making economic and financial policy decisions.

The experience confirmed the constraints under which the Bank laboured trying to persuade the Government of its point of view. L.K. Jha, who had been an active participant in the negotiations with the Bank, noted in 1971: "If the World Bank's influence gets beyond a certain point, if it begins to look like pressure, even if it is something desirable in itself or something desired by the country itself, pressure by the Bank to achieve it can be a very deadly political weapon."[44] Many years of directing the Bank's active work in support of structural adjustment and policy reform moved Ernest Stern to conclude:

> "The fact of the matter is that the Bank cannot force any Government to do anything. e are only an outside agency that has money to lend but even the amount of money that we can contribute to any country is a small fraction of the country's own resources. We can only support what the Governments and people themselves are prepared to do. We can help in the process. We have world-wide experience, we have some idea of what works and what doesn't work....In India or elsewhere if these reform programs are not indigenous, they would not survive. The reform programs are fundamentally political; they are economic reform programs but they are essentially part of the political process. No foreign agency can involve itself in such a process."[45]

---

[44] L.K. Jha: "Leaning Against Open Doors", in *The World Bank Group, Multilateral Aid and the 1970s*, ed. by John P. Lewis and Ishan Kapur, Lexington Books, London 1973, p.99.

[45] Ernest Stern, as quoted in *The World Bank in India*, published by The World Bank, New Delhi, 1993, p.42.

In India the Bank learned these lessons early and refrained from pressing its views. It did not limit the Bank's analytical economic and sector work, the results of which informed officials and experts in the Government and influenced their decisions. But this process worked quietly and many of the Bank's reports did not even go beyond the draft stage and were never formally discussed with the Government. The Bank played a special role in bringing the experience of other countries to the attention of decision-makers in the areas of agricultural, industrial, trade and infrastructure policies. The Bank was most effective when it could reinforce the policies of the Government. A good example was the Bank's concern about India's external debt and the burden of debt service and its regular exhortations to refrain from incurring additional debt on onerous terms. This advice, in combination with IDA's concessionary credits and the Bank's pressure on the members of the Consortium to soften the terms of their assistance, was in tune with the cautious and conservative financial attitude of the Government and effective in persuading the Government to keep a tight reign on commercial and suppliers' credits.

As an Institution Builder

While the Bank's role as a provider of policy advice was often surrounded by controversy, its role in strengthening some of the country's important institutions was generally welcomed. Success in economic development rests in considerable measure on the strength of a country's institutions. The implementation and operation of projects depend critically on the organisational capacity, financial soundness and skills of the staff of the responsible institutions. The Bank had acquired early on particular expertise in building institutions. Although a relatively highly developed institutional infrastructure distinguished India from the outset, the need to expand and strengthen it was also apparent.

The Bank devoted much attention to this matter. It recognised that "lending for individual projects [was] probably the most effective vehicle for influencing specific policies."[46] The selection of projects by the Ministry of Finance and the Bank was often motivated by the felt need for the institutional as well as financial support required to assure the success of a venture. The most prominent examples of the Bank's involvement include the railways, ICICI, the power sector, and long- term agricultural credit. A complete list would have to include virtually every individual operation supported by the Bank, but these examples may be sufficient to illustrate the Bank's role in this field. The Bank was associated with the Indian railways throughout most of the past 50 years and, in the context of 19 successive projects, contributed to their modernisation and organisational evolution. In the case of ICICI, the Bank was involved in its creation and subsequently assisted its growth and diversification through 13 lending operations, as well as through technical assistance. The Bank supported the activities of the State Electricity Boards in all the major states of the Union. It also contributed to the establishment of NTPC and to the construction of many of its power stations as well as to the integration of the country's regional grids. The Bank provided many credits to the Agricultural Refinance Corporation and subsequently to NABARD for long-term agricultural lending by the cooperative banks in the states. Characteristic of the Bank's role in all these institutions was its

[46] Country Program Paper—India, November 16, 1993, p. 21.

support of policies that were designed to ensure their financial viability, managerial integrity and organisational autonomy.

The Bank was effective in these cases in establishing the ground rules and the framework for continuing institutional development. But with the exception of ICICI, and to some extent the railways, the initial success could not be sustained. In the absence of the political will to ensure the proper functioning of the institutions and to support the necessary financial discipline, the institutions fell victim to populist political pressures to forego tariff increases, to prevent them from collecting revenues or to force them to employ unnecessary staff. The Bank, even with the support of the Ministry of Finance, was unable to protect against these pressures and consequently it ceased to provide funds for agricultural credit, most of the State Electricity Boards, and, of course, many other projects affected by political exploitation and corruption.

For a long time the Bank was hesitant to sever its relations with particular borrowers and to withdraw when the circumstances did not favour effective institutional support. The general pressure to step up the transfer of resources and the desire to remain actively engaged inhibited taking a tough line. There was also a tendency to accommodate imperfect arrangements which seemed beyond the Bank's ability to remedy as long as there was a chance that the outcome would still remain marginally satisfactory. This was the case, for example, with environmental conditions or the provisions for the resettlement of displaced persons.

But times have changed. The pressure to lend has given way to a much closer scrutiny of the performance of the portfolio. The Bank has come to accept that just as it cannot force countries to adopt policies against their wishes, it cannot expect projects to be built and managed unless they reflect a strong commitment of the beneficiaries, or effective institutions to be established as long as they lack the necessary support of those they are intended to serve.

At the same time, the Bank has come to follow its own convictions more unequivocally. Its lending conditions attempted to define more closely the policy and institutional context of the projects it supported, and it enforced those conditions more consistently. The Bank now would not lend when the circumstances did not seem to warrant successful implementation and operation. It would suspend lending if borrowers were unwilling or unable to meet the agreed conditions. This has limited the Bank's assistance in the power sector, prevented lending for building any highway and effectively ruled out any further financing of urban projects. It is still uncertain whether the Bank's more assertive attitude will induce the necessary change in policies and institutional behaviour. In the meantime, the Bank's lending has expanded in the health and education sectors. This reflects both the focus of the Bank on the human needs in developing economies and the close understanding on priorities and policies in these critical sectors which has developed between the Government and the Bank.

The Bank's Contribution

The Bank's contribution to India's economic development since independence has been substantial and many-sided. The volume of lending exceeded any other source and was critical in alleviating the foreign exchange constraint which posed a problem until the mid-1970s. The Bank's role as a financier and coordinator of external assistance was crucial in helping the Government to overcome major balance of payments crises.

The Bank assigned many of its best staff and allocated large budgetary resources to its work in India. It extended the benefits of its project lending beyond the successful completion of projects to improvements in implementation capacity, long-term sustainability of projects, and institution building. In the course of its involvement in the design and implementation of projects, the Bank's technical assistance and policy dialogue extended to issues of general application at the sectoral and sub-sectoral level. The emphasis on command area development, water management, on-farm development and innovative extension services are some of the themes advanced by the Bank through its irrigation lending. The insistence on groundwater discipline, dam safety, environmental safeguards, and resettlement and rehabilitation of displaced families showed the Bank's attempts to press for improvements.

The Bank played an important role in facilitating the implementation of the projects it helped to finance. It insisted on the essential financial and logistical support by the Government. This was often resented and criticised as an unfair distortion of the Government's planning process because it came at the expense of other Government projects not financed by the Bank. But it also forced planners to make more realistic assumptions and to confront difficult political choices. Considerable technical assistance was provided by the Bank through its regular and close supervision of project implementation. The Bank's supervision missions, although sometimes regarded as intrusive, also facilitated coordination and decision-making across the different layers of the center and state administrations.

The success of the Bank in furthering economic growth and poverty alleviation in India cannot be measured. The Bank's role was always a supporting one, and the success to the Bank therefore a reflection of the success of its borrowers. The Bank's success mirrored the performance of India's economy which did well in times of crises but disappointed even relatively modest expectations. Evaluations of the Bank's role in India today tend to criticise the Bank's hesitation to press its views more vigorously and to insist on strict observance of its lending conditions. Commentators question whether a tougher stance adopted by the Bank could have helped avoid some of the problems which affected the success of Bank projects and the performance of critical sectors.[47]

India's prominent position in the Bank and the eagerness to help India, established special, more indulgent norms of treatment. In the 1960s and 1970s there was a widespread feeling that India was treated more favorably than most other borrowers. The Bank's representative noted the "double standard" applied to India in the 1960s and observed "that the double standard was good neither for India nor the Bank."[48] During the discussion of one of the early program loans to India, one of the

[47] See for instance S. Guhan: *The World Banks Lending in South Asia*, The Brookings Institution, Washington, DC. 1995, p.62ff.

[48] Communication from Benjamin B. King to Raymond Goodman dated August 19, 1964.

Latin American Directors commented sarcastically that an "interesting feature of this collaboration with India has been instead of the Bank imposing on India a certain policy, and requiring India to adjust to the thinking of the Bank, the Bank has been trying to adjust to the needs of India and the problems of the Indian government. When they have a project, you finance the project, and when they don't have a project, you give non-project loans...."[49]

Arguably, the Bank might have been tougher but the Bank's remedies to press its point of view were limited. The threat to abandon a project may be of little help. The Bank's ability to control the outcome of reforms or of specific projects was always limited. It is the government and the borrower that is in charge of the implementation and responsible for the impact. The Bank can try to chart the direction of the borrower's actions by establishing indicative benchmarks for performance, but if the actors disagree with the design or change their mind, there is little the Bank can do to safeguard the outcome.

The Bank's real influence rested less on its role as a lender and more on its role as chairman of the Consortium. Its seal of approval was essential to the flow of assistance by the major donors. Although the Bank's analysis pointed to the shortcomings of the Government's economic policies, it was perhaps too willing to accommodate the Government's point of view. The Bank and the members of the Consortium had lost the taste for messy confrontation. This leaves open the question whether a more insistent attitude of the Bank could have contributed to greater liberalisation and earlier reform.

India in the Bank

Indians have often worried about the World Bank's influence on the Government and this has shaped the perception of the Bank in India. As long as the Government and political leaders were seen as exponents of patriotic commitment, the Bank's influence was regarded as inappropriate; now that politicians and bureaucrats are frequently seen as part of the problem rather than its solution, the influence of the World Bank is more often welcomed. Few, however, have considered the influence India exerted on the World Bank. Yet, as much as 25 years ago the Bank's historians observed: "No country has been studied more by the World Bank than India, and it is no exaggeration to say that India has influenced the Bank as much as the Bank has influenced India[50]The following sections illustrate how India influenced the Bank's understanding of developmental issues, how its needs moved the Bank to modify the terms and modalities of its assistance, and how the Government of India was able to influence the Bank to change some key policies to accommodate its own principles.

Shaping the Priorities of the Bank

India was, of course, one of the largest shareholders of the Bank. Ever since the Bank opened for business, that is even before India became independent, India was represented on the Board of Executive Directors, the key policy-making body of the Bank. Until January 1971, India was the fifth largest shareholder of the Bank and as

---

[49] Board Meeting August 10, 1965.

[50] Edward, S. Mason & Robert B. Asher: *The World Bank Since Bretton Woods,* The Brookings Institution, Washington, D.C. 1973, p.675.

such entitled to appoint its own Executive Director. The Government was determined to maintain its relative position in the Bank and for this reason insisted on its preemptive right whenever a capital increase was considered to accommodate new members or changes in the shareholding of other members. Eventually, it yielded reluctantly when Japan acquired a larger shareholding and thus the right to appoint its own director. This changed little in substance since India forming a group with Bangladesh and Sri Lanka was assured of being able to elect its own director.

Since decisions by the Bank's Board are rarely taken by vote, the influence wielded by the Executive Directors rests largely on their competence, experience and personalities, which determine the respect they enjoy of the Bank's management and of their colleagues. The Government of India sent many of its most distinguished civil servants to serve on the Board of the Bank, who represented India effectively and became articulate spokesmen for the developing countries at large. India was thus able not only to safeguard its own interests but, in the process of doing so, to influence the institution in important ways.

An illustration of this influence was India's interventions at the Bretton Woods conference and during the formative years of the Bank, which drew attention to the plight of the poorer countries. The Indian delegation to Bretton Woods felt that the purposes and policies of the institutions needed to refer explicitly to the needs of the economically backward countries. In his statement moving an amendment to Article I of the Articles of Agreement of the International Monetary Fund, Sir Shanmukham Chetty, who later became independent India's first Finance Minister, noted that "international organisations have tended to approach all problems from the point of view of the advanced countries of the West." He intended to "ensure that the new organisation...will avoid this narrow outlook and give due consideration to the economic problems of countries like India."[51] Although the amendment failed, the assembled delegates recognised that they could not meet the objectives of the new institutions "if [they] allowed large countries to be festered with poverty."[52]

Although India did not become a borrower from the Bank until 1949, India's Executive Director noted the exclusive focus of the Bank's lending on reconstruction projects during the initial years. He pointed out that: "The Articles of Agreement of the Bank enjoin concern with both development and reconstruction. Of course there is a certain degree of priority to immediate problems of reconstruction, which is to bring back the economies of devastated countries to order, but beyond that, and not very far beyond that, lies the problem of undeveloped areas with the required capital to modernise their economies and to increase productive efficiency and improvement in the general standard, which is a rise in the levels of employment and production all over the world."[53] Unhappiness over the lack of lending to developing countries was

[51] 51 Statement by Sir Shanmukham Chetty before Commission I on July 14, 1944; in *United Nations Monetary and Financial Conference*, United States Government Printing Office, Washington, D.C. 1948, p.1181.

[52] A.D. Shroff, another member of the Indian delegation as quoted by M. Narasimhan: *Bretton Woods—Forty Years On,* 19th AD. Shroff Memorial Lecture, Forum of Free Enterprises, Bombay 1984, p.10.

[53] B K. Madan commenting on the draft annual Report of the Bank in the Meeting of the Executive Directors on July 23, 1947.

becoming a matter of some concern. The Bank stressed the funding of projects. "which promise the greatest increase in productive output in the shortest possible time," and recognised that "money spent on repairing a damaged source of production will effect greater result, and in a shorter time, than the same amount spent in building an entirely new source of production."[54] C.D. Deshmukh, India's Governor, addressed this issue emphatically in his address to the Annual Meeting in September 1947: "I cannot say that I feel quite easy in my mind in regard to what has been said in the [Annual] Report about the strategic use of funds. I hope it does not foreshadow....in any sense a decision to hold over applications for loans for schemes of development.... When we are in a position to apply [for a loan], and if we decide to do so, I hope that no commitments based on notions of strategic use of funds will bar the expeditious and helpful disposal of our application. Usefulness and urgency are attributes that are not confined to schemes that Europe alone can put forward, and productive capacity and skills are relative terms that must have reference to the degree of development aimed at. If it is true that 'the world cannot be half skyscraper and half rubble,' it is equally true that it cannot be half skyscraper and half hovels."[55]

The concerns expressed by India's representatives were echoed by delegations from Latin America and made a strong impression on the Bank's president, John Mc Cloy. The Bank made a loan to Chile in March 1948, its first loan to a developing country, soon followed by other loans for development purposes and eventually a first loan to India in August 1949. In fact, with the creation of the Marshall Plan and the assistance it provided for the reconstruction of Europe, the Bank stopped lending for reconstruction of war damaged countries altogether and devoted itself almost exclusively to the problems of the developing countries.

While India played an important role as one of the larger shareholders of the Bank, its influence on the understanding of development issues by the Bank was probably more significant. India was for a long time the Bank's most populous members country and the Bank's biggest borrower. Its problems thus inevitably assumed a central role whether one focused on economic development or poverty alleviation as key Bank objectives or on the portfolio of the Bank. When the Bank entered the business of development assistance in the late 1940s, scholars had hardly begun to study the problems of "economic underdevelopment"— as it was then called—and how to overcome them. The approach to development issues relied heavily on pragmatic involvement and empirical research, which was how the Bank took on the subject. Its unique advantage was close contact with its borrowers and practical experience in the reality of their economic problems. The recognition of the needs of its members and the desire to respond to those needs shaped the Bank's perceptions.

India played a special role in shaping the evolution of the Bank's approach to economic development. Because of its size and diversity, it presented a broad array of

---

[54] International Bank for Reconstruction and Development: *Second Annual Report to the Board of Governors for the Year ended June 30, 1947*, Washington, D.C. 1947, p.8f.

[55] Statement by C.D. Deshmukh in the Third Session of the Second Annual Meeting in London on September 15, 1947.

development problems. Its government seemed aware of the dimensions of the country's economic problems and was determined to overcome them. Below the level of cabinet politicians, government business was managed by able administrators and planners, who had been trained in the elite branch of the British civil service and who approached the task of development with the confidence bred of that training and experience. They were the people with whom the Bank's management and staff dealt in the Government Ministries, who served as India's Executive Directors, and many of whom in the course of time would become members of the staff of the Bank. Communication, so often a frustrating obstacle, was easy with the Government's representatives. The Indian Government was thus in a good position to put across its point of view effectively and to influence the outlook of the Bank, just as it acquired an uncanny understanding to the Bank's views and the way it worked. In the circumstances, the similarity between the Bank's perception of developmental issues and the thinking of the Government of India is not surprising. What may be surprising is that this harmony of views developed in the context of a growing divergence of views on key policies.

The emphasis on infrastructure and on basic industries in the 1950s reflected the shared belief that modernisation was the key to more rapid growth. Lending for schemes such as the Damodar Valley Corporation or the modernisation of India's steel industry predominated in the Banks assistance program for India and for other important borrowers, such as Japan.

Although the Bank supported a number of important irrigation schemes, agriculture was not prominent on the agenda of either the Government of India or the Bank. Adequate food supplies and the extent to which India had to rely on food imports were important concerns in the rhetoric of Indian politicians and planners and were extensively covered in the Bank's economic reports; but investment in agriculture was limited and lending for agricultural projects did not appeal to the self-liquidating project concept favoured by the Bank at that time. The rapid population growth led to a steady aggravation of India's food problems and made the country dependent on food imports even in years of adequate harvests. The question of feeding its people increasingly determined the viability of the country's economy and compelled the Government to give greater priority to agricultural productivity. It was at that point that the President of the Bank decided• that the Bank needed to "intervene earlier in the development process"[56] and, for this purpose, to focus on agriculture as a priority area. The breakthrough in the development of new high-yielding varieties of wheat and rice provided the impetus for major investments supported by the Bank in surface and groundwater irrigation and in fertiliser production not only in India but throughout the developing world.

Nowhere was the effect of rapid population growth on economic development more striking than in India. India's population growth rate had been seriously underestimated at the outset of the planning process. It therefore came as a shocking surprise at the end of the 1950s that much of the progress achieved had been offset by the increase in the country's population and that per capita income had hardly grown at all. This knowledge persuaded the Government to initiate an official family

[56] George D. Woods: *Address to the Board of Governors, Annual Meeting, September 30, 1963*, Series 4530 (Information and Public Affairs-President George D. Woods Speeches) WBGA, p.7.

planning program—the first among democratic governments to do so. Because of the large numbers involved, India's population growth came to epitomise questions about the sustainability of unchecked population growth and the limits imposed by the available resource base. Although the significance of the population problems was not lost on Eugene Black and George Woods, they were worried by the climate of opinion in the United States on this subject and they were, in any event, dubious about how a financial institution might be able to offer meaningful support in this field. This changed, when under Robert McNamara, the Bank began to address development issues more broadly and to finance activities beyond the traditional definition of "productive" investments.

n the 1950s, both India and the Bank had seen faster economic growth and increasing prosperity principally as a function of the volume of investment. The First and Second Five-Year Plan were cast with this relationship in mind. The Bank likewise linked productivity and production to the amount of investment it supported within the limits of a member's creditworthiness. This belief began to give way to considerations of equity and social justice. India's Government began to adopt more strident socialist economic policies. The political slogan "garibi hatao" (get rid of poverty) adopted by Indira Gandhi in the early 1970s reflected the realisation of researchers and planners that poverty was hardly affected directly by economic growth and needed to be addressed as a distinct problem.

The Bank under McNamara also began to focus on income distribution and equity. The studies of Pitamber Pant in the Planning Commission in the 1960s had identified the need for a focus on rural development to alleviate poverty. Hollis Chenery, McNamara's economic adviser, was acquainted with Pant's work and expanded on it. The fight against poverty became the Bank's principal objective. Support of small farmers, landless rural poor, and slum dwellers in the sprawling urban areas and eventually the satisfaction of basic human needs became the focus of the Bank's development assistance.

Influencing the Terms and Form of Bank Assistance

If Indian perceptions of developmental priorities influenced the thinking in the Bank during its formative years and up to the end of the 1970s, India's foreign exchange crisis had a significant impact on the terms and the form of the Bank's assistance. The immediate response of the Bank to the Government's request for help in raising additional foreign exchange resources had been the establishment of the Aid India Consortium which marked the beginning of the Bank's role in the field of aid coordination. The Bank's own financial contribution, however, remained limited. Although Bank lending to India increased from an average of about $20 million during 1949-55 to an average of $120 million between 1958-60, concerns about India's creditworthiness imposed clear limitations on the size of the portfolio invested in that country. The Bank had been founded and managed up to that point in time in the belief that sound banking and investment principles should allow all countries to borrow enough to provide the resources needed for investments to overcome backwardness and poverty. India's experience in the late 1950s demonstrated that the development problem was not entirely amenable to banking solutions. Income levels and savings in countries such as India were out of proportion with the investment requirements. To help these countries, substantial transfers of external resources were needed in excess of their debt servicing capacity, to fund even a fraction of their most essential investments.

From the outset, the Bank had been anxious to preserve the conservative financial image which could assure the favorable credit rating on which its access to the world's capital markets depended. The Bank's management was concerned that the so-called concessional lending would muddle the understanding that debt service represented an onerous commitment which had to be honored even if it involved painful sacrifice. Developments in India now convinced the Bank's president that this position needed modification, and conceded that it would not be possible "to carry out even a minimum amount of economic development in a good many parts of the world without more money being available than would be available on a hard loan, conventional banking basis ."[57] The Bank's historians observed in 1973 that "in the eyes of the Bank's management, India (because of its obvious needs and limited creditworthiness) offered the clearest justification for the creation of IDA as its soft-loan affiliate; without IDA, the Bank could not have continued to be heavily involved in India."[58]

IDA was created in 1960 as a legally separate affiliate extending loans on concessional terms to the poorer members of the Bank. Use of IDA's resources allowed the Bank to step up its lending without concern about the impact this could have on the solidity of its own portfolio or the soundness of its financial position. India along with Pakistan readily absorbed the lion's share of IDA's resources. Credits to India and Pakistan represented such a sizeable proportion of IDA's lending during the early years that the organisation was often referred to in private as the "India-Pakistan Development Association."[59] India received on average 51 per cent of IDA's resources until the Executive Directors decided in 1968 that there should be a ceiling of 40 per cent on IDA commitments to India, a rule which remained in effect until the People's Republic of China asserted its claims to a share of IDA and the crisis in Sub-Saharan Africa required a refocusing of IDA's priorities in the early 1980s.

The creation of IDA offered an important opportunity for the Bank to expand its activities. Few of the African countries which joined the Bank in the 1960s were creditworthy for Bank loans; without IDA the Bank would not have been able to provide financial support to countries clearly in need of assistance. The Bank was also able to strike out into sectors which had hitherto not been regarded suitable for Bank assistance, mainly because operations in those sectors did not produce adequate revenues. Thus, investments in agriculture, rural electrification, education and water supply, and later in nutrition, health care, family planning and urban development gradually became part of the activities supported by the Bank with IDA resources. The addition of IDA to the institutional setup led to a transformation of the World Bank from an institution guided strictly by banking principles to a development

[57] 'Eugene R. Black: Statement to the Executive Directors, February 26, 1958.

[58] Edward S. Mason and Robert E. Asher: *The World Bank Since Bretton Woods,* 1c., p.681If.

[59] Edward S. Mason and Robert E. Asher: *The World Bank Since Bretton Woods,* Ic., p.401.

institution specifically designed and oriented to meet the needs of the growing number of developing member countries. India played a critical role by demonstrating the need for this transformation.

The foreign exchange crisis in India affected not only the terms of the Bank Group's assistance, it also shaped the form of that assistance. Concern about the constraints imposed by the shortage of foreign exchange had prompted the Secretary of Finance as early as 1951 to explore the possibility of "an over-all development loan" which would "give the Indian Government more flexibility in the execution of the.... development program."[60] This early proposal to add program lending to the tools of Bank assistance was quickly turned down with reference to ample opportunities for project assistance. Experience with widespread defaults in foreign lending in the 1920s and 1930s had taught the founders of the Bank that a direct link between foreign loans and productive investment could help prevent profligacy and provide a source of income to facilitate the debt service. This had made lending for specific projects the preferred vehicle of the Bank's assistance.

But specific project loans had two major drawbacks: the disbursement of funds was tied to the implementation of the underlying project, and the amount of lending was limited to the projects' import components. These drawbacks soon became apparent. India was large enough to meet most of its investment needs domestically so that many projects had relatively limited import needs. In turn, the foreign exchange crisis accentuated the Government's efforts to devote the limited foreign exchange available to the requirements of raw material and component imports essential to keep existing productive facilities running.

The Bank found it not too difficult to extend its project financing beyond the import costs by covering not only the direct but also the imputed foreign exchange cost associated with the project. In exceptional cases, when a project was judged of high priority but had only limited foreign exchange costs, the Bank was prepared to cover a portion of the rupee expenditures as well, in order to make a reasonable contribution to its financing. These exceptions became the norm in India starting in the 1960s, especially when IDA extended its support to the social sectors and to activities involving the construction of widely dispersed rural and urban activities:

Even though the Bank was thus able to provide what was in effect freely available foreign exchange, the shortage of essential imports became a binding constraint once the Third Five-Year Plan got underway. The Bank's 1962 economic mission reported widespread underutilisation of capacity as a result of the lack of imported materials. In the Consortium meetings, the discussion of the level of non-project assistance, as distinct from the general level of assistance, assumed growing prominence. President Woods was persuaded that lending for new facilities would not help in this situation and agreed "in addition to normal project loans, to make available, in appropriate cases, long-term financing for the import of components and spare parts for industry generally or for some particular segment of industry of special importance to the given economy."[61] Thus, the Bank started to provide funds for raw materials and spare parts

[60] Letter from W. Koster to A.S.G. Hoar, dated November 20, 1951, enclosing his mission's field report

[61] President's Memorandum on Bank Financial Policy, FPC 63-8, July 18, 1963, Series 4219 (General Files-Operation Policy: Committee on Financial Policy), WBGA.

to selected industries in India through "industrial import loans," a thinly disguised form of program lending. The major shareholders of the Bank accepted this departure from the established project lending concept with some reluctance, but the need for greater flexibility had been established. The provision of non-project assistance became an important form of Bank assistance in a number of countries, especially after the second oil shock, when program lending in support of structural economic reforms assumed a central position in the Bank's strategy.

Pressing for Policy Changes

The Bank was not only willing to change to respond to the peculiar economic and financial needs, it was also prepared to amend its policies to accommodate some strongly held beliefs of its most important borrower. The Bank's procurement rules presented a particular problem for the Government of India, especially when the Bank began to finance contracts with Indian manufacturers and contractors. The Bank had always insisted on open international tendering of the contracts covered by its loans, in order to provide for transparency and to obtain the benefit of competitive prices and conditions for its borrowers. The Government of India, however, was intent on developing its domestic industry and to overcome the dependence on imported goods and services. The Government therefore wanted to maximise the contribution Indian manufacturers and contractors could make to the construction of Bank financed projects and to limit the competition of imports. The Government objected in particular to the Bank's insistence that all contracts associated with Bank projects, irrespective of whether the Bank financed the contract, should be subjected to international competitive bidding.[62]

Following extensive discussions, the Bank eventually agreed that international competitive bidding would not be required for contracts financed with India’s own resources.[63] The Government welcomed the Bank’s willingness to be pragmatic, but this gave rise to protracted haggling over the form of procurement to apply to the various contracts. The process of determining what could be domestically procured and whether domestic suppliers would be able to stand international competition proved time-consuming contributed to cost increases and delayed the disbursement of badly needed Bank resources. Although the Government had succeeded in pushing the Bank to accommodate its point of view, little was gained in the process.

The Bank was not unmindful of the need to support the development of the industries of its borrowing member countries. A general preference of 15 per cent for domestic manufacturers was allowed by the Bank’s procurement guidelines. However, this was inadequate so long as the tariffs protecting Indian manufacturers—which had to be disregarded in the evaluation of foreign bids—were significantly higher. The Government therefore argued for a significant increase in the preference granted to Indian manufacturers. There was some indication that the Government might be prepared to modify its insistence that anything produced in India had to be reserved for local procurement if a preference of 27.5 per cent—the average level of

[62] Letter by Moraji Desai to Goerge D. Woods, dated July 10, 1967.

[63] Letter by J. Burke Knapp to K.S. Sundarrajan dated September 8, 1967.

tariffs—was granted to local bidders. [64]The Bank staff advocated a change in the amount of preference in the hope that this might reduce the administrative interference in project procurement. Yet, the proposal apparently went nowhere. It required review and approval by the Bank's Board, which in matters affecting the spending of the Bank's loan proceeds was clearly not exclusively guided by the perspective of the Bank's borrowers.

While the practice of reserving the procurement of those items which could be manufactured in India continued, the issue of a domestic preference in procurement developed into a test of strength on another front: in the matter of preference for Indian civil works contractors. As the Bank under McNamara was getting ready to expand its lending for the many irrigation projects vital to the spread of the "green revolution," the Government rejected the Bank's insistence that major civil works contracts be awarded on the basis of international tenders. Although McNamara initially thought the difference was largely over technicalities and could be resolved easily, the dispute dragged on for almost two years. The Government insisted that Indian civil works contractors should be given a 15 per cent preference; the Bank, however, dismissed the claim that Indian contractors relying on labour-intensive methods and with the advantage of their familiarity with local conditions would be at a disadvantage in international competition. A detailed study carried out by the Bank in 1972 seemed to confirm this position. But the Government would not budge and McNamara became increasingly anxious to find an acceptable solution "so that India and the Bank could resume work on the preparation of high priority projects in irrigation and highway construction."[65]

A compromise was reached eventually when McNamara submitted to the Board a proposal ostensibly dealing with the "Promotion of Domestic Construction Industries in Developing Countries."[66] It offered a 7.5 per cent preference for domestic contractors in the evaluation of bids. The Executive Directors were seriously divided over this issue and the discussion dragged on for a number of months until the proposal was finally approved in October 1973 in a form which limited the applicability to countries with a low per capita income, which has ever since safely included India.

It is doubtful whether the policy on preferences for civil works contractors had significant effects on the award of contracts, especially in India. Financing of major civil works contracts was no longer the focus of the Bank's assistance program; the contracts included in command area development, rural works or urban renewal projects hardly attracted the interest of foreign contractors. But India's intervention was a demonstration of the influence it exerted in modifying the Banks policy in a field which, as the discussion in the Banks Board showed, was contested by the major donor countries. McNamar's determination to resolve this issue was obviously

[64] Memorandum from Gregory B. Votaw to Files dated October 15, 1968: India— Delegation Meeting with Mr. Robert S. McNamara on October 4, 1968.

[65]Memorandum Jochen Kraske to Files dated October 3, 1972: India—Meeting of Annual Meeting Delegation with Mr. McNamara.

[66] Considered by the Executive Directors on August 7, 1973.

crucial; he wanted to press ahead with an enlarged IDA program and India, still the largest IDA recipient, was critical to the achievement of his ambitious lending targets.

There was another area where the Bank's eagerness to support the "green revolution" in India contributed to an important policy shift. The success of the high-yielding varieties was dependent on adequate and reliable supply of water and fertiliser. Since the supply of fertiliser was likely to involve major foreign exchange outlays, Bank funding of fertiliser supplies seemed to be especially relevant.

The Government of India had decided early that, given the size of the fertiliser market, India needed a massive expansion of its fertilisers industry. President Woods, both anxious to assist India and personally experienced in putting together major investment operations, submitted an assessment of India's fertiliser needs to the Minister of Agriculture.[67] In his confidential covering letter, he described how he thought the problems might be tackled: "In the area of fertiliser production and distribution, the magnitude of the hydro-carbon feedstock requirements so clearly exceeds the prospective domestic Indian supply and the need for speed is so great that every effort should be made to enlist the financial and technical capabilities of the foreign companies experienced in this field and in a position to use the natural gas resources of the Persian Gulf area for Indian purposes." Woods expected that foreign investors would be ready to team up with private partners in India or even with the Government, but did not believe they would be prepared to participate as minority partners. Aware that his proposal was in conflict with the Government's policy, he suggested that "a modification of this policy is necessary with respect to fertilisers."

This sounded as though earlier disagreements over the respective roles of the public and private sector were once again entering into the dialogue. But Woods assured India: "We are primarily and principally interested in the efficiency and the experience of the management....As regards the question of ownership....that is a subsidiary question." If he had no confidence in the management, he would not recommend financing a project "be it the private sector or the public sector." He admitted that the public sector fertiliser projects planned by the Government at that time did not "arouse his banking interest."[68]

McNamara confirmed the Bank's indifference as to the ownership of enterprises in the course of his first visit to India as President. When the Deputy Chairman of the Planning Commission suggested that assisting India, a country with a "mixed economy," the Bank should rethink its reluctance to support public sector industrial enterprises, McNamara assured him that the Bank had "no preference for either the public or private sector industry, ideologically speaking. The only conditions that projects needed to meet were that they should respond to priority needs and be well managed,"[69] This was a view McNamara expressed on many occasions, not only regarding India.

---

[67]Letter by George D. Woods to C. Subramaniam dated February 28, 1966.

[68]'Proceedings of the Press Conference held by Mr. George Woods, President of the World Bank, on 9th May 1967 in Conference Room No. 72, North Block, Central Secretariat, New Delhi.

[69] Memorandum Jean Baneth to Files, dated November 25, 1968: Meeting at the Planning Commission, November 18, 1968.

While the priority of fertiliser projects in India was not in doubt, the management of projects and the policies determining construction, operation and marketing raised many questions. Yet, the Government was anxious to limit the Bank's involvement. As the Bank started to look at specific projects, I.G. Patel asked McNamara to avoid any link between actions required to assure competent management of the plans financed by the Bank and actions required to improve the management of existing plants, much as he agreed that was necessary.[70] The Bank proceeded to finance a dozen fertiliser projects, all in the public or the cooperative sector, but it failed to insist on the policy changes which would have strengthened managerial autonomy and rewarded greater efficiency. As a result, the performance of the Bank financed projects, regardless of their ownership, suffered. Insistence by the Bank on necessary policy reforms might have been a reasonable price for India to pay for the Bank's willingness to be pragmatic on the issue of ownership.

Although Woods and McNamara played down the change in the Bank's policy, it did represent an important break with the past. Their pragmatic attitude reflected the understanding at the time of the government's role in the economy. It also cleared the way for the Bank's active involvement in the socialist economies of Eastern Europe and Asia and for the global role which universal membership implied.

Some Reflections

India's influence in the Bank declined in the 1980s and 1990s. The arrival of the People's Republic of China in the Bank changed India's position as the largest member country and borrower. The end of the cold war, removed any remaining political motives of the Bank's major shareholders to accommodate India's interests to keep it from tilting further towards the Soviet camp. The breakdown of the Soviet Union and the Bank's focus on the Eastern European transition economies further diminished India's predominant role in the institution.

It is ironic that this decline of India's prominence in the Bank should have coincided with a more assertive attitude by the Bank in its lending decisions and in the imposition and enforcement of its conditions. The pressure to lend had been replaced by a growing concern about results and performance. Where the Bank had been prepared before to accept Government decisions as an expression of the borrower's sovereignty and to design the projects it supported within the constraints imposed by these decisions, the Bank was now much less willing to compromise its own prescriptions. That this change in the attitude of the Bank today appears to attract applause rather than scorn or opposition, seems to have less to do with the relationship between India and the Bank, than with the growing skepticism about the role and performance of the Government in India.

Quite aside from the coincidence of anniversaries, therefore, this seems an appropriate moment to reflect on the significance of the relationship. Those interested in the evolution of the World Bank should study the relationship between India and the Bank with particular attention. The evolution of the Bank, at least during its first

[70]Memorandum Alexander Kirk to Records, dated October 6, 1969: India—Delegation Meeting with Mr. McNamara, October 6, 1969

three decades, was strongly influenced by its relationship and by its work in India. This does not belittle the influence other developing countries or regions have had. Latin America and Africa have contributed to the making of the Bank in ways that responded to their particular needs. The problems leading up to the debt crisis in Latin America, for example, strongly influenced the Bank's emphasis on trade liberalisation; and the crisis in Sub-Saharan Africa strengthened the Bank's focus on public expenditures and governance. India, however, because of its size and diversity, the continuity of its long association with the Bank, and the quality and sophistication of the persons charged with dealing with the Bank left a significant imprint on the Bank. It was not always noticeable, yet the impact on both policies and operations was unmistakable.

The intellectual vigor with which development issues were debated in India stimulated the thinking in the Bank early on. Experience gained on the ground in India enriched the Bank's understanding of the development process. It was the Indian experience above all which highlighted the Bank's limits in dealing with the problems of poverty and facilitated the broadening of the conventional development paradigm. Though this was a continuous learning process, no one event shows the impact of India's needs more clearly than the creation of IDA and the gradual transformation of the Bank from a financial institution into a development agency.

Notable, too, was India's influence on what might be called the "micro-aspects" of Bank policy and practice. Negotiation of particular loans sharpened awareness of occasional conflicts between the modes, terms and conditions of Bank lending and India's perceived needs, reflected in its own policies and practices. Accommodations reached with India benefited other Bank and IDA borrowers in due course as well. The Bank-India relationship also highlighted the ever-present tension between maintaining the flow of essential resources and the insistence on good practices, or even conditions, regarded as beneficial for the success of the Bank's projects.

It is more difficult to trace the Bank's impact in India. The Bank's contribution to India's economic development has been significant and many-sided. The volume of lending exceeded the funding available from any other source and, while small in relation to India's own efforts, played a critically important role in supplementing scarce foreign exchange resources required for development and for the functioning of the economy. As a project lender, the Bank facilitated investments in many sectors of vital importance to India's growth, self-reliance and welfare. The benefits of the Bank's assistance extended beyond the successful completion of projects to their long-term sustainability, to institution building and to sectoral reform.

Looking back over the 50-year history of independent India, the rate of economic progress is not one of the more striking achievements. It is true that the Indian economy grew a lot faster during the second half of this century than during the first. It is also true that India can take pride in having dealt successfully with major calamities, was able to feed a vastly increased population and proved to be a careful and reliable manager of its constrained financial resources. But despite these accomplishments, India's economy did not grow as fast as it could have grown. The choice of more effective policies would have allowed significantly greater increases in production and would have contributed to a much more substantial reduction in poverty. India had the resources and the potential to do much better than it did, but failed to use available opportunities. This has now been recognised and has led to the adoption of more pragmatic policies.

This raises the question whether, along with the large amount of assistance provided by the Bank, the Bank could have expedited the necessary policy reforms. Receptivity to outside advice was never a strong suit of India's policy-makers, especially after the apparent initial success of India's development effort seemed to confirm that the country was on the right track. Short-term political imperatives often determined economic policies, and outside advice could hardly make up for the lack of the political willingness to give up short-term political gains for longer-term economic benefits. The general suspicion of outsiders and the mistrust of the Bank as an agent of foreign, especially U.S. interests obviously did not help. Indeed, when the Bank used the leverage of its lending to press a reluctant Government to reform, its intervention was deeply resented and counterproductive. As long as the Government was not itself willing to change course, there was little the Bank could do; it analysed the Government's policies and pointed out their implications. The Bank's annual economic reviews and its sector reports conveyed the appropriate critical perspective, but did so sotto voce and in a spirit which tended not to question the primacy of political judgments.

There is, however, little evidence in the first three decades of the relationship that the Bank took a sufficiently assertive view of the role it could play. Internal strategy reviews thought that the Bank's "leverage to press for fundamental and broad policy change [was] limited."[71] "The management of the Bank concluded that "little would be gained, and a good deal might be lost, by making IDA lending contingent on broad policy improvements."[72] India's eligibility for IDA assistance was primarily linked to its poverty and not to its performance. The Bank saw itself principally in the business of transferring resources and as a lender looked with great care at the projects and sectors it supported. Its concerns about the Government's policies were closely linked to the creditworthiness of the country and to the volume of IBRD loans. Since IBRD lending remained at modest levels until the 1980s, these concerns did not lead to a more stringent assessment of the policy framework. In any event, except for the crisis which occurred in the early and mid 1960s, India's economic performance, while it was not spectacular, seemed to warrant sustained, although perhaps unenthusiastic, external assistance and, consequently, did not call for a more proactive role of the Bank.

The influence attributed to the Bank by the Bank's critics in India was generally overstated. Although familiarity with the Bank had built trust and confidence, any suggestion of a closer involvement in the decision-making, any active role in policy analysis and reform was strictly ruled out by the bureaucracy, and meetings with the Ministers or the Prime Minister were generally discouraged. The Bank's advice, if it entered the picture at all, was filtered by the civil service to conform to what was considered politically feasible.

---

[71]Country Program Paper—India, November 16, 1973, p.20.

[72] Memorandum from Hollis B. Chenery to Robert S. McNamara: Issues Posed by the India SPP, July 18, 1974.

The Bank, nonetheless, may have played a stronger role in stimulating a critical reexamination of accepted policies than is apparent from the documentary record of discussions between the Bank and the Government or from the Bank's reports. Neither the Government bureaucracy nor the Bank staff represented undifferentiated, monolithic points of view. There was much willingness on both sides to examine and question traditional beliefs and to look for new solutions, and there was at all times an active dialogue which fostered appreciation of critical analysis. The prominence and publicity given to the Bank's comments and views by its critics helped bring the Bank's message to a wider audience; the information available through the Bank often stimulated a lively debate on economic and social issues. The Bank thus played a role as an important source of information, especially on the development experience of other countries. Information on the reform of the Chinese economy, for instance, attracted much interest. In this sense, the Bank may have contributed to the acceptance of public sector reform, more competition, a greater role for the private sector and the policy reforms needed for a restructuring of the economy adopted in 1991.

Indian officials deserve much credit for the mutual relations that have linked India and the Bank for 50 years. They affected the activities of the Bank and of the Bank's staff not only in the sense of controlling them but also by guiding them. They articulated the needs of the country in a way the Bank was able to respond to, and they conveyed the understanding of the local context which is so essential for any effective foreign assistance. Of course, in the process they also conveyed their own prejudices which often did as much to determine the positions held by the Bank as did the Bank's own wisdom.

The relationship between India and the Bank endures but has matured. Perhaps for that reason, the prospects for effective cooperation seem more promising today than they were 50 years ago. There is today greater harmony in the views about how to achieve agreed economic and social objectives. The economic crisis of 1991 has forced India to adopt much needed economic reforms. The Bank is well placed to assist in the reform process and to help India mobilise its own considerable resources for faster economic progress. For its part, the Bank is trying to redefine its mission in a world vastly different from the one in which it was created and in which it operated for much of the past 50 years. Perhaps the continuing work of the Bank in India will help the Bank adapt to a new role in the future, as it did before, during the Bank's early years.

Fifty Years On: India's Manufactures Exports

Signals of Lag, Signs of Hope

Jean Baneth[1]

Fifty Years On

Fifty years ago, India became independent. Much has changed beyond recognition in the world since then, in unpredictable ways. British India, including Burma, was the only colony whose independence was fully recognised in 1947. Another decade was to pass before African decolonisation gathered momentum, but the more perceptive may well have recognised the coming end of the old empires. Some already predicted the rise of the Red Star over China, the ascendancy of the United States, the decline of European power. It was easy to see the extension of the Soviet Empire to Eastern Europe, but not its peaceful retreat before the half-century was out. The Cold War was beginning, and the era of only two Great Powers was at hand. None would have ventured to predict the break-up of the Soviet Union, the shrinking of Russia to its smallest since Peter the Great and its abandoning of Communism in a swift peaceful reversal of the October Revolution. Soviet-style economic management had plenty of critics, but even those would have failed to foresee that, by 1980, life expectancy would be declining in the countries practicing it. A few visionaries foresaw the coming of the European Union, and a very few had already started to bring it about; not many would have believed how far this vision has advanced.

The majority may not have been too surprised at the unemployment problem experienced by Europe today, though they would have been disappointed that almost 70 years after the onset of the Great Depression, the total number of jobless in Europe is higher than it ever reached at that time. Nevertheless, most would probably have marvelled at the level of economic prosperity achieved today by North America, by Europe, despite its unemployment; and by Japan. But they would be truly amazed at the progress achieved by many developing countries— both in the positive and the negative sense. Africa's regression into ever greater poverty, and, all too often, turmoil and war, would have surprised those who were still expecting at least further decades of colonial relationship and orderly exploitation. It would have both surprised and pained those who were hoping for independence, and expecting it to bring fast economic benefits. Disappointment may also have been the lot of many Latin Americans. Argentineans still enjoyed standards of living most Europeans could only hope to achieve one day, and expected to progress further, by combining the exploitation of their country's agricultural potential with industrialisation; they certainly did not expect to end up with standards of living substantially unimproved half a century later.

---

[1] The author is a Visiting Professor at CERDI (Centre for Research on International Development) at the Universite d'Auvergne. He has been a visiting fellow of the Rajiv Gandhi Institute for Contemporary Studies; and has occupied various positions at the World Bank, notably those of Chief Economist for Asia, Director of the International Economics Department and Representative in the Uruguay Round trade negotiations.

In some other parts of the developing world, however, the past 50 years produced more progress and a faster march towards prosperity than even the most sanguine observer would have expected. This has been the case of much of East Asia. The first wave of success that rose from its periphery was joined by a second, deeper wave that has uplifted some of its larger countries, including Thailand and Indonesia; and more recently China. Who would have believed, in 1947, that the world's tallest building and fastest-growing industries would be found in Asia?

And India?

Many had predicted her political collapse, social regression and economic decline, once the<< *beneficial rule*>> of the British Raj had been withdrawn, and not a few had hoped for them. These critics would be disappointed. In the past 50 years, all colonial empires disappeared, Eastern Europe went to communism and back again, China underwent bloody political and cultural revolutions, Yugoslavia, Czechoslovakia and the Soviet Union decomposed, Belgium half-separated along linguistic lines, Canada at times seemed set to do so, and in France the Fourth Republic was pushed out by the Fifth. India, reborn in these fifty years, was not spared the trials and vicissitudes of a society in transition. But her Constitution and Parliamentary Democracy have survived in substantially unchanged forms, within unchanged borders. Moreover, it cannot be denied that prosperity also grew, and society changed deeply for the better.

Yet it cannot be denied that this improvement was less than what had been expected. Fifty years after independence, India is much farther from fulfilling her tryst with destiny than most Indians and most of Indians well-wishers had then hoped. This shortfall is great even if one only refers to the prevailing conditions and hopes that were nurtured at the time India achieved independence. The shortfall is even more apparent when measured against the progress of other countries, including some whose economic prospects had then appeared much worse.

India, Asia, and the World

Among underdeveloped countries, as they were then called, India was unique 50 years ago. She had been granted independence without armed revolt and, in the last stages, through a consensual process, after long preparation through the build-up of local administrative and political organs. During the years preceding independence, her foreign rulers had actively favoured the integration of a small but significant Indian high cadre into the administration, the judiciary and lately even into the armed forces[2]. In the arts and sciences, British colonial rule had not prevented the formation of a well-educated elite, numerous and qualitatively equal to the world's best. India had a solid economic infrastructure, a well-functioning administration and judiciary, and a modern framework of commercial laws and institutions. She had the largest and most advanced economy among developing countries. Though post-independence partition had brought much woe and suffering, it wrought material destruction and

[2] Symptomatically, an Indian General of the Indian Army was one of those accepting the Japanese surrender at Singapore. At the time, the highest ranking <<*natives*>> in the Dutch colonial army were non-commissioned officers, while in the French Army ethnic Asians and Africans rose normally only if they adopted French citizenship.

economic damage on a much smaller scale than the foreign wars, Japanese occupation, armed liberation struggles and civil wars that had raged across much of Asia, and had stopped at India's borders.

India also had a well-established modern manufacturing sector. Indian arsenals had long provided British armies with supplies and ammunition. Not many non-Indians knew of Dum-Dum arsenal near Calcutta, but for 50 years fighting men the world over had known of <<*dumdum*>> bullets. Bengal's jute industry had long been giving Dundee a run for its money, modern looms were weaving cotton textiles in large factories in western India, and even that sinew and symbol of modern manufacturing, steel production, was more than a decade old. In Asia, apart from Japan, only China had approached this level of modern industrial development, but that country had suffered much from its long war with Japan, and it was still in the throes of a civil war, soon it was to lose many of its entrepreneurs, scientists and administrators. India had been the pioneer of developing countries in political advancement; it was reasonable to expect her also to progress fastest and farthest in economic and social development. That hope was to be disappointed.

It is not easy to get a consistent statistical data series for the last 50 years. Because of this, most of the statistics used in this paper only go back to the mid-1960s[3]. By that time, most previously colonial countries had become independent. China had had 15 years to recover from the ravages of war, and was even beginning to recover from those, little less severe, of its <<*Great Leap Forward*>>, preparatory to embarking on its cultural revolution. Hong Kong's transformation from entrepot trader to industrialist was well on its way. India herself, in the throes of drought and of a brief war, was conducting the agonizing reappraisal of her economic policies that in 1966 was lead to devaluation and to a bride flirtation with reduced controls and increased outward-orientation Nevertheless, even at that relatively late date, India still seemed well ahead of most developing countries in most dimensions of their march to modernity.

No single indicator defines progress. Several have occasionally been combined, with savant and careful weightings (as in the United Nations Development Programme's <<*Human Development Index*>>) to summaries in a single number the sum of human achievements, but such attempts are in vain. Yet by long convention, the term<<*industrial*>> or <<*industrialised*>> countries has come to apply to those territories also recognised to be among the most advanced in economic terms, whose inhabitants are not only the wealthiest, but also generally the healthiest and the most literate. Industrialisation has long been rightly seen as the road to development, almost synonymous with it. And among economists and other informed observers, manufactures exports have come to be seen as the royal road to industrialisation.

Manufactures exports constitute a particularly good focus for examining India's achievements and progress in the half-century since independence. A broad segment of the Indian polity now also recognises the enormous role manufactures

---

[3] Most of the statical data in this article come from *World Development Indicators* 1997 on CD-ROM, the World Bank, Washington, D.C. However, that series begins only in 1970, and gives trade information only after 1980, so it has been complemented, with *World Data on CD ROM 1994* and 1995. When other sources are used, they are separately identified.

exports have played elsewhere in accelerating development, upgrading technology, and feeding growth of employment and of labour incomes. Manufactures exports, constitute an indicator that amplifies India's achievements, but also her shortfall form the achievements of others, and from her own capabilities and expectations. They may constitute an appropriate indicators of progress for yet another reason: after almost a half-century during which India lagged behind much of Asia in this respect, she may, at long last, have begun to catch up; the recent increase in India's share in manufactures exports from Asia is one of the most hopeful developments of the 1990s.

This paper examines the evolution of India's manufactures exports in the context of the achievements of other countries and in the light of their respective starting positions and policies. It concludes that the protectionist and restrictive policies pursued by the Government of India (GOI) since independendence explain much of the delayed development of India's manufacturing potential, just as other GOI policies (and even some of the same ones) largely explain the survival of the Indian Union as the world's only truly multi-religious, multilingual, multicultural democratic state. However, far from being a dark shadow cast over the otherwise bright development of Indian manufacturing, exports are in fact its most dynamic dimension—notwithstanding the highly unfavorable way in which they compare to exports from other countries. To be able to continue on the road to industrialisation, India must improve her export performance, but she can do so, in a sustainable fashion, only if she greatly enhances the efficiency and dynamism of her manufacturing sector, and indeed of her whole economy, this certainly requires a new policy framework, the continuation and deepening of the reforms undertaken in the early 18990s. Policies, however, cannot achieve everything, and they are not formulated in the void; particularly central government policies in a federal State.

Thirty Years of Global Trade Revolution—Without India

India's overall merchandise exports barely grew in the early years after independence. This slow performance continued into the period covered by our data. Exports were then dominated by raw materials, whose volatile prices had been boosted by the Korean War boom, and tumbled thereafter. It was Korean price boom that had caused the value of exports to rise from $ 1 billion in 1949/50 to $ 1.5 billion two years later, and it was the post-Korean bust that made them tumble back to $1.1 billion with-in two years through normal volume growth, they recovered to $1.3billion by the end of the decade, and rose gradually by another 18 percent in dollar value during the period 1960 to 1965. Price were then fairly stable and overall export volumes grew roughly in parallel with the dollar value of exports in the early 1960s, at an annual rate of less than 3 percent.

This was an exceptionally, but not uniquely low export growth performance for the period. In Europe, the dollar value of foreign trade rose by 50 percent or more during 1960 to 1965 (by 100 percent in the case of underdeveloped Spain and 140 percent in that of even more underdeveloped Portugal)[4] the volume increase was just a shade less. The exports of many developing countries were increasing at equally

[4] World Data on CD-ROM, op. cit. Refers to exports in national accounts, as that series is available for the 1960-65 period while, for some strange reason, trade data proper are not.

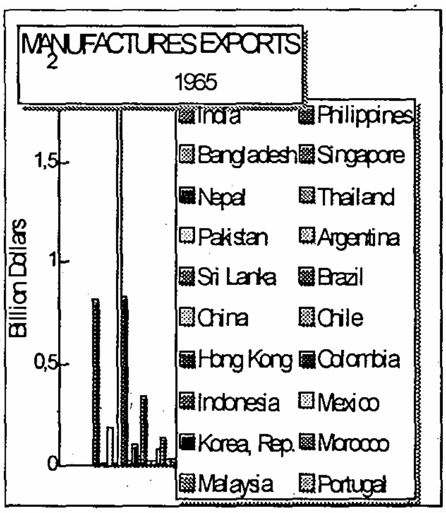
high rates: Brazil’s by 60 percent during the five years to 1965, Mexico’s by 50 percent, Egypt’s by 40 percent, while the exports of Hong Kong and Korea both doubled. On the other hand, Sri Lanka and Argentina, but also countries later to become dynamic exporters, like Malaysia and Singapore, saw the values of their export stagnate or even fall during the same five years.

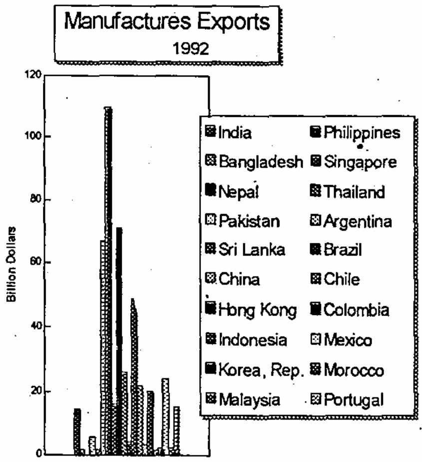
Despite its indifferent export performance, India remained the second most important developing country exporter in 1965. She was just behind China, whose exports had actually fallen, during and because of the <<*Great Leap Forward*>>. Indian manufactures exports also came behind China’s and at par with Hong Kong’s. No other developing country came even near this trio in this field. In 1965, when China’s manufactures exports were about $ 1.8 billion and India’s (and also Hong Kong’s) about $800 million, the next biggest manufactures exporters amongst developing countries were Singapore and Portugal, with manufactures exports of a little more than $300 million each. Still much farther behind came Korea and Brazil, with over $100 million.

An extraordinary double revolution was to modify the global economy fundamentally during the 30 years that followed 1965. Throughout the world, trade in manufactures rose much faster than manufactures production during that period; and the role of developing countries greatly increased as suppliers of manufactures, mostly to the industrial countries, but also to one another. By the late 1980s, developing countries collectively had become more important than the United States or Japan as manufactures exporters to Europe; and more important than either Europe or Japan as manufactures exporters to the United States. This was true not only for relatively simple manufactures as textiles and clothing, but increasingly also for categories like sophisticated machinery, automobiles, automobile parts and other transport equipment.

This revolution had got under way in the 1960s. On the industrial countries’ side, it had been launched by the return to external convertibility and the trade liberalising Kennedy Round. On the developing countries’ side, the causes and modalities of their participation in the trade revolution were diverse. Hong Kong got into it through the dynamism of the Chinese entrepreneurs that had taken refuge there, and as a replacement of its entrepot trade with China. Korea set out deliberately to match and surpass Japan’s success in becoming an industrial powerhouse through manufactures exports. Brazil’s modernising military governments realised that large-scale modem industries needed export outlets. The trade revolution was broad, sweeping and attractive, and participation in it took many roads.

This global trade revolution mostly by-passed India. Or, perhaps, it would be more correct to say that India decided to stay out of this global trade revolution.





Following the failed devaluation and trade liberalisation episode of 1966, Indian manufactures exports stagnated in the second half of the1960s. Their dollar value only rose from $820 million in 1965 to a mere $1 billion five years later. China was meanwhile undergoing the violent upheavals of the cultural revolution, and its manufactures exports fell from $1.8 billion to $1.62 billion during the same period. But elsewhere, the trade revolution truly got under way. Hong Kong's manufactures exports doubled during these five years, and relegated India's to the third place among developing countries. Starting from much smaller bases, Korea's manufactures exports sextupled, Brazil's trebled, and those of several other developing countries increased by more than 50 percent. Clearly, there had been a take-off of manufactures exports from developing countries, and India had not participated in it.

The composition of the exported manufactures highlights the nature and importance of the missed opportunity. In 1965, the manufactures exported from India, like those exported by other developing countries, still consisted mostly of textiles. China was then the only developing country to export more than $100 million worth of <<*machinery and transport equipment*>>; and most of those consisted of managed and barter trade, exchanges with the Soviet Union and other centrally planned economies, and aid to a few developing countries. Five years later, the $100 million mark had been reached by India. It was also reached by Brazil and, almost, by Portugal. Machinery and transport equipment exports from Hong Kong had risen to $240 million, to $170 million from Singapore, and to $130 million from Mexico. Other East Asian countries were small players still, but the more important point is that they had become players: they had embarked on exports of sophisticated manufactures. In the late 1960s, Korea had imported railway wagons from India; in 1970, it was exporting machinery and transport equipment to the tune of about $60 million. It would soon surpass India in exports of such equipment and of more sophisticated capital goods. Other, even more unexpected countries were soon to follow.

During the 1970s something at last stirred in India. The dollar value of her manufactures exports doubled during the period 1970 to 1975, and more than doubled again between 1975 and 1980, thus quintupling during the decade. Even granting that rising prices probably accounted for a little more than half this increase, a doubling in constant prices over the decade signaled a decisive departure from the past stagnation, a real growth rate of over 6 percent. While decisive, this departure was wholly insufficient when compared to the need, potential and the much faster rise in the manufactures exports of a wide range of developing countries, despite their generally later start on the road to development.

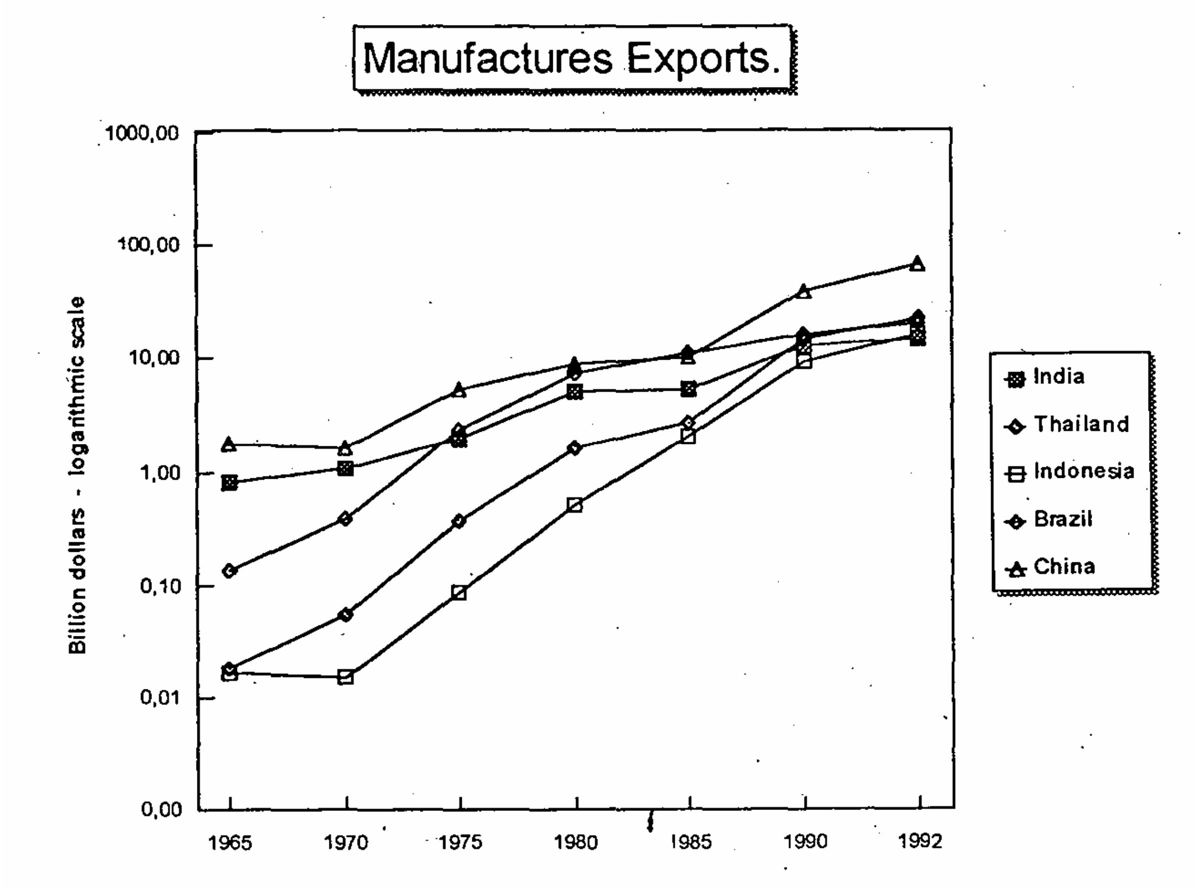
Both trends continued during the decade of the 1980s. India's manufactures exports again almost trebled in dollar value. Most of this increase occurred between 1985 and 1990, when the exchange rate of the dollar was declining[5], but considering the slowdown in dollar inflation, the decennial growth rate in constant prices also accelerated significantly. Yet India's share continued to fall steeply amongst developing country manufactures exporters.

China, having started to recover from the turmoil of the cultural revolution, surged ahead. Hong Kong, an equal performer in 1965, was exporting three times more manufactures by 1980. Korea and Singapore in Asia, and Brazil in Latin America had had *combined* manufactures exports smaller than India's in 1965. They were each well ahead of her by 1975, by 1980 their *combined* manufactures exports had grown to more than six times higher than India's, and by 1990 Korea alone was exporting six times more manufactures than India. Its machinery and transport equipment exports had been half of India's in 1965; they were more than 23 times larger than India's in 1990!

Though much of the volume increase was coming from developing countries that had launched into manufactures exporting in the 1 960s and 1 970s the fastest growth came from relative newcomers, countries that had taken this orientation only in the 1980s. For instance, neither Thailand nor Indonesia had had any manufactures exports at all in 1965, and they also had precious little manufactures production. Yet by the early 1990s they had both overtaken India as manufactures exporters, as did also Mexico, and others.

Three Asian countries, Indonesia, Malaysia and Thailand constitute most interesting comparators. All three had long relied on rich primary sectors, which in the first two include oil and gas. They turned to manufactures exports only in the 1980s as a means to get more employment and labour incomes, and as a source of economic growth. None of these countries had much manufacturing capacity to speak of in the 1960s and as recently as in 1980, the three countries' combined manufactures exports fell well short of India's; Indonesian manufactures exports were then less than 10 percent of India's. By 1990, Thailand and Malaysia each exceeded India as manufactures exporters. Two years later Indonesia had also caught up.

[5] Some economists, mostly Latin and North Americans, call a decline in the value of a currency an increase in its exchange rate (presumably because the number of reference currency wits per dollar rises). For others, including the International Monetary Fund, a fall in value constitutes a decline. In collective works (and even in some individual ones), one rarely knows for sure whether a falling exchange rate means devaluation or appreciation. The IMF practice is uniformly followed here. A decline in the dollar's exchange rate is also a decline in its value.



Beyond Exports

Many people in India noticed and cared about the impact of slow export growth on the country's ability to finance its imports, and export promotion plans of various sorts (whose only common feature was their unfailing lack of effectiveness) were formulated by successive governments with considerable regularity. Few paid much attention to the broader implications of what was happening. Most of those who thought about such things appear to have believed that India had maintained, and perhaps even accentuated, its technological advance over other developing countries. Thus, the occasional export promotion missions to India's Asian neighbors have continued to stress India's capacity to help with sophisticated capital goods and high technology, long after they had surpassed her in familiarity with the use and production of advanced materials and techniques.

Though the 1970s had been a bad period for economic growth in India, the country traversed the decade without the debt burden that was to crush so many others. In the 1980s, she embarked on a more determined and more confident course of modernisation and development. Much impressive change was indeed initiated. For the first time since independence, per capita income growth became markedly positive. Poverty was also substantially reduced, no matter how one defines <<*poverty*>> and <<*reduced*>>. Many in India thought that, at long last, the country's economy was beginning to meet its tryst with destiny.

Meanwhile, events elsewhere seemed to bear out the benefits of the Indian model, and highlighted the drawbacks and resounding failures of the development models that India had rejected. While India's progress was accelerating, the 1980s turned into the <<*lost decade*>> for many financially profligate countries, notably in Latin America. Their debt- based growth model had led them to considerable apparent success in the 1970s, but set them back markedly, and caused much suffering, in the 1980s. At the same time, the model based on comprehensive central planning and full state control of the economy was also showing its inherent weaknesses in the 1980s, well before its final spectacular collapse at the decade's end. It was possible to think of Indian practice as a middle way between outward-oriented financial capitalism and inner-oriented, fully centralised planning without private ownership; and this middle way seemed to be more successful than either extreme.

Comforting as those comparisons with financially outward oriented Latin American capitalism and full-fledged Soviet <<*socialism*>> might have appeared, the unfolding story of Asian economic successes, whose major manifestation and main driving force we have just reviewed, presented a less favourable comparison. Much of this was galling; but the fast increasing gap with China, India's potential strategic rival, should have been frankly disturbing. Perhaps the image was blurred by excessive focus on Pakistan, a country no longer (if it ever was) in the same league as India, and where progress had been even slower.

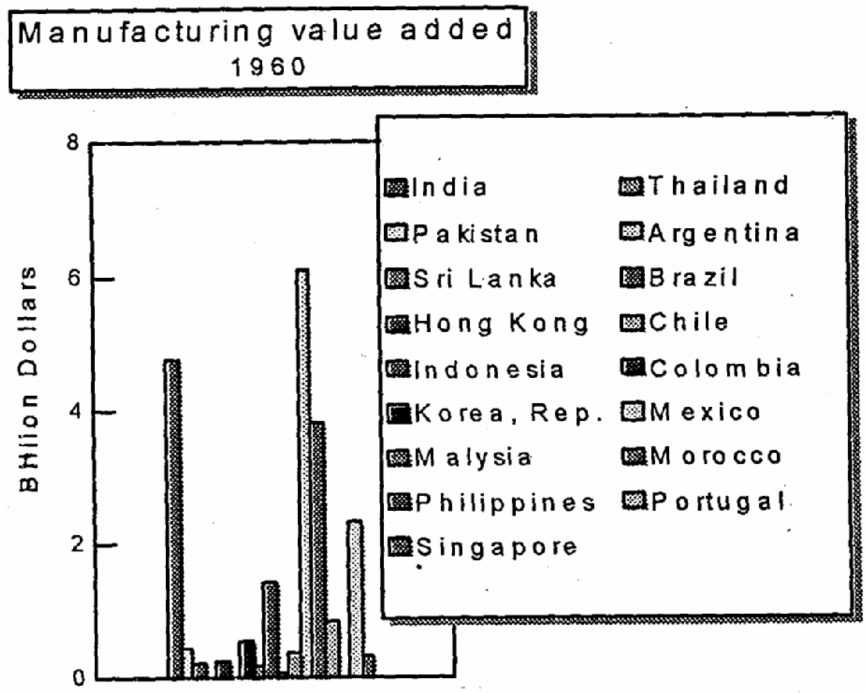
Manufactures exports were a major cause and the most easily visible statistical sign of the divergence, but it showed up throughout the economies concerned, in human welfare as much as in potential strength. India's gradually accumulated lag in manufactures was not limited to their export. The country's place in the <<*export league*> could leave many indifferent, and did. They were not paying much attention to her place among industrial producers. They should have.

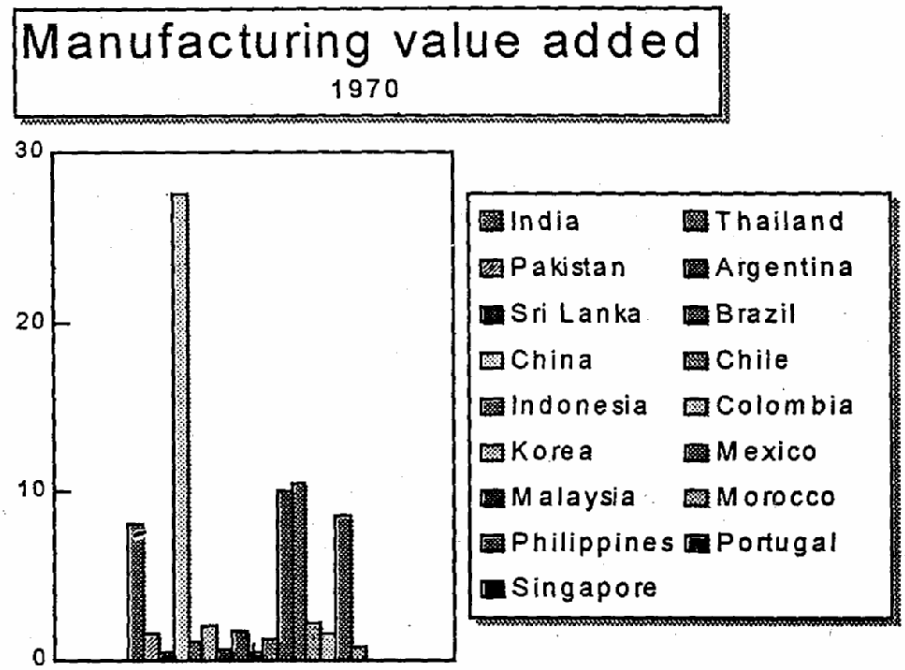
Industrialisation, raising the value of manufacturing production and its share in the national income, raising its contribution to employment and to labour incomes, and also improving the country's ability to produce technically ever more complex products, had been the central aim of India's development strategy and of its stress upon self-sufficiency. On those scores this strategy was found wanting.

Value added in the manufacturing sector in India was about 5 billion dollars in 1960 and almost 8 billion dollars in 1965. Both figures are overstated, particularly the later one, because the increasing overvaluation of the Rupee during this period exaggerates the dollar value of domestic aggregates. One can roughly correct this by applying to the 1965 figure the exchange rate introduced by the June 1966 devaluation. This places Indian manufacturing value added at about 5 billion in 1965; the corresponding figures may have been about $3.6 billion in 1960. Though somewhat rough estimates, these figures provide a reasonable basis for international comparisons.

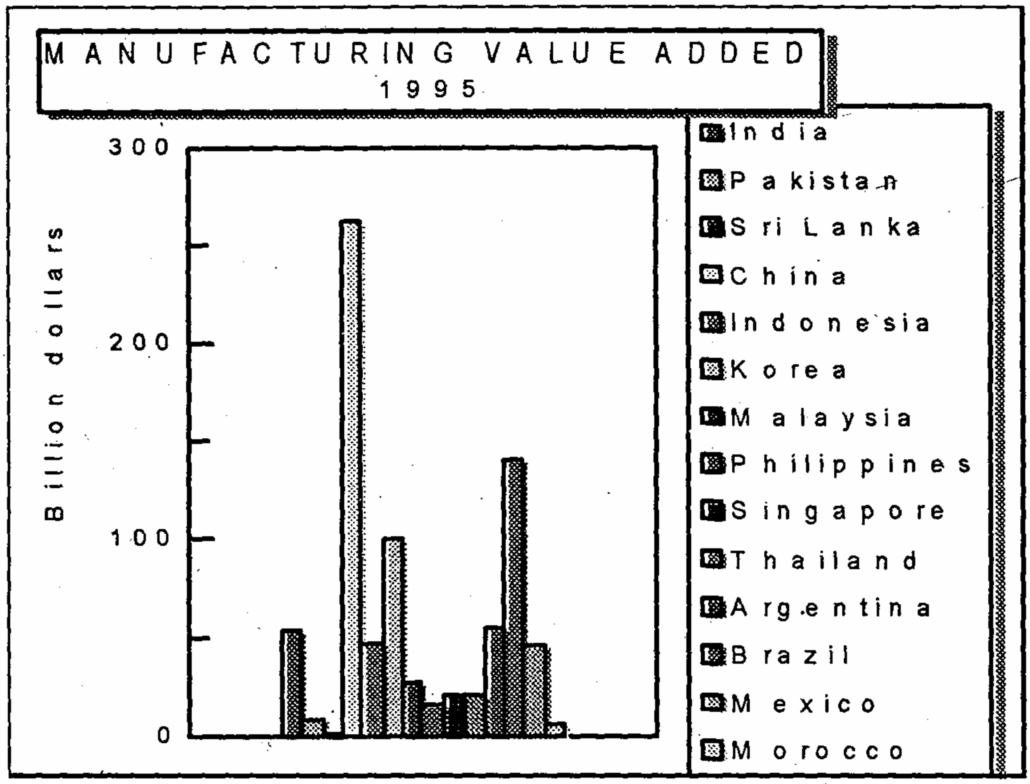
In 1960, value added in Korean manufacturing was about $500 million; in Thailand; it was only about $350 million. Among developing countries outside China (for which the first known figure is for 1970), only in Argentina did manufacturing production (perhaps) exceed India's. <<Perhaps>>, because high protectionism and an overvalued exchange rate (for which no correction is made here) may well cause the Argentine figure to be overstated. In Mexico, value added in manufacturing had reached 2.3 billion dollars.

These figures were all, of course, quite insignificant when compared to manufacturing production in the most advanced industrial country, the United States, but not relative to those of other industrial countries: Japan, for instance, had manufacturing value added of about $ 15 billion in 1960. The World Bank series does not give data for Belgium, but Lenin's erstwhile dictum, that the size of India's manufacturing industry was comparable to Belgium's (then the epitome of the fully industrialised country) still seemed valid.





In 1990, value added in Indian manufacturing had risen to almost $50 billion at current prices and exchange rates. In Mexico, where incomes and production had stagnated or regressed during the <<*'lost decade*>> of the 1980s, the manufacturing sector's value added just exceeded India's. India had also not done too badly in comparison with the Philippines, where manufacturing value added has remained about one third of India's. Argentina did even worse, its manufacturing production fell somewhat below India's in 1990.



Yet the very fact or comparing India with Argentina, that epitome of long-term decline, shows how much room India has lost in international comparisons. In Japan, value added in manufacturing had risen to almost a trillion dollars: from three times India's to twenty. Manufacturing had also risen to more than $70 billion in Korea; the relative size of the Korean manufacturing sector has risen from 10 percent of India's to 150 percent. Meanwhile, the value of Thailand's manufacturing production had risen from 7 percent of India's value in 1960 to almost half in 1990, and almost equal to India's in 1995. Indonesia, Malaysia and Singapore present similar stories.

China deserves a special discussion, for obvious reasons. The World Bank's Chinese data series only begins in 1970, when total GDP was less than twice of India's, but manufacturing production was already more than three times higher ($27.6 billion as against $7.9 billion). This ratio actually fell thereafter, in 1990 Chinese manufacturing production was valued at only about $120 billion, to India's $50 billion. However, much of this change had been due to the evolution of relative exchange rates: from 1970 to 1990, China had devalued by about 54 percent relative to India, in *real terms,* as deflated by the implicit deflators of GDP converted into dollars at the current exchange rates used by the World Bank[6]. What this means is that the nominal relationship would have appeared to have fallen by over half if the <<*real*>> relationship had not changed. Some of the exchange rate divergence has been corrected since then as from 1990 to 1995 China revalued by about 16 percent relative to India. The 1995 relationship may not be too far from some underlying reality. Value added in China's manufacturing sector, whose dollar value had more than doubled since 1990, was then about five times larger than India's. The real gap had probably doubled since 1970. Though its measurement has been influenced by the evolution of the relative exchange rate, most of the real change probably happened in recent years, as China's manufactures exports expanded very fast, and the related production (which is the fastest growing element of manufacturing) acquired weight in the overall manufacturing sector and began to seriously influence its growth rate.

The pursuit of technical excellence through the export route had arguably been most successful in Malaysia, where it has transformed a purely primary commodity producing country into an advanced manufacturer. Deliberately fostered by the Government, Malaysia's manufactures exports rose from next to nothing to two thirds of its total exports. More significantly, to achieve this, its manufacturing production also rose sharply. Per capita manufacturing production in Malaysia and India had been comparable; today, per capita production is ten times higher in Malaysia, and much of it is composed of high-technology products.

How Not to Succeed in Exports: Pessimism and Protectionism

Comparisons of the policies pursued by Hong Kong and Singapore, Korea and Taiwan, Thailand and Indonesia, and of course China, show that many different roads have led developing countries to their success in enhancing exports. These are a far cry from the almost classical free competition of Hong Kong to the anarchy of China, or to Singapore's deliberate fostering of collaboration between the domestic public sector and foreign investors. One is unable to select an optimal recipe for export success among the many differing experiences, but in reality this matters little. The inability is due to the multiplicity and diversity of the success stories, from which one must conclude that any one of a broad spectrum of policies can be conducive to success.

This should have been expected. Developing countries all started with one major comparative advantage, inherent in their condition: their wage rates were low relative to those of advanced industrial countries. The low wage rates of poor catenaries give them an immense competitive advantage in a sector as footloose as manufacturing, an advantage so high that it easily overcomes a variety of other obstacles. The ranks of highly successful manufactures exporters include geographically remote countries, countries with only modestly educated labour forces, countries whose governments were not setting high standards of honesty or efficiency.

No one is surprised when developing countries possessing large petroleum reserves or precious mineral lodes exploit them profitably, and export the resources they extract, even if they are remote or have imperfect governments. Yet, to push the

[6] Normally, the World Bank uses the official exchange rate as concession ratio. However, during much of this period China had multiple exchange rates, and one ratio had to be chosen.

analogy further, it is not impossible to fail to exploit even such primary wealth. Domestic uncertainties (or those in neighboring countries) may deter the investment needed; more commonly exports may be reduced and their benefits diverted through dishonest and incompetent policies, of which Congo- Zaire-Congo provides an illustration. In such cases, analysts will not ask what it took successful exporters to develop their petroleum or other minerals exports; but they rightly wonder what it takes to keep such resources from being profitably exploited.

Mutatis mutandis, this also goes for manufactures exports. The real question is not what it takes to develop them; clearly, many different policies adequately perform that function. It is more profitable to enquire what sort of unfavourable circumstances, including policies, can counter the competitive advantage created by low wages, and what sort of extreme adversity can cancel it completely, and thus prevent a low wage developing country from becoming a successful manufactures exporter.

Among the countervailing burdens one should include the skills of workers in developing countries, often lower than in rich ones; the capital with which they have to work, which is at times somewhat costlier; poorer infrastructure; less competent management; and in some countries, geographic isolation. There are also handicaps of the broader environment: little will be invested where elementary security is not assured, and robbers pillage or the government confiscates without recourse. Other policies can assure uncertainty and insecurity in barely more orderly ways: variable, arbitrary, or simply excessive taxation, ill-adapted legal frameworks, inefficient or dishonest judicial processes. And, of course, all, manner of economic policies can effectively discourage investments and efforts on a broad basis, or more selectively penalise some of them, for instance, exports.

These include exchange rates so overvalued or other policies so distorted as to transform the low real wage into a high nominal wage; taxation or other compulsory, legal or extralegal, levies high enough to offset the wage-cost advantage; a similar impact of legislated or customary inflexibilities of labour, possibly applying only to the formal sector. Entrepreneurship deserves a particular mention. It may not be naturally abundant, but even if it is, the State can usually manage to stifle it when it puts its collective mind to it, or to channel it away from exports.

At the outset, most of these circumstances were at least as favourable in India as in other developing countries, including many that have become successful manufactures exporters. It is obvious that one main cause of India’s failure to win major export successes is that she did notary hard enough, and that she built the rejection of export-dependency into her early development strategy. She expressed this rejection mostly by building up very high protection of her domestic markets.

A powerful myth has played an important role in shaping Indian policies. The early planners had argued that primary commodity exports faced inelastic foreign demand, and that manufacturing exports would be prevented by the protectionism of industrial countries. This export pessimism was incorporated into Indian plans and development strategies, and has until very recently remained one of their main foundations.

Yet India needed capital goods to develop. Her pessimism regarding export signified that she could not pay for them through exports; therefore she herself had to <<*make the machines that make the machines*>> needed for her own development. Such endeavors had to be protected from import competition; the manufacturers of intermediate goods obviously had to be similarly protected. Because exports could not be counted upon to earn foreign exchange, and the country's scarce foreign exchange resources were needed to finance those capital goods and intermediates that could not yet be manufactured domestically, they had to be husbanded carefully. Surely, they could not be allowed to be wasted on the importation of mere consumer goods. Thus, domestic manufacturers of consumer goods became the most protected of all.

Let us dispose of this pseudo-obstacle first. There would indeed be no point in producing cheap goods for export to rich countries if these imposed on them exorbitant duties or quotas. When such industrial country protectionism had been assumed by early Indian planners, this was not an unreasonable assumption, based on the experience of the I930s. What was unreasonable, however, was to persist with this assumption long after it had been belied by well-known facts. True, even in industrial country academic circles and international organisations, a mixed chorus, composed in equal measure of free-trade ideologues, in search of the ideally free trade, and of protectionists, in search of self-justification, has continued to deplore <<*rising protectionism*>> in a loud dirge. Policy- makers should nevertheless have known that, for trade in manufactures, reality has long been quite different.

The proof of the pudding is in the eating, and the proof of free trade has been in its flowering, in the explosive growth of manufactures imports in industrial countries. This has only been possible because protectionism has all but disappeared from the spectrum of policies actually applied in industrial countries7. Even 40 years ago, their customs duties could not neutralise significant comparative cost advantages. In industrial countries, tariffs on manufactures imports have been reduced to a few percentage points since the Kennedy Round. These weigh little indeed in cost comparisons. Even non-tariff restrictions have been gradually all but eliminated. International trade in manufactures is not <<*free*>> in the academic sense, but it is rather closer to such freedom than many domestic markets. Protectionist measures still interfere significantly with international competition at the level of individual commodities and specific suppliers; but at the level of the whole spectrum of potential manufactures production and trade, they constitute as most minor irritants.

When other Asian countries were undertaking their great leap forward in manufactures exports, India's export pessimism was incorporated into Plan targets. Many of the Fourth Five Year Plan's objectives had been so ambitious that the whole Plan had to be abandoned eventually. Yet this same, generally very ambitious, Plan only called for an annual export growth of[7]percent in dollar value (this meant a slightly lower real growth rate)[8]. This increase was to be obtained mostly through

---

[7]On the myth of growing protectionism, see *"Fortress Europe" and other Myths about Trade-Policies Towards Merchandise Imports in the EC and other Major Industrial Economies (and what they mean for Developing Countries)?* by Jean Baneth. World Bank Discussion Papers 225, December 1993. The World Bank, Washington D.C.

[8] As the World Bank economies responsible for India at the time, I had strongly argued that the manufactures export plan was much too undemanding. Because of the implications of a more

unrealistically high projected increases of the exports of most traditional primary commodities and semi-finished products. Conversely, the planned growth of more elaborate manufactured goods, including garments, engineering goods and handicrafts, was unrealistically low.

The export target was roughly equivalent to a planned doubling of exports in 10 years. To put this into perspective, just a few years later Korea highly publicised its intention to raise the value of its exports more than tenfold over a decade, from $830 million in 1970 to $10 billion in 1980. In the event, the actual value of its 1980 exports exceeded $17 billion (the quasi-totality of the increase having consisted of additional manufactures exports)! In 1970, Korea's total exports were less than half of India's; in 1980, India's total exports were less than half of Korea's.

Pessimism regarding exports justified protectionist policies, the construction of steep barriers against imports. These barriers in turn hindered exports, and thus seemed to bear out export pessimism, if one did not bother to look at global developments. India built up policies which were supposed to help her cope with low exports, and these policies in turn effectively contributed to keeping exports low. In reality, export success did not elude India. India deliberately renounced exports.

The link between extreme protectionism and the difficulty of exporting is quite simple. The Indian domestic market for manufactures has long been *absolutely* protected from imports. With very few exceptions, consumers goods have not been allowed to be imported at all. For over 50 years, they have been excluded by means of a double barrier of prohibitions on their imports, and of extremely high customs duties for the very few that managed to slip through those.

Imports of capital goods and processed intermediates were tolerated, but until the recent reforms the importer still had to shoulder a double burden of proof. He had to show that he had a legitimate business need for the machinery, for the sprockets and the whatnots he wished to import. He also had to prove that he could not obtain adequate substitutes domestically. In the long-prevailing jargon of import controls, he had to get an-agency of the Government to issue an <<*indigenous non-availability Certificate*>>. The rules governing such certificates made no formal allowance for price and quality differentials. They were, on the whole, applied with common sense, and extraordinarily costly or extraordinarily shoddy domestic goods were not imposed as substitutes for desired imports. However, price differentials of 200 to 300 percent and quality ratios of 30 to 40 percent were not necessarily considered <<*extraordinary*>>.

Thus a manufacturer producing goods in India was assured that foreign suppliers would be allowed to compete with him only if his prices were egregiously high or the quality of his products was egregiously shoddy. Under such conditions, despite relatively low wages, many would have preferred to concentrate on the domestic market and not launch into export adventures, in markets where prices had to be competitive and products were expected to be in good working order.

---

demanding target, for past policy (i.e. the inadequacy of the recent devaluation) rather than for the future, that analysis was violently opposed by the IMF.

All the more so as those manufacturers nevertheless willing to face the hustle and tussle of exports had to do so with a heavy handicap, imposed on them by the very policies destined to <<*protect*>> domestic manufacturing. Producers forced to rely on expensive and low-quality domestic capital goods and current semi-manufactured inputs are clearly ill placed to compete in foreign markets with producers who have free access to better and cheaper capital and intermediate goods. For many would-be exporters, the advantage of low wages was offset by the high costs of the domestic industrial supplies to which they were restricted. Clearly, this inhibited the development of much export potential. Various duty drawbacks and partial exemptions from the obligation to rely on indigenous supplies were granted at times, and may have succeeded in partially compensating exporters for the high costs of the domestic market, at the risk of imposing additional distortions on the economy. This shield was obviously not enough to promote the development of a class of dynamic export-oriented firms.

Real Wages and Real Exchange Rates

The expectation of export success relies on low real wages in manufacturing; and it is low real wages that have allowed so many other developing countries to overcome the deficiencies of their infrastructure, inadequacies of their capital base and, all too often, the rapaciousness of their rulers, to develop thriving manufactures exports. Obviously, low real wages cannot overcome all obstacles: if goods are liable to be pillaged or confiscated before reaching the border, or if transportation is simply unavailable to take them there, nothing can be exported even if real wages fall to zero. But low enough real wages can overcome many obstacles, including the sort of policy-induced obstacles rife in India.

By lowering domestic costs, low real wages reduce the costs of the domestic processes forced upon producers by protective policies, and they increase the attractiveness of those processes chosen voluntarily. By allowing the cheaper elements to become even cheaper, low real wages help offset the cost of high-priced elements; they allow greater use to be made of labour, thus perhaps enhancing the quality of products or substituting for other, costlier inputs.

To illustrate this: exports of leatherwear have been handicapped by the high price (and often the lack of availability) of good quality locks and other metal fixtures. Lower real wages would lower the dollar price of domestic substitutes. They would also lower the dollar price of the non-metallic part of the leather goods, so that the complete goods could more easily absorb the high price of domestic metal fixtures, or of imported fixtures subject to imperfectly refunded duties. Such lower prices may also induce more foreign buyers to overcome their distaste for shoddy locks and clasps. For all these reasons, if real wages are low enough, they can help more potential exports overcome the obstacles raised by domestic protectionism, and indeed, more generally, obstacles of all sorts.

The argument outlined above is always valid. It should, however, be remembered that the discussion refers to real wages (and is similarly applicable to other factors' *real* incomes). Moreover, in all countries for some industries, and in some countries and in some circumstances for all industries, even zero real wages may not be <<*low enough*>> to overcome other handicaps.

Since the First World War and the end of the gold standard, the traditional way to lower real wages has been by lowering the real exchange rate[9], or <<*devaluation in real terms*>>. <<*Real*>> devaluation, i.e., devaluation that exceeds the differential in price rises, causes domestic prices translated into foreign exchange (say, dollars) to fall relative to the price of foreign goods. This is a mechanical effect, but it is preserved only if nominal wage increases do not cancel it out, that is, if real wages fall relative to their pre-devaluation levels[10]. Devaluation in real terms has played a major role in launching the export efforts of some countries, and in maintaining the competitiveness of others. In the longer run, however, some of the most successful exporters have succeeded in maintaining low real wage costs despite rising real wages, thanks to labour productivity rising even faster.

After independence, the rupee had remained linked to the pound sterling at its pre-war rate. Though the relative inflation rates in India and the United Kingdom had not diverged massively, by the early 1960s India's economic situation was dominated by an acute foreign exchange shortage, a long-standing and apparently structural difficulty in bringing about balance of payments equilibrium. Except during the height of the Korean War boom, India's imports had exceeded her exports by at least 30 percent, rising to well over 50 percent in the early 1960s. Large foreign capital inflows, mostly from foreign governments and usually on quite lenient terms, did not suffice to finance this imbalance: foreign exchange reserves, earlier boosted by India's *de facto* contribution to financing the allied war effort, and later replenished by the Korean boom, had been drawn down to almost nothing by the mid-1960s.

Even this tenuous hold on financial solvency had only been maintained through the application of draconian import controls. The mechanisms described earlier (complete bans on imports of finished consumer goods, and certification of need and of <<*indigenous non-availability*>> for capital goods and current inputs) were not even sufficient by themselves; even those imports <<*cleared from the indigenous angle*>> and certified indispensable were subject to highly restrictive quotas, as were also some semi-manufactured products, notably iron and steel, and copper.

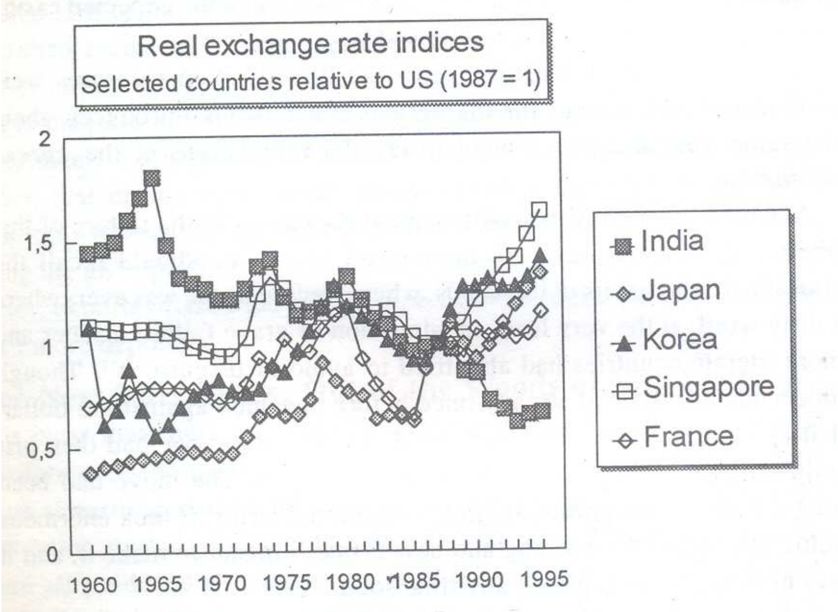
Imports had nevertheless risen, from almost \$1.3 billion in 1950 to over \$2.3 billion a decade later, and about \$2.8 billion in 1965, partly excluding foodgrain imports arranged under the American Public Law 480 (PL 480). During this period of considerable international price stability, growth in current dollars roughly corresponded to growth in real terms, an annual growth rate of less than 5 percent. This modest import growth only turned into a severe problem, a source of <<*foreign exchange shortage*>>, because exports had been almost stagnant. The shortage itself

[9] Etymologically and in common sense, the exchange rate is <<lowered>> when its value falls. That is also the usage of the IMF. However, some economists, mostly in the Americas, call a devaluation (fall in value) an *increase* in the exchange rate, under the pretext that the number of domestic currency Units per dollar rises. In this paper, up is up, and a rise in the exchange rate will always refer to a rise in value.

[10] Devaluation also modifies relative *asset* values, including the value of already embodied capital. It may, for instance, reduce the real incomes of rentiers even more than real wages. Usually, however, the latter must account for the brunt of adjustment.

and the controls intended to deal with it created increasing distortions in the domestic economy and severe dependency on foreign aid.

Confronted with this situation, Prime Minister Indira Gandhi grappled with it with characteristic vigour and decisiveness just a few months after assuming power. In June 1966 she devalued the rupee, from its old rate of Rs.4.76 to Rs.7.50 per dollar, and initiated various measures to relax controls. These were widely understood to constitute the beginning of much greater liberalisation, to be continued when the expected easing of foreign exchange shortages allowed it.



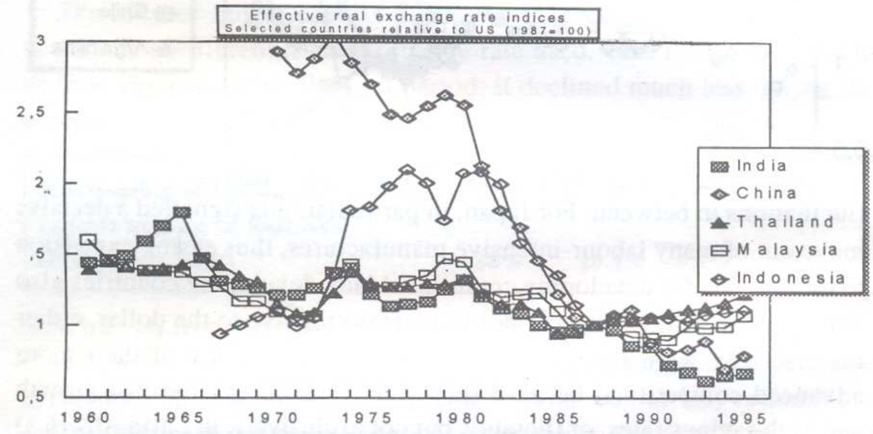
It never did. Even the early tentative liberalisation measures were soon abandoned, except for the agricultural reforms introduced about the same time and which were to lay the foundations of the <<*green revolution*)>>.

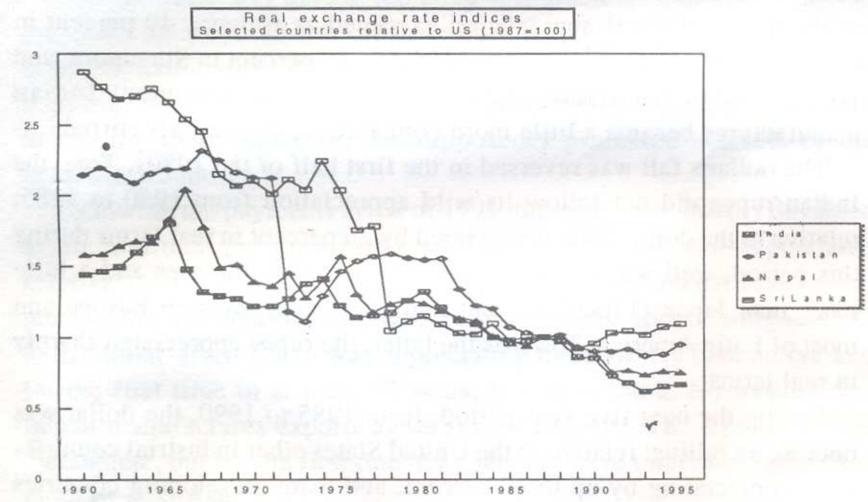
Much has been said and written about the causes of the failure of this liberalisation experiment. To understand them, one should recall the atmosphere and habits of the 1960s, when <<*devaluation*>> was everywhere a dirty word, at the very least an admission of grave failure. Richer and more literate countries had also tried to avoid or disguise it"[11]. Though independent India had already once before devalued against the dollar, that action had not been so perceived, because the rupee had then just followed the sterling. This time it was different. The move had been long debated, and opposed in highly emotional terms. It took enormous political courage for a young and new Prime Minister to make it, and it was unthinkable to repeat it any time soon.

The move failed because an insufficiently low new exchange rate had been selected in consultation with the IMF (not incidentally, the IMF Director then in charge of India was on leave from the Reserve Bank of India). The devaluation did not provide enough impetus to exports nor, despite continued high customs duties levied even on raw materials, enough disincentive to imports. Subsequently, various subsidies to manufactures exports were reinstated, but as Indian prices were by then also rising faster than in the United States, the real exchange rate applicable to manufactures exports tended, if anything, to rise somewhat during the remaining few years of the

[11] In 1957, a French Government was reluctantly forced to devalue, but desperately and comically sought to avoid the term. All foreign exchange purchases, without any exception, were made subject to a 20 percent tax; all foreign exchange sales, to a 20 percent subsidy. For all transactions, the rate became F. 420 per dollar. Yet the official exchange rate remained at 350 for another year.

decade[12]. Exports did not rise, the foreign exchange shortage did not ease, the liberalised import regime could not be maintained, no export lobby was created to press for further favourable measures.





Things started to change in the 1970s. True, India was slow (or reluctant) to take the opportunity provided by the general currency turmoil, and it stuck close to the dollar exchange rate established in 1966, finishing at Rs.7.9 per dollar the decade had begun at Rs.7.5; in real terms, the rupee had actually appreciated by about 8 percent relative to the dollar. But many of India's potential clients and even some of her competitors had revalued against the dollar after the collapse of the dollar-gold standard system. Japan and most of Western Europe revalued by about 60 percent in real terms between 1970 and 1980, with major fluctuations in between. For Japan, in particular, this signalled a decisive move out of many labour-intensive manufactures, thus easing expansion in these fields for developing countries. Many developing countries also allowed their real exchange rates to increase relative to the dollar, either because they were sheltered by the stronger revaluation of their more advanced competitors, because they were benefiting from fast growth and high savings rates, or (notably, but not exclusively, in Latin America) because they were borrowing large amounts of foreign capital. Relative to the dollar, the real appreciation exceeded as follows, 40 percent in Korea, 30 percent in Malaysia and Mexico, 20 percent in Singapore, and 10 percent in Thailand and Brazil. In this environment Indian manufactures became a little more competitive, and exports stirred.

[12] Real exchange rate to change data have been derived using GDP deflators. Other deflators would give somewhat different figures but would not change the main story

The dollar's fall was reversed in the first half of the 1980s. True, the Indian rupee did not follow its wild appreciation from 1980 to 1985; relative to the dollar India depreciated by 26 percent in real terms during this period, well within the range of other Asian countries and a little more than Japan (l7percent), but much less than Western Europe and most of Latin America. Towards the latter, the rupee appreciated sharply in real terms.

During the next five year period, from 1985 to 1990, the dollar was once again falling; relative to the United States other industrial countries were appreciating by up to 60 percent, and many developing countries by lower, but still appreciable margins. During this period India pursued a deliberate depreciation policy, and lowered the real value of her currency by another 11 percent relative to the dollar, thus gaining in price competitiveness, e.g., 27 percent relative to Thailand and 40 percent against Korea.

It is unlikely to be a coincidence that Indian manufactures exports stagnated in dollar value during the first of these five year periods and rose by 140 percent from 1985 to 1990.

The ratio of Indian exports to those of other countries during given periods is indifferent to the exchange rate used. This ratio continued to decline sharply during the first period; it declined much less during the second.

Relationship of Indian manufactures exports to those of East Asia (excluding China)	1960	1980	1985	1990
	58%	10.5%	6.9%	5.8%

While far from yet matching the growth of manufactures exports from East Asia (let alone those from China, whose real exchange rate depreciated even more sharply during this period), India was at last becoming a serious player in the manufactures export game. The GATT could soon report that India was among the large manufactures exporters that had increased their overall market share during the decade. Though relative to the dynamic developing country exporters, India's share was still slipping, she had at last joined the developing countries that were increasing their shares on the supposedly protected markets of the industrial countries.

Following the payments crisis of 1991, the rupee was sharply devalued again, and then put on a managed float. In real terms, it depreciated relative to the dollar by about 22 percent, to its lowest level ever; meanwhile, the majority of other currencies were appreciating relative to the dollar. Even China was depreciating more slowly than before and for the first time in at least 30 years, less than India. No wonder that Indian manufactures exports again surged forward. The records are yet incomplete, but for the first time they seem to have increased faster than those of East Asia.

Policies and Consequences

Two Readings of the Facts

The apparent sensitivity of manufactures exports to the evolution of real exchange rates seems to provide support to the conventional explanation of India's dismal record in this field. Why did not India get a larger share of the fast increasing world market? The conventional answer is that high protection from imports made the home market more attractive than the export market, while making exports more difficult. Carrot and stick both oriented Indian manufacturing towards the home market, away from exports. These twin forces were only attenuated when India undertook to lower domestic prices and wages relative to foreign prices, not just those of the United States but more broadly those of other potential clients and competitors too; in other words, when she devalued significantly in real terms against the currencies of a broad spectrum of countries.

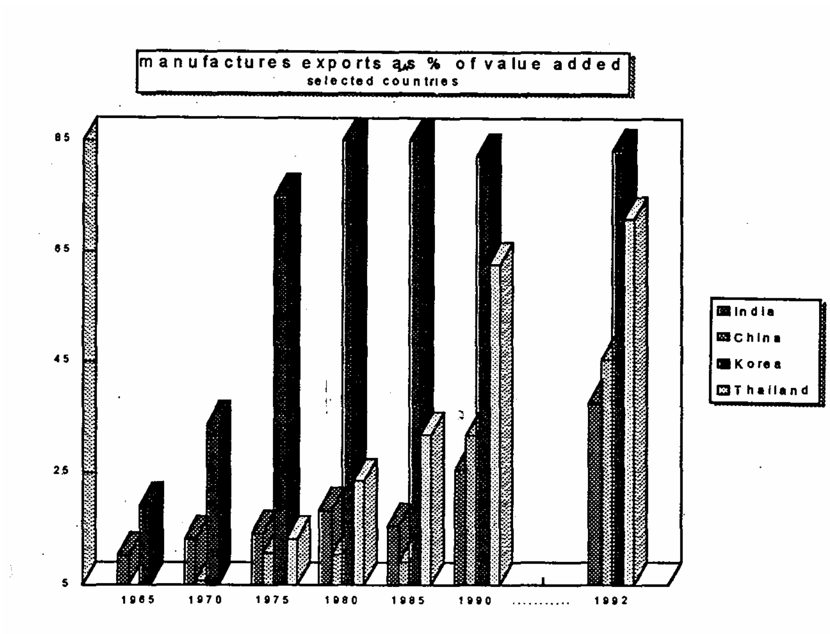
Lowering real wage costs substantially can help offset other, relatively high, domestic costs, and boost exporter's profits. When real exchange rates were lowered in the early 1970s, manufactures exports stirred; they rose more markedly when the rupee was devalued more sharply after 1985, and accelerated to East Asian rates in the 1990s, when the lowest ever real exchange rate was assisted by the beginnings of reduced protection. In sum, a classical response to what seems, after all, to have been a classical problem; reduce the overvaluation of the currency and the excessive protection of the home market, and Indian exports respond like exports from other developing countries have responded before.

Yet neither the intellectual puzzle nor the policy problems have been fully resolved. Indian wages were low, relative to those of industrial countries, even when the rupee was at its strongest, just before the 1966 devaluation. At that time, there were few low-wage competitors for industrial country markets; and in any case, the share of developing countries on these markets was still so low that there was plenty of room for all. The only competition that counted then was (in sharp contrast to today) that of the industrial countries themselves. Why did Indian manufacturers not exploit the opportunity offered to them? And again, more recently, Indian wages were much lower than those of industrial countries in, say, 1990, before the last episode of devaluation. They were also already quite low relative to those of the developing countries that had launched earlier into export-led industrialisation, like Hong Kong or Korea. And were low even relative to those prevailing in Thailand. Why did Indian manufacturers need another boost from a substantial decline of the exchange rate, before launching into a greater export effort?

Related to this puzzle is a statistical fact. If indeed the lure of the highly protected home market, or its high relative costs, are what kept Indian manufacturers from exporting, one would expect manufactures exports to have grown slower than manufacturing production, over the years. The ratio of exports to production should have been falling. But it has not. The reverse is true. The ratio was nominally 10 percent in 1965, but this does not take into account the under-valuation of exports (because of the overvaluation of the rupee, partly compensated by export subsidies). Correcting crudely for this, by using the post-devaluation exchange rate, yields a ratio of about 15 percent. The share of exports fell, as would have been expected, during the following five years: it then rose, but very slowly, during the next few years. In 1975, the exports! value added ratio was about 14 percent, still below the corrected ratio of1965.

In earlier sections we have seen that the behaviour of Indian manufactures exports has been in conformity with to the expectations of classical theory; their growth rate accelerated significantly each time the value of the rupee fell in real terms. This has a double impact on the manufactures exports to production ratio. Devaluation mechanically depresses the dollar price of domestic sales and production more than the fall (if any) in the dollar price of exports. Another effect, not mechanical but predicted by theory and verified by experience, is that devaluation raises the growth rate of exports. Both these effects tend to increase the exports to production ratio.

The episodes of acceleration (usually coinciding with periods during which the dollar was declining) were broadly the second halves of the 1970s and of the 1980s, and the post-reform period of the 1990s. The manufactures exports to value added ratio reached 18 percent in 1980, fell marginally to 16 percent in 1985, and from 25 percent in 1990 rose



to 38 percent in 1992. The setback of the early 1980s did not cancel out the earlier rise, however modest it had been. Recent increases had been strong, partly because the mechanical compression of the dollar value of manufacturing by the most recent devaluations was combined, during the reform period’s early years, with a brief industrial recession.

Manufactures exports rose less in India than in other Asian countries, not only in absolute value and in terms of their growth rate, but also relative to production. Even China exports a much higher share of its manufacturing production. Nevertheless, Indian manufacturing has started growing more outward-oriented since 1975, and even more markedly since 1985. Is this consistent with the standard image of Indian manufacturers being kept from foreign markets by the lure of a relatively profitable domestic market, and the burdens of its high relative costs? At the very least, this finding impels one to re-examine the standard paradigm.

A last piece of the puzzle concerns the composition of Indian manufactures exports. The self image, once justifiable, was that of a relatively advanced, technically developed manufacturing capacity. In1990 (the last world Bank figure) about 10 percent of Indian manufactures exports consisted of <<*machinery and transport equipment*>>; the same year, the corresponding ratio for Indonesia was 14 percent, and for China about 33 percent, the share of machinery was much higher in the more advanced developing countries, like Hong Kong or Korea, or even Brazil.

More recent data on India is available in the *Economic Survey*. According to this document, the early post-reform export surge brought no fundamental change to the composition of Indian exports; all broad categories have tended to increase at similar rates. Anecdotal evidence rather than statistics complement this information: most of the export increase came form small and medium firms, their products sometimes channelled through specialised export houses; the contribution of large- scale industry has been small. As their production and profitability have undoubtedly increased since the reforms, this must have been related to their prospects and endeavours on the domestic market.

Another Paradigm: Manufacturing as an Obstacle Course

Not counting recent exchange rate effects, the share of exports in total manufacturing has doubled in the 15 years since 1975. That certainly does not suggest a manufacturing sector so lured by domestic profits that it was unable to look to outside markets. A better paradigm than that of Indian manufacturing deterred from exports by the relative ease of the domestic market may be the obstacle course imposed upon all manufacturing. The net effect is to render difficult the development of all production, but without quite cancelling the superior possibilities offered even to Indian manufacturers by the world market.

Numerous and varied obstacles had been placed on the path of Indian manufacturing, and the reforms of the last few years have by no means removed them all. Restrictions on all imports of goods, know-how and factors of production do not simply render exports more difficult; they weigh on all investment and production. The impact of the <<*indigenous*>> reliance policies did not merely raise costs. The adoption of new technologies was hindered, not only through lack of incentives, but also because policy prevented the marketing of products into which such new technology was incorporated, just as it barred the importation of products 119and patents needed to develop new technologies domestically.

Actions meat to stimulate <<*indigenous*>> technical development actually hindered it. The Indian automobile industry illustrates this point almost like a caricature. It was the first such industry to be established in Asia outside Japan; it has turned out to be one of the least advanced. Half-century old models have been manufactured and sold without any competition, as imports were excluded and domestic production was limited through the licensing of new investment and that of necessary imports of inputs. From such a market, obviously no export was taking place. Through domestic buyers were queuing up, despite prices that were double international levels. There has been little need to adopt technical improvements introduced elsewhere and great difficulty in doing so. That there was little point is obvious from the existence of excess demand for the existing models, long obsolete elsewhere. The difficulty of doing so was no less real. Prototypes were not available, their importation disallowed and their production meeting the same difficulty of unavailable inputs at one level removed.

In more open economies, competing suppliers stimulate demand for innovations; once it is offered by any producer and meets consumer approval, all producers must match it or lose their markets. But the same environment also facilitates innovation, and not only through the stimulus of need and example. The stream of new products is not composed only of finished consumer goods. Even more, it is made up of elaborate new inputs. Much recent automotive innovation has been built on new measuring instruments and specialized computers, most of them originally produced for quite different purposes. Other innovations have used new materials, like plastics. None of these materials was until recently available in India. The difficulty of obtaining materials inputs has been matched by that of importing new technologies, and compounded by that of obtaining the capital goods required to apply new techniques or produce new products.

The fertilizer industry provides another illustration, Indonesia developed production by importing not only technologies, but indeed whole projects built up by foreign contractors on a <<*turnkey*>> basis and party managed by them well into the production stage. Indonesia is still into the production stage. Indonesia is still into turnkey fertiliser projects, but Indonesian firms themselves are now building them abroad. Turnkey project building has developed into a domestic industry, in which domestic and foreign techniques are intimately interwoven. By contrast, in Indian fertilizer projects foreign capital goods and foreign technology were only authorized most charily, in effect subject to the usual <<*indigenous angle*>> hurdles. As a result, production remains expensive and the production technology itself remains underdeveloped.

By analogy (and without any disrespect) one can compare the task facing would-be Indian innovators to that of producing efficient steam engines in the early 19th century. Even if someone had been able to design one, he would have lacked metals resistant to high specifications, and the measuring instruments for verifying those specifications.

It would be difficult to overstate the importance and pervasiveness of restrictions on foreign economic relations; on the quality and dynamism of production for the domestic market, their effects were equally pervasive and disastrous, and counterproductive. At the time of independence, India had a substantial industrial and technological advance over most other developing countries. She is now increasingly lagging behind a rising number of them. The measures meant to hasten the development of domestic industry and of indigenous technology have substantially contributed to this reversal of positions.

But there was more to the policy-induced weakness of Indian industry than deprivation from goods, services, capital and technology. Licensing, taxation and labour laws had been designed to compensate for the supposed advantages of larger firms, or at least to force them to share some of the benefits of size with other elements in society: the State, through differential taxation; labour, through higher than strictly market-determine4d wages and other benefits, including job security; smaller and supposedly less advantaged firms, through licensing that prevented the entry of large-scale firms into certain sectors and impeded their growth in all.

The escalating burdens placed on private firms as they increase in size have acted as a series of barriers to growth. Above the small workshop level, any significant expansion has been sure to bring a successful firm up against the next barrier, and place upon it the additional burdens of the next stage. No matter how dynamic and efficient an enterprise, it has had strong incentives to stop growing before passing such thresholds. This has created a sort of reverse Peter's Principle; Indian manufacturers competent in a given field had a strong incentive not to reinvest and develop in that field, as they would then have reached thresholds of stronger negative discrimination. It has been preferable for them to use their profits for investment in other firms and other fields, for luxury housing and consumption, or in illegal enterprises: black money, by definition, need not be concerned about legal thresholds. Such barriers are clearly a recipe neither for fast growth nor for efficient use of resources.

It had been well understood that these burdens had to weigh down the larger firms, and hinder their expansion; but that was not considered a major drawback, for several reasons. The Gandhian heritage understated the economic and technical disadvantages of smallness and of primitive technologies. It had not been realised that the same policy framework that impeded large-scale firms also hindered technical and commercial improvements and productivity increases in small ones. Also, it had been believed that in sectors where size, modern technology and productive equipment were important, they would be provided by the public sector that was, in any case, meant to capture and hold the commanding heights of the economy.

Licensing was indeed less of a burden for the public sector—there was no political will to hinder its growth, quite to the contrary. However, the other burdens weighing on large-scale private firms weighed on public sector firms too, if anything more heavily, because they were less able to evade them. And the public sector has also carried additional burdens. The original sin of the politically determined location of many large plants forced them into inefficient and expensive starts. The *de facto* rights granted to labour have been even greater than those set out by law. Together with often politicised recruitment and the relationship established between powerful politicians and labour Unions, these have practically invited labour indiscipline in public sector units. Chief Executive Positions have been usually assumed for short periods only, generally by superannuated civil servants. Detailed management controls have been exercised by physically remote administrators of the supervising ministries.

Singapore Airlines and other firms have proven that public sector enterprises need not be badly managed, inefficient, nor unprofitable; but they have been all that in India. we need not go into details, because the issue is no longer contentious. even in India, it is generally admitted that, at least in the past, the public sector did not provide a dynamic alternative to large-scale private industry. But this environment did not merely keep public industry inefficient' it also kept it small. Because the public sector was unprofitable it contributed little to financing its own expansion, while the increasing strain on the ordinary budget did not allow much infusion of additional capital.

Exporters have been favoured through partial exceptions from import restrictions. They also occasionally received somewhat privileged treatment relative to some of the handicaps of size. In the generally difficult world of manufacturing, these favours acted as incentives, all the more so as the exceptional imports could, in fact, often be used for products actually destined to the domestic market' sometimes such <<*diversion*>> was merely tolerated. But not frequently it was consciously acknowledged, or even encouraged. The scarcity of authorized imports meant that small amounts thus released onto the domestic market could provide very valuable incentives to exports this, however, depended on the scarcity of the particular imports' it made small exports profitable, but the same mechanism automatically reduced the profitability of any export that turned out to be successful.

Successful exporters encountered the same problems of size as all other producers, even if sometimes in attenuated forms. Their reluctance to cross the diverse thresholds was enhanced by their dependence on exemptions and *de facto* subsidies, that were temporary by nature, while the handicaps of size were seen to be permanent. Hence the concentration of export success in small-scale firms' hence also, more generally, the dismal employment record of manufacturing in all but the smallest establishment: according to official data, employment in manufacturing establishment with more that ten employees actually declined between 1981 and 1991, and rose by only 3 percent over the next three years[13].

Thus one might propose an alternative paradigm of Indian manufacturing industry. In this new paradigm, protectionism and import barriers are seen not so much as the direct causes of low export growth, but rather as a burden weighing on all Indian industry (including small-scale industry), and weakening it. In addition to this burden, licensing, discriminating fiscality, and highly restrictive labour restriction applied to large firms only have slowed down the growth of large firms and the passage of small-scale firms to a larger size. This has directly penalized the growth of efficient firms in their fields of efficiency, and reinforced the tendency towards the formation and growth of inefficient conglomerates.

Add, on top of all this, the slow growth of domestic demand and the limited size of the market. Add low private savings and, until recently, restricted access to foreign capital. Add the shortage of human skill and of infrastructure, reinforced by budget pressures, themselves partly due to the failure of the public sector to generate returns on government investment. No wonder that manufacturing grew slowly. No wonder either, that in this grey overall picture, exports provided the brightest spot, notwithstanding the special burdens weighing on them. Far from being the underprivileged segment of a generally healthy manufacturing sector, exports offered the only escape from a general position that was even more depressed.

[13] *Economic Survey* 1995-96, Government of India, Ministry of Finance, New Delhi.

The Next Fifty Years: Out of the Woods or into the Bogs?

It is clear that India has failed to participate fully in the commercial revolution of the past half-century. That revolution continues, but its most rewarding period of developing countries is gone. When the revolution started, the manufactures sold on industrial country markets were all produced in industrial countries, at industrial country wages. Early developing country exporters into that market could price their goods at prices determined by industrial country costs and wage rates; and even if they were only half-efficient producers, they could still reap huge profits, which were reinvested and helped raise both employment and productivity, thus pulling up domestic real wages but staying ahead of this increase and still maintaining significant cost advantages. By the time the second wave of developing countries became substantial manufactures exporters, wages in the first wave had risen and the composition of their exports had moved towards higher technology, less labour-intensive items. But now, as India is, perhaps, entering the field, the markets for labour-intensive products in industrial countries are supplied mainly from the poorer developing countries (notably, increasingly from China), at prices determined by developing country wage rates. The profit margins allowed to the successful exporter into this market, even if it is an efficient producer, are necessarily thinner than those reaped by the Hong Kong firms that first competed with American producers in supplying shirts to the American market.

While the road is more arduous, it is still the best road. There are many reasons for this, but there is no need to go beyond the most obvious; it is simply not practicable, for a small manufacturing sector, to be autarchic. And India’s manufacturing sector is indeed small; to come back to Lenin’s comparison, whether or not Indian industry was indeed similar in size to Belgium’s in the early 1920s, it is similar in size to it now. The idea of an efficient Belgian manufacturing sector not wholly opened to the outside world would seem ridiculous; the feat would be no easier for India.

If manufacturing exports are still to be developed, preferably as speedily as that was once done by East Asia, then it is still important to understand why India’s manufactures exports did so poorly than those of other developing countries. If the cause is essentially discrimination against exports, corrective policy lay relatively easily at hand, and may already have been taken. The exchange rate of recent years may be sufficient to do the trick, and even if it is not (or if, as seems likely, it has been allowed to drift up somewhat in the past year), it would be easy enough to devalue again, in real terms, and provide adequate incentives. It would also be easy enough to reduce protectionism, as is indeed required of India within the World Trade Organisation, if she is not to face retaliatory protectionism, this time in reality and not merely in myth.

Such measures can be called <<*easy*>> only in rhetorical contrast to much more difficult ones. In reality, even changing the *nominal* exchange rate runs into difficulties, and not only the sort of political difficulties discussed earlier. Changing the *real* exchange rate demands difficult action on prices and wages; it also demands acceptance of relative income changes that are not always easy nor necessarily desirable by themselves. And if reducing protectionism had been easy, India would have done it decades ago. But at least such measures are relatively concentrated, relatively easy to define. If there exists a latent group of potential exporters, raring to go and capable of rapidly expanding their exports as soon as such measures are taken, a simple set of measures would rapidly achieve results, bring political rewards; create a pressure group for further reinforcing moves. If the problem is one of broad-based obstacles to efficiency and growth in Indian manufacturing industry, the remedy itself should be broader and more complex, the insults more uncertain, and the political rewards slower to come.

The two diagnostics and their remedies are not mutually quite exclusive. No matter what the causes of inefficiency, high overall costs can always be somewhat lowered through the lower relative labour costs brought about by lower real exchange rates. Nor does protectionism set up a quite distinct category of high costs; on the contrary, we have seen that protectionism, particularly when it is as pervasive, as extreme and as long-lasting as it has been in India, raises costs and hinders progress throughout the economy. The greater inner-orientation of the Indian economy has certainly contributed substantially to the high costs of its manufacturing sector.

Devaluation, when it has effectively lowered India's real exchange rate and costs, as compared to those of a wide range of competitors, has each time boosted exports. This by itself should have some effect on efficiency, by opening the door to greater economies of scale, relieving foreign exchange <<*shortages*>> and thus weakening the rationale for restrictive practices, familiarising Indian producers with the technologies and practices of world markets and with their profit potentials. In an inner-oriented economy all export profits are still potential; they do not fuel lobbying efforts. Once a large share of manufacturing activity is oriented to export markets, exporters can form an effective lobby, provided they realise their true interests.

Nevertheless, if it is true, as is argued above, that the roots of the problem go deeper than protectionism and discrimination against exports, policies that merely boost the profitability of exports will quickly meet their limits. These limits are partly economic. It was said earlier that, however great the benefits of low real wages, they cannot overcome all handicaps, simply because real wages cannot fall to zero, let alone become negative. Yet, even a real wage of zero does not compensate for extreme inefficiencies; often, not even for a lack of infrastructure. No matter how low wages may be, they do not compensate for other economic policies that weaken incentives, discourage investments and hobble productivity. After all, what is important to enterprises and their profits is not wage *rates* by themselves; it is wage *costs*, which also depend on productivity. And there is an asymmetry between the potential gains labour costs can derive from lower wages and higher productivity: the former can at <<*best*>> go down to the iron law survival level; the latter can rise indefinitely. Moreover, labour productivity is not independent of wages; these directly influence incentives, and indirectly such determinants of productivity as education and health.

There are also social limits to policies that depend mostly on lowering real wages in order to overcome other obstacles to development and growth. In a pluralistic democratic society like India, these obstacles may actually become effective earlier than those of a purely economic nature. Such a society cannot tolerate that basic real wages should forever be compressed, in order to compensate for inefficiencies that are not directly due to unorganised labour. This is all the more so as much economic inefficiency consists in obtaining less than the fair exchange value of goods and services provided to certain purchasers, notably, of the public sector's products. Other related inefficiencies consist in paying some factors of production more than they contribute to the social product—sometimes in paying them so that they should reduce their negative contribution to social product, or put it to bear elsewhere.

It is well known that obtaining permits gives rise to profits openly, and sometimes, not so openly, so does the granting of permits. Such parasitic capitalism has long been a feature of Indian manufacturing. But more broadly, every economy has its share of actors remunerated in accordance with political power, custom or their exigencies, not their contribution to the value of final products. Under perfect competition, such excess incomes are squeezed out by the workings of the market; firms that pay them out go bankrupt, the only firms that survive are those that pay nothing to any contributor to production beyond the marginal revenue-product of the contribution. But even under perfect competition, the process takes time. By lowering real wages, devaluation lengthens this time, allows inefficient firms additional time during which they can distribute excessive incomes to ineffective owners and managers, to indolent supervisors—and, of course, also to idle or non-productive employees. Lowering the remuneration of those who contribute effectively to production does not merely serve to boost profits, investment and ultimately production and incomes; it also serves to shelter the incomes of those whose actual contribution to production is weak, nil or even negative.

The sharp devaluation that marked the beginnings of the reform process was highly desirable. By easing the foreign exchange shortage (partly because it boosted exports, and much more substantially because it helped reverse speculative capital flows), it has made it possible to initiate other reforms, above all the already significant liberalisation of international economic transactions. But very large elements of inefficiency remain in the Indian economy, and further substantial depreciation of the real exchange rate would be an act of desperation and a signal of failure to ease the other constraints. This does not mean that the time has come to allow the rupee to *appreciate* again, and yield back the competitive gains it has so recently made. This point is all the more important as the dollar (to which the rupee is, at least informally, tied) has itself has once again appreciated sharply, and that most East Asian currencies have recently depreciated against it, though not yet followed by India at the time of writing (late July 1997). But while maintaining competitiveness is important, and still requires that the real exchange rate should not be allowed to appreciate much from its post-reform levels, this competitive edge should be used to attack, not to defend and maintain, the other artificial constraints on Indian economic efficiency.

These other constraints have been examined and described ad nauseam by others, and such a short paper cannot contribute much to their knowledge. It can perhaps add a useful thought to the debate as to what to do about them. Most present-day critics of the legal and regulatory framework of the Indian economy start out by attributing its origins to a mixture of misguided starry-eyed Fabian socialism and equally misguided perceptions of Soviet communism. There was indeed plenty of those; but one can also put a more charitable interpretation on the preoccupation of the early guardians of the Indian economy, and even on the achievements of the system they put into place.

In a fully liberal system, adjustment to market signals is impelled by pull and push: the pull of the higher incomes to be obtained by adjusting, i.e., moving to a new job or a new location, learning a new skill, starting a new business venture; and by the push of the loss of income and other costs, and the pain that afflicts those who do not adjust. Willy-filly, adjustment always takes place under those twin impulsions, and classical economic theory (unlike some of its modem followers) fully recognised that such adjustment took time. However, it found little interest in the process of adjustment itself, essentially studying only the position after adjustment had been completed, <<*in the long run*>>. The recognition that what happened during adjustment was of considerable interest to those undergoing its pain and turmoil prompted Keynes to remark that <<*in the long run, we are all dead*>>.

How long and how difficult the adjustment will be is of crucial interest to those undergoing it. Much in India still renders the process particularly protracted and painful for the most vulnerable sections of the population. Many of those concerned have low skills, which reduces their ability to learn new tasks. Social habit, tradition and the caste system in India have confined them to a narrow range of tasks from times immemorial. Even in a fast expanding economy, few attractive alternatives pull the potter, the remover of night soil or the *chamar* to more remunerative occupations. The push has always been there, but when the starting income provides bare survival, an additional *push* easily means starvation. Because of these circumstances, slowing down change by protecting old occupations, and by treating acquired habits as acquired rights, may well have been not just politically expedient but also socially desirable.

Many of the controls and related policies introduced in the early days of independence, or indeed carried over to swaraj from the days of the British Raj, played a useful, perhaps an essential role, for a time. But they have mostly well outlived their usefulness. Though growth has been slow and India’s poor and uneducated remain very poor and very uneducated indeed, they have nevertheless acquired a slight layer of additional incomes and additional skills. The obstacle to change formed by the caste system, too, while still formidable, has been somewhat weakened. Many people could now adjust to market pressures (no doubt with great discomfort) whose only alternative not so long ago would have been starvation. Also, a layer of resources and expertise has been created with which to extend a safety net to the most vulnerable, who still cannot adjust to market forces on their own.

Even more important, mechanisms originally intended to protect the most vulnerable and poorest (and which may well indeed have performed that function once) now mostly protect the more powerful and prosperous. Any lingering social benefit they may still bring is much outweighed by their cost in terms of growth, employment and income generation foregone. The remainder of the arsenal once constituted to protect the weakest now constitutes the most formidable obstacle to the progress of the weak and poor. This, of course, does not make it easier to dismantle them—even in democracies the political weight of the relatively well- off is often heavier than that of the poorest.

Yet decisions must soon be made. Slow change may well have been desirable in the early years of independence, because faster change might have caused too much social turmoil and human misery, as it did in China. But by the 1960s, many of the early policies had become counterproductive. They slowed down positive changes that would have created additional employment and incomes, much of them for the benefit of the very poor; and were ineffective in slowing down change of the negative kind. Handloom weavers and producers of *khadi* ended up by losing their livelihood anyway, but for lack of fast growth in manufacturing they became agricultural labourers rather than workers in large-scale industry. And India missed participation in the most profitable years of the commercial revolution.

The global commercial revolution continues. Participation may be less profitable than it was earlier, but it is still vastly more profitable than staying out. Although she has lost much of her advance over other developing countries, India still retains some strengths. These could be built up if there is, now and without delay, a determined push to remove the obstacles to economic efficiency. Or they too could be allowed to slip away.

Less than a century elapsed between the final demise of the Mughal Empire and the independence of modern India. More than half of that time has gone by since then, and many of today's adults will one day celebrate the centenary of independence. When they look back upon these first hundred years, they will see that the present period was crucial. They shall see that in the space of a few years, around the turn of the millennium, the energies created during the first fifty years were harnessed into a powerful engine of progress, and the many strings and cobwebs that had impeded India's forward march were cut and swept away. From these years will date the second birth of modern India, her transformation into a dynamic economy that brought growing prosperity to her people, and into a strong bastion of democracy, well able to hold her own among other prosperous and powerful countries of Asia.

They will also see that if this had not happened now, the strings and cobwebs would have turned into ropes, the momentum would have been lost, and a poor, weak and self-doubting India would have lost all chances and given up all hopes of keeping her tryst with destiny.