INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRESS OF ECONOMIC DEVELOPMENT IN INDIA

MEMORANDUM FOR NINTH MEETING OF INDIAN CONSORTIUM

February 14, 1964

Department of Operations
South Asia and Middle East
CURRENCY EQUIVALENTS

1 Indian Rupee = U.S. $0.21
1 U.S. Dollar = Rs. 4.762
Rs. 1 crore = $2.1 million

FISCAL YEARS AND FIVE-YEAR PLAN PERIODS

The Indian fiscal year begins on April 1. The periods covered by the different five-year plans are as follows:

FIRST PLAN  April 1, 1951 - March 31, 1956
SECOND PLAN  April 1, 1956 - March 31, 1961
THIRD PLAN  April 1, 1961 - March 31, 1966
FOURTH PLAN  April 1, 1966 - March 31, 1971
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I. INTRODUCTION

1. India is seeking the equivalent of $1,100-1,150 million in new pledges of aid from the consortium for the fiscal year beginning April 1, 1964, which will be the fourth year of her Third Five-Year Plan. This compares with last year's request for $1,255 million, against which the consortium actually pledged $1,052 million.

2. After the eighth meeting of the consortium, which took place in Paris in June 1963, the President of the World Bank wrote to the Indian Finance Minister drawing attention to the concern expressed by members of the consortium over the disappointing progress of the economy during the first two years of the Third Plan and suggesting the need for a reappraisal of India's development program. Copies of Mr. Woods' letter and of the Finance Minister's reply are annexed to this memorandum. The document now presented to the consortium by the Indian Government has been prepared in response to the proposals made by Mr. Woods. It contains a review of India's economic programs and policies and explains the basis of the 1964/65 aid request.

3. Economic developments during the first half of the Third Plan have been reviewed by the Government of India in their "Mid-Term Appraisal", copies of which have been made available to members of the consortium. There is also the report of the mission from the International Monetary Fund which visited India in December 1963 for annual consultations. No separate economic report has been prepared by the Bank. However, the present memorandum starts with a brief review of the current economic situation and goes on to discuss in general terms some of the policy choices which India faces in undertaking the further development of her resources.

4. It should be made clear that the Bank is not in a position to evaluate the individual projects put forward by the Government of India for consortium financing, except for projects in which the Bank or IDA is directly concerned. Certain observations are, however, made in this memorandum on the way in which planning decisions are reached and on the policies related to the development of particular sectors of the economy.

5. It should also be emphasised that estimates of the costs and phasing of projects and forecasts of the balance of payments are inevitably subject to a considerable margin of error. Little useful purpose is therefore served by trying to make a precise estimate of the amount of external assistance "needed" for a period as short as one year. The case for continuing
external assistance to India must rest rather on a broad assessment of development needs and possibilities over the long haul. It is on this basis that future aid requirements are examined here.

6. The Central Government Budget for the fourth year of the Third Plan will be introduced on February 29. This is traditionally the occasion for announcing important changes in economic and financial policies. The Government of India will arrange for copies of the Finance Minister's budget speech and the annual Economic Survey to be circulated to the members of the consortium at the beginning of March, and a senior official of the Ministry of Finance will make an oral report on the Budget at the consortium meeting in Paris.

II. CURRENT ECONOMIC SITUATION

Production

7. As the Mid-Term Appraisal points out, the growth of national income in the first two years of the Third Plan was at an average rate of 2½ per cent a year, or less than half the rate envisaged in the Plan. The slow rate of growth was largely attributable to the lag in agricultural production, which increased by less than ¾ per cent in the first year and fell by over 3 per cent in the second. Industrial production increased by 6½ per cent in the first year and by another 8 per cent in the second.

8. In the third year of the Plan, which is now almost at an end, some recovery in agriculture can reasonably be expected after the exceptionally poor harvest of the previous year. The only crop for which official estimates are already available is jute, and here the figures show an increase in production of about 8 per cent. There is believed to have been a fairly substantial increase in rice production, but some fears are expressed for the wheat crop, which is harvested in the spring, on account of unusually cold weather in northwest India. It will be April or May before the first overall estimates of agricultural production in 1963/64 are produced.

9. Estimates of industrial production are available for the first seven months of 1963/64, and these show an increase of 9 per cent over the corresponding period of the previous year. Most of the principal industries participated in varying degrees in this expansion. Notable increases occurred in outputs of coal, aluminium, sulphuric acid, caustic soda, chemical fertilisers, paper and board, electrical equipment and railway wagons. On the other hand, production of sugar and motor vehicles declined. In textiles activity in the cotton industry increased only slightly, but more rapid advances took place in jute and woollen goods.

10. Coal production, though it increased sharply towards the end of 1962 following the introduction of seven-day working in the mines, has since levelled off as supply has caught up with demand. There is still a shortage
of the better quality coals, but inferior grades are now in surplus and output has been cut back as pithead stocks have accumulated. Present expectations are that in the full year 1963/64, total production will reach about 66 million tons, as compared with just under 64 million tons in 1962/63.

11. Output of finished steel in 1963/64 is expected to be around 4.3 million tons, as against 4.0 million tons in 1962/63. All the main plants are now working at or close to full capacity, and little further increase can be looked for in the quantities produced until the expansion schemes at the public sector plants are completed. The Bhilai expansion is the furthest advanced and should contribute most of the additional output expected during the next two years. Total production of finished steel is forecast as rising to 4.9 million tons in 1964/65 and 5.3 million tons in 1965/66.

12. A marked improvement has taken place during the past eighteen months with respect to supplies of electric power and transport, and neither is at the moment considered by the Government a serious obstacle to increasing industrial production, although local power shortages create difficulties from time to time. Power generation is expected to be about 15 per cent higher in 1963/64 than in the previous year and rail movements of freight nearly 10 per cent higher. The railways are having no difficulty now in moving all the coal produced.

13. There are many indications that production is still being held back by shortages of materials and components, particularly in the metal-using industries. However, no comprehensive study has been made of the extent to which capacity is under-used on this account. Flat steel products, special steels and non-ferrous metals are all in short supply. Scarcity of cement is a problem in some parts of the country. There is still reported to be a large unsatisfied demand for chemical fertilisers.

Prices

14. The decline in agricultural production in the second year of the Plan was followed by a marked increase in wholesale prices during 1963, and the wholesale price index rose by 7½ per cent in the course of the year, from December to December. There were particularly sharp increases in prices of sugar and gur, rice and pulses. Prices of kerosene, cigarettes and some other articles were enhanced by additional taxation, but generally speaking prices of industrial raw materials and manufactured goods remained fairly stable. The index of working class consumer prices started to move up during the summer of 1963 and in November was 4 per cent higher than a year before.

Internal Finance

15. Honey supply with the public rose by just over 11 per cent in the twelve months up to the end of November 1963, mainly as a result of the expansion of bank credit to the Government. Although taxation has already been raised well above the levels contemplated in the Third Plan, there has also
been some further increase in deficit financing. The level of public investment has continued to rise, and defence expenditures in 1963/64, while likely to fall some way short of the budget estimates, will probably still be well over double what they were before the Chinese invasion late in 1962.

16. The private capital market has not yet fully recovered from the shock of the Chinese invasion and is anyhow at present in a state of pre-budgetary suspense. The index of share prices at the end of November 1963 was at much the same level as a year before and 12 per cent below the all-time high of May 1962. However, new issues offered by companies with attractive growth prospects have generally met with an excellent response, and some recent issues in chemicals and engineering have been heavily over-subscribed. Basic industries like coal, cement and fertilisers, which are subject to price controls, have found it much more difficult to raise money.

17. Interest rates in India continue to edge upwards in line with government policy. Recent changes are described in Appendix II of the Indian submission to the consortium.

**Overseas Trade and Payments**

18. India's gold and foreign exchange reserves, including government balances abroad, amounted at the end of January 1964 to the equivalent of $599 million. The official forecasts set out in the Indian submission assume that they will rise to $616 million by the end of March; this is after allowing for the repayment of $25 million to the International Monetary Fund in February. If the forecast is correct, the net movement in reserves during the fiscal year 1963/64 will be a decline of $8 million.

19. Exports have done better than expected this year - mainly because of the continued buoyancy of jute exports, coupled with larger sales of sugar and oilseeds. These three commodities between them have accounted for over half the increase in total export earnings during the past three years, jute manufactures and sugar both having benefited from what appear to be exceptionally favourable world market conditions. Iron ore exports were boosted by the incorporation of Goa in the Indian Union at the end of 1961, but apart from Goa progress in this field has been disappointing.

20. Expenditure on imports in 1963/64, including imports under PL 480, is expected to be 15 per cent higher than in the previous year. Larger food-grain imports have been required to help make good the deficiency in domestic supplies, and there has been a steady rise in imports of capital goods, reflecting the progress of investment in industry, power and transport. Equipment is now being delivered against orders placed abroad in the early part of the Third Plan. Much of this equipment is being financed by foreign aid, and aid disbursements too have been rising. But as in previous years both equipment deliveries and corresponding disbursements of project aid have risen less than forecast. Imports of machinery and transport equipment in 1963/64 are now expected to be nearly $250 million less than projected a year ago and total aid disbursements $300-400 million less.
Imports other than cereals, machinery and transport equipment have apparently risen very little during the current year. There has been a sharp increase in expenditure on petroleum, but other maintenance imports have continued to be tightly restricted and have remained at about the same level in total as in 1962/63. Very little of the non-project aid pledged by the consortium a year ago has so far been disbursed. If this aid had been negotiated earlier in the year, it might have opened the way for more liberal import licensing policies.

India's overall deficit on current account, excluding official grants, has grown from $741 million in 1961/62 to an estimated $1,154 million in 1963/64. The increase in the deficit is almost wholly attributable to merchandise trade. On invisible account, there has been a fairly sharp rise in interest payments on foreign loans, but this has been largely offset by an increase in net receipts from other sources. The net balance of current invisibles, as now projected for 1963/64, is rather better than forecast a year ago.

III. DEVELOPMENT PROGRAMS AND POLICIES

Planning and Controls

23. An account of investment programs and policies is given, sector by sector, in Part II of the Indian submission. Some comments on these programs are made later in this memorandum. First, however, a few general observations are called for on methods of economic planning and on the policies being followed with respect to industrial development.

24. As industrialisation progresses, the choices that have to be made become more and more complex. The task of planning investment in detail is correspondingly more difficult. This the Government has recognised, and a number of steps are being taken to reduce and simplify licensing controls over industry and to relax controls over prices, so that market forces can play a larger part in determining the allocation of resources. Practical limits to the extent of de-control are set primarily by the shortage of foreign exchange. But while the complete removal of controls over the use of foreign exchange is plainly out of the question for the foreseeable future, greater reliance on the price mechanism, coupled with the use of appropriate fiscal devices, can help to take the pressure off the licensing system.

25. The Indian submission refers to a number of recent steps in the direction of de-control. Others are under consideration. It is particularly important that something should be done about the controls over prices and distribution of coal and steel. There also appears to be a prima facie case for removing controls over cement prices; the control of cement prices has discouraged new investment and helped to perpetuate a condition of shortage. Prices of fertilisers are regulated through the operations of the fertiliser pool, which equalises delivered prices of domestic and imported fertilisers,
Apart from these basic commodities, articles still subject to price control include sugar, kerosene, woollen yarn, ethyl alcohol and molasses. Informal arrangements exist under which certain industries have agreed not to increase prices without consulting the Government; the industries concerned are paper, cotton yarn and textiles, motor vehicles, bicycles and petroleum.

26. A genuine effort is being made by the Government to simplify the procedures for granting licences for industrial development (and related licences for the import of capital goods) and to cut down the time taken to consider applications. The committee looking into this question, which includes representatives of private industry, has already announced a change in procedures which should reduce the time required by the prospective investor to obtain the Government's approval in principle. The committee is now scrutinising the application forms that have to be submitted to see if they can be simplified. One of the important changes envisaged is that applicants will in future be invited to appear before the licensing sub-committee in person to answer questions rather than having to deal with them by correspondence. Cases involving private foreign investment or technical collaboration will be reviewed by a special committee of top level officials, assisted by a special officer, who will be responsible for seeing that applications are processed without unnecessary delay.

27. The Department of Technical Development (formerly the Development Wing of the Ministry of Commerce and Industry) plays a central role in scrutinising proposals for industrial investment. Complaints are frequently made that officials of this Department, who are mostly people with technical qualifications, lack the detailed and specialised knowledge required to reach a sensible judgement on matters referred to them - for example, whether or not a particular proposal for investment is technically sound; whether the proposed scale of manufacture is economic; whether such and such an item has to be imported; or whether an adequate substitute can be found from indigenous production; and so forth. Naturally, the degree of competence and common sense displayed will vary from individual to individual. But however capable the officials may be, there are limits to the extent to which a body of this kind can usefully attempt to "second guess" the industrialists concerned. It may be necessary to have some sort of technical screening to sift out obviously unsound projects, but there are dangers in trying to go beyond this. The cost of the delays caused in the past by arguing over minor details (particularly on the question whether indigenous components can be substituted for imports) has probably been out of all proportion to the benefits.

28. It is significant that, in examining applications for industrial investment both from the public and private sectors, the licensing authorities and their technical advisers have given comparatively little thought to the economic or financial evaluation of projects. Indeed, the Department of Technical Development is composed almost entirely of technical people and does not have an economic section. Even in the case of public sector projects involving substantial investment, decisions appear to be guided largely by considerations of technical feasibility and physical need, and the question
of production costs is apt to be regarded very much as a secondary matter. The defects of this approach are aggravated by the fact that the actual prices charged for capital and foreign exchange are quite unrealistic. Consequently, insufficient attention is given to the possibility of economising in these scarce factors in deciding both what should be produced in India and how techniques should be employed in producing it. The time factor is also liable to be ignored in arriving at investment decisions. All this helps to explain what many would regard as an excessive bias in India towards highly capital-intensive (and import-intensive) investments.

29. Economic planning in India is still conceived of essentially in terms of physical planning enforced by means of direct controls. The use of indirect methods of control, and the corollary that the price mechanism has an essential function to perform in allocating resources, is only gradually coming to be considered. The move is now in this direction, as it becomes increasingly evident that the Government has neither adequate staff nor adequate information to make a success of detailed physical planning in a more and more complex and diversified economy. Nevertheless, physical production targets laid down in the five-year plans continue to exercise a strong hold over the minds of the Planning Commission and the government departments responsible for investment, even though circumstances may have changed completely since the targets were set. Projects may be added to the Plan from time to time, but once a project has been included, it is difficult to get it dropped. All this contributes to rigidity and lack of realism in economic thinking, and it is to be hoped that the Fourth Plan will be more flexible in conception and spelt out in less detail.

30. Criticism of Indian planning methods must be tempered by an appreciation not only of the enormous difficulties of organising development in such a vast country, but also of the limits of the federal power in relation to the sixteen States. Much of the time — probably too much of the time — of the Planning Commission is taken up with negotiations with State Governments, and one of the principal functions of the five-year plans is to provide an agreed basis for the allocation of investment resources between the Centre and the States. State and regional interests have continually to be weighed against the economic interests of India as a whole, and it is inevitable that some concessions should be made to the former at the expense of the latter when it comes to deciding such matters as the location of industry and the development of transport. Nevertheless, before these concessions are made, the cost of making them should be objectively assessed, and this is not always done.

31. Another criticism of Indian planning both at the Centre and in the States concerns what is sometimes considered to be the excessive influence of the general administrator. While the regular civil service has a fine tradition, it does not always seem to be aware of its own limitations. There tends to be too little delegation of authority down the line, and insufficient use is made of expert advice in arriving at important decisions. The problem is aggravated by the difficulty of attracting competent specialists into the public service when their status in the service is so low and
when they can earn much more outside. The Government recognises the need to build up in the departments responsible for investment a staff of economists and technicians capable of preparing and evaluating projects and advising on policies. But little has so far been achieved, and the Planning Commission itself is still quite inadequately equipped with this sort of talent. In the long run, a solution to this problem may have to be sought in a reform of the civil service based on a reassessment of the relative values of different qualifications. The more the Government tries to plan at the Centre, the more important this reform becomes. Meanwhile, greater use is being made of outside experts to help with particular aspects of economic planning. The Power and Energy Survey Committees and the Coal Transport Study Group afford examples of the way in which this can be done. Consulting firms in India and the technical staffs of some of the public corporations are also making a useful contribution to the country's planning resources.

Preparatory work is now proceeding on the Fourth Plan. A preliminary outline assessing the resources that may be available and indicating some of the policy choices that have to be made is expected to be completed by the Planning Commission this summer for consideration by the National Development Council. There appears to be a danger in the meantime that the authorities responsible for putting forward investment proposals will continue to plan on the basis of rather unrealistic assumptions about the availability of capital and about attainable rates of economic growth. Very large numbers have already been mentioned in public in connection with programs for the expansion of some of the basic industries, and the wider currency these gain, the more difficult it becomes for the Government to get away from them. The sooner a hard look is taken at the limitations likely to be imposed by such factors as foreign exchange resources, domestic savings and the lag in agricultural production, the easier it will be to impress on the planning authorities the need to find the most economical solutions to their problems.

Private Foreign Investment

The respective roles of the private and public sectors in India's mixed economy have by now been fairly clearly demarcated. This demarcation follows the line laid down in the 1956 Industrial Policy Resolution, and although there have been occasional deviations from it, the Government apparently has no intention of introducing any radical changes. At the same time, there is growing recognition in India that shortages of foreign capital and trained management are the principal factors limiting the progress of industrialisation, and the Government is looking to private foreign investment as an important source of both. In spite of high taxation and other deterrents, many foreign firms have found that investment in Indian industry can be highly profitable. The Government's attitude towards private foreign investment seems to be more welcoming today than at any time in the recent past. Special efforts are being made to secure the participation of private foreign capital on a minority basis in public sector enterprises. This is something of a new departure and is being tried out to begin with in the petroleum industry (see paragraphs 51-55 below). The idea is that the foreign investor should take a share of the equity and also help in providing management and technical services.
Part III of the Indian consortium submission contains a statement on government policies in respect of private foreign investment and assesses the role which such investment can play in the development of industry. There is, however, a lack of reliable and up-to-date statistical information on the actual inflow of private long-term capital, and it is time that better arrangements were made for collecting the data. The official estimate is that, excluding reinvestment of retained earnings, the present gross inflow is at the rate of around $50-60 million a year, but this could be an underestimate.

Private foreign investment is no substitute for official aid. Indeed, the continuance of aid to India is essential if foreign enterprises are to be persuaded to invest their own money in the country. As the Indian submission points out, it would be unrealistic to expect private foreign capital to make more than a marginal contribution in the foreseeable future to covering India's balance of payments deficit. Nor can it always be assumed that servicing of an equity investment will be less onerous from a balance of payments point of view than servicing of conventional loans.

The coming Budget should provide a clearer indication of the Government's intentions with regard to private foreign investment. The petroleum industry remains a special case and is discussed in paragraphs 50-56 below.

Public Sector Enterprises

The Government is now giving more careful attention to the problem of management in public sector enterprises. As an initial experiment in greater decentralization of control, the Minister of Steel, Mines and Heavy Engineering has introduced important changes in the management of the Sindri fertiliser factory and the Durgapur steel plant (see Appendix III of the Indian submission). The Government's intention is that similar changes should be made at other plants, several of which are admitted to be in serious difficulties. Major obstacles to more efficient management are still the insistence of the Ministry of Finance on outside financial control and continual interference by the Comptroller and Auditor-General, whose officers are stationed in every plant. No enterprise can be expected to operate efficiently under these conditions.

Too many of the top posts in the new public sector enterprises are still occupied by persons drawn from the civil service or from long-established organizations such as the Railway Board where the qualifications required are quite different. Efforts are, however, being made to encourage promotion from within and to give more weight to technical skills and specialized know-how and less to seniority. Many of the younger men who have worked their way up in the enterprises are reported to show great promise. A recent study carried out by the Indian Institute of Public Administration at the Government's request has some eminently sensible things to say on this subject. "As the author remarks, "the idea that age and

seniority should weigh more than talent is normally prevalent in all traditional societies. But it has to be given up by a society which wants to bring about a technical and economic revolution. The fact that at this stage of our economic growth some persons, especially specialists, rise to important positions at a comparatively young age need not be considered alarming. The tendency to insist on a certain rigid relationship between the age of a person and the grade that is to be given to him needs to be firmly resisted.

39. The same study focuses attention on the controversial subject of pay scales in public sector enterprises and concludes that substantial increases in pay will be required to attract and retain qualified technical personnel. More specifically, the recommendation is made that the top salaries in public undertakings should be raised to Rs. 5,000 a month, as against the present maximum of Rs. 2,750, and that the lowest salaries in these undertakings should be at least about 90 per cent of those in good private firms. The problem is seen as one of competing for talent not merely with private enterprise in India, but also with employers abroad. Thousands of Indian technicians, as well as many economists and scientists, are at present working overseas because the rewards there are higher than in their own country. India cannot afford to lose these people, and ways have to be found of encouraging them to come back.

40. Genuine competition between public and private undertakings can often be of benefit to both. There are cases in India where public undertakings have provided a useful and necessary stimulus to greater efficiency and enterprise in the private sector. Equally, without private competition, it will be difficult to ensure the long-run efficiency of the public plants. From this point of view, it seems desirable to avoid any hard and fast demarcation of spheres of activity between the two sectors.

Iron and Steel

41. The five main steel plants are working close to capacity, and three of them are in process of expansion. Domestic production of many categories of steel is now more or less adequate to meet demand, but there are large deficits in flat products and special steels; there is also a shortage of pig iron for sale to foundries. Highest priority in the further expansion of the industry will be given to the creation of additional capacity for flat products and to the installation of two more blast furnaces, one at Bhilai and the other at Durgapur.

42. The project for a continuous strip mill at Bokaro, where steel-making would be based on the LD process, has now been worked out in detail, and it is proposed that tenders for the different parts of the plant should be invited from firms in consortium countries. A separate company has been established to run the plant, and design and engineering services are being provided by a firm of Indian consultants who have been responsible for the project report. The Government has indicated that there will be no objection to the employment of foreign consultants, where necessary, to advise on special problems related to the design and construction of the plant and ancillary facilities.
Government also recognises that foreign assistance will be needed in running the plant. According to the timetable set out in the Indian submission, it is hoped that orders can be placed for Bokaro before the middle of 1965. This is probably optimistic.

43. Other possibilities of increasing output of flat products are also to be exploited. The Government attaches particular importance to the projects for the further expansion of the TISCO and Rourkela plants, since both will produce mainly this type of steel. Allowing for further expansion to be undertaken at the IISCO plant and at Bhilai and Durgapur, the five existing plants could have a combined capacity of around 14 million tons of ingot steel by the end of the Fourth Plan or shortly thereafter. Adding another 1½ million tons for the first stage of Bokaro, total steel-making capacity would be in the region of 15½ million tons of ingots or 11 million tons of finished steel. This may be compared with the estimates of demand set out in the Indian submission. The lowest of these estimates, which was made a year ago by the U.S. Steel Corporation, puts demand for finished steel in 1970/71 at 11.2 million tons.

44. A committee of economists appointed by the Minister of Steel, Mines and Heavy Engineering has recommended a considerable simplification of the present system of steel controls, along with a major revision of the price structure. The committee’s recommendations are still being considered by the Government, and a decision is expected shortly. If, as the committee has proposed, prices are to be set at levels which will enable the steel plants to provide adequately for replacement and expansion, and if the relative prices of different categories are to take account of relative costs of production, very substantial increases will be necessary in the official prices of the scarcer and more difficult categories.

45. If investments in the government steel plants were charged 10 per cent interest, the average cost of saleable steel produced at Bhilai and Durgapur, even after the current expansion, would probably be some way over Rs. 600 per ton; at Rourkela it would be about Rs. 100 more. This may be compared with the present average retention prices of Rs. 550, 5 and Rs. 612 per ton respectively, and sale prices (f.o.r. railhead) ranging from Rs. 600-650 per ton for bars and structural steel to over Rs. 800 per ton for sheets. Black market prices for the scarcer categories have in some cases been over Rs. 1,000 per ton.

Iron Ore

46. The way in which India’s iron ore resources are being developed for local consumption and export exhibits many weaknesses in planning and execution. Major investments have been undertaken on the basis of quite inadequate technical studies, one result of this being that few of the mines have succeeded in producing ore of the qualities envisaged. A number of the public sector mines appear to have been heavily over-capitalised by comparison with similar ventures in the private sector, or in other parts of the world. The result is that costs of production at some mines (e.g., Kiriburu...
in Orissa) are quite uncompetitive. The various export projects have been taken up without detailed cost comparisons, without adequate attention to economics of scale and without an expert study of marketing possibilities and requirements. Nor have the related investments in mining, rail transport and ports been properly coordinated. The capacity planned to handle iron ore exports at Goa, Vishakhapatnam, Paradip, Madras and possibly Haldia appears to be greatly in excess of possible requirements. Serious delays have occurred in the installation of the necessary port facilities at Vishakhapatnam with the result that deliveries of ore to Japan under a long-term contract for the export of 2 million tons a year will be delayed by at least six months and possibly longer.

47. The fact that many different authorities are involved in the iron ore export business and that nobody can be held responsible for things going wrong is perhaps in itself significant. Whatever the reasons for what is happening, the situation appears serious enough to warrant radical changes in planning methods, in arrangements for the exploration and mining of iron ore and in the handling of exports. A proposal to set up a small committee of officials to supervise the progress of the various export schemes hardly seems to meet the case.

Coal

48. The present situation with respect to the supply and demand for coal illustrates the distortions that can be caused by rigid price controls. Too much appears to have been invested in developing production of inferior grades particularly in the outlying fields, and too little in the mining and mechanical washing of the higher grades. The narrow differential between prices of the superior and inferior grades has given the mines little incentive to concentrate on producing what the consumer wants, and the low average return on capital invested in the industry has made it difficult for the private sector to secure the finance needed for expansion. The Government has recognised these problems and is now giving fresh thought to the whole system of controls and prices. A decision is expected shortly.

49. Plans for the expansion of production are based on the assumption that consumption of coal in India will rise as high as 85-88 million tons in 1965/66, and that output of around 90 million tons will be needed to provide for this. Some preliminary calculations made by the Energy Survey Committee suggest that consumption may rise rather more slowly. At the margin, much will depend on the extent to which oil continues to be substituted for coal in areas distant from the coalfields, and this in turn will depend on the relative prices at which alternative fuels are available. There are still restrictions on private companies extending their activities into new areas. If these restrictions were removed and prices de-controlled, the need for additional public investment in the industry could be reduced.
petroleum

50. Relations between the Government and the private oil companies in India have improved considerably during the past year. At the same time the Government's policies towards private investment in the industry continue to be based on the Industrial Policy Resolution of 1956. Broadly speaking, the majority ownership and control of all new ventures is reserved to the public sector. Private participation is welcomed on a minority basis. Units established in the private sector prior to 1956 continue to operate, but their expansion is controlled by the Government.

51. As far back as November 1959 private companies were invited to put forward proposals for participating in the exploration and production of oil in specified areas of India and a number of companies expressed interest in doing so. More recently, in June 1963, it was announced that the Government would welcome private participation in exploration in Kerala, the Cauvery Basin and the Andaman Islands. Three oil companies showed interest in the announcement. As yet, however, no new agreements have been negotiated.

52. The Burmah Oil Company, through its 50 per cent participation with the Government in Oil India Limited, is still the only private company with an equity investment in exploration and production. Oil India has recently been granted new concessions in Assam. All other exploratory work is being carried out by the Government's Oil and Natural Gas Commission, which is receiving technical assistance from the Soviet Union, Italy and France. The foreign exchange costs of the ONGC's operations during the Third Plan have been largely covered by credits from the Soviet Union, Rumania, France and Italy (ENI). ENI and the French Petroleum Institute have both concluded agreements for contract drilling, the former in the Ganges Valley and the latter in the Jaisalmer area of Rajasthan.

53. On the basis of discoveries made so far, production of crude oil in India can be expected to rise from roughly 2 million tons in 1963 to 6-7 million tons a year early in the Fourth Plan. This would be more or less equally divided between Assam and Gujarat.

54. All the new refineries built in India since 1956 have been in the public sector. The first three - at Numalai, Barauni and Koyali - are wholly owned by the Government and their foreign exchange costs have been covered out of credits from the Soviet Bloc. A new pattern has been set by the agreement reached last year with the Phillips Petroleum Company for the construction of a 2½ million ton refinery at Cochin. The Central Government has subscribed 51 per cent of the equity, the State Government 7 per cent, Phillips 25 per cent and their Indian partners 2 per cent. The remaining 15 per cent is being offered for public subscription in India. The foreign exchange costs of the refinery are to be covered mainly by loans of up to $18 million from banks in the United States. The effective rate of interest payable by India on these loans will be 5½ per cent, with repayments commencing in 1967 and extending up to 1980. Management and technical services are to be provided by Phillips.
55. Invitations have been extended to other oil companies to participate on a minority basis in additional refineries to be established at Hadras and Haldia (outside Calcutta), and a number of offers have been received which are at present under study. The Government is also interested in attracting private capital and technical know-how into the petrochemical industries. Two complexes are contemplated, one in Bombay and the other in Gujarat or possibly at Haldia. The intention is that the Government should have a majority interest in the main units (e.g., refineries and naphtha crackers), but that the peripheral plants should be wholly private.

56. Arrangements which provide for the greater participation of private capital and management in the development of India's oil resources mark an important step forward. Of course, the Government's adherence to the principles embodied in the Industrial Policy Resolution continue to some extent to restrict the scope for such participation. This is true not only of exploration, production and refining, but also of distribution, in which the government-owned Indian Oil Company is investing substantial sums with the object eventually of taking over the greater part of the domestic market. The existing private refineries are not being allowed to expand any further for the time being. The Government maintains that the regional pattern of demand for petroleum products in India does not yet justify any further expansion of refining in Bombay, where the two largest private refineries are located. Against this must be set the fact that the per-ton cost of expanding these refineries would be very much lower than the cost of establishing new capacity elsewhere. The basis on which the so-called "economic supply areas" for the different refineries are demarcated is also open to question. Costs of transport from the refinery to the point of consumption are assumed to be equal to the prevailing railway freight rate, and no account is taken of the fact that actual costs of transport by pipeline may be very different.

Power

57. The work done by the Power and Energy Survey Committees should provide a useful basis for the more systematic planning of power facilities in India in future, and when the Committees have completed their work, the list of power projects already drawn up for the Fourth Plan should be reviewed in the light of their findings. There appears to be some tendency on the part of the power authorities to assume that very few changes will be needed, but this assumption should not be allowed to pass unchallenged. Few of the Fourth Plan projects have yet been committed beyond the stage where major changes can be made.

58. The Government has accepted the need to put more emphasis in future on investment in transmission and distribution facilities and is looking into the practical possibilities of extra high voltage transmission of power generated in large thermal stations burning by-product coal. The concept of regional planning of power facilities has also been accepted by the Centre, and as noted in the Indian submission, two regional Electricity Boards have already been established to assist in forming interstate power grids, one in
the north and the other in the south. The State Electricity Boards will, however, continue to be responsible for "planning, construction and operation of power stations and transmission systems", and it is not clear how far the State Governments will be ready to cooperate in putting the new policies into practice. Consideration is meanwhile being given to the possibility of strengthening the Central Electricity Authority, so that it can play a more effective role in future in the development of India's power resources.

59. The work done by the Energy Survey Committee appears among other things to support the view that if realistic prices are charged for capital, nuclear energy is not in present circumstances competitive in India with thermal or hydro power. The argument is, however, advanced by the Indian Atomic Energy Commission that in the long run nuclear energy will have to be developed in certain regions of India for lack of adequate alternatives, and that a start must be made now in building up experience in the operation of nuclear plants. Two such plants have accordingly been included in the power program for the next five years, one at Tarapore on the coast north of Bombay (being assisted by the United States) and the other in Rajasthan (to be built with Canadian assistance).

60. The Central Government has long been pressing State Governments to increase their power rates to levels which would generate more adequate resources for the financing of future expansion. As noted in the Indian sub-mission, a proposal has been put forward that electricity tariffs should generally be framed so as to produce a return of about 10 per cent on capital invested. Many of the States, however, continue to resist this idea on the grounds that cheap power is necessary to attract new industries and to develop agriculture. No major changes in tariffs have been made during the past twelve months, but three States are understood to be revising their tariffs at the present time. These are Kerala, Madras and Punjab.

61. Considerable differences of opinion exist as to the likely trend of demand for power during the period of the Fourth Plan. Load forecasts prepared in the past by the Central Water and Power Commission, in consultation with the State Governments, have tended to over-estimate demand, and the forecasts included in the First Electricity Power Survey of India, which was undertaken in 1963, may be on the high side. There can be no question, however, of the importance of planning new facilities well in advance as part of a properly phased program, and the Government is rightly concerned to avoid a repetition of the bunching of projects which occurred at the start of the Third Plan. Some new schemes should be started every year if there is to be an even development of power supplies, and the list of projects suggested this year for consortium financing, which includes additional facilities for transmission and distribution, does not seem unreasonably large. However, as already noted, the World Bank is not in a position to comment on the merits of individual projects.
Transport

62. The adoption of more rational taxation, pricing and regulatory policies could help to secure a better allocation of resources as between alternative modes of transport in India. The present very heavy taxation of road transport, for example, has been one of the factors inhibiting balanced development in this sector. The fact that gasoline is much more heavily taxed than diesel oil has induced road transport operators to concentrate on diesel vehicles to the point where substantial quantities of diesel fuel have to be imported, while gasoline is in growing surplus. The fact that coal prices have been kept artificially low, while diesel fuel bears a heavy duty (which more than compensates for the scarcity of foreign exchange), has tended to obscure the possible economic benefits of converting the railroads in some parts of India from steam to diesel traction. Un-economic use of transport resources has also been encouraged by the structure of railway freight rates, which has not always been closely related to the costs of different traffic movements. These and related questions are now receiving increasing attention in India. Some of them are being examined by the Coal Transport Study Group, which is expected to complete its report in a few months.

63. This year's Railway Budget, introduced on February 12, provides for a supplementary charge of 2 per cent on freight rates, a downward adjustment in rates charged for certain high-rated commodities and an increase in the rate for coal carried over 500 kilometers. These changes are very much in line with recommendations made by last year's Bank economic mission.

64. The railways are now able to move all the freight offered and even have some surplus capacity. This is a welcome change from the situation a year or two ago and reflects credit on the railway management. Past experience in India supports the view that rail capacity should always be some way ahead of demand. Nevertheless, plans for future expansion need to be kept under close scrutiny in view of the continuing scarcity of capital in general and foreign exchange in particular. Earlier estimates, which suggested that originating freight traffic on the railways might rise from the present level of around 195 million tons a year to well over 400 million tons in 1970/71, are now recognized to have been greatly exaggerated. If thermal power plants are in future located mainly on the coalfields, and if the possibilities of EHV transmission over long distances can be fully exploited, substantial economies should be achieved in rail movement of coal. The progressive dieselisation and electrification of the railways will have similar consequences. At the same time, there is still scope for reducing the need for additional investment in the railways by further improvements in operational performance (e.g. measures to speed up the marshalling, movement and turn-round of freight trains, more efficient inspection and maintenance of rolling stock, etc.).

65. Indian roads have been planned in the past with insufficient regard to the economic justification of the investments proposed. As the Indian sub-committee points out, efforts are now being made to rectify this situation, but
there is still evidence that projects are being undertaken without any serious attempt to evaluate their costs and benefits. A conspicuous example is the proposal to spend an additional Rs. 20 crores ($2 million) on roads in the West Bengal/Bihar region during the Third Plan mainly for the purpose of moving coal. Out of this, Rs. 8 crores are to be spent on improvements to the Grand Trunk Road between Calcutta and the coalfields and another Rs. 8 crores on what are described as feeder roads to the collieries. Now that congestion on the railways has been eased, it is difficult to see how the demand for moving coal by road could possibly justify investments on anything approaching this scale. There is the further consideration that the West Bengal Government still intends to build (and has already started work on) a new expressway from Calcutta to Durgapur which is designed to bypass the Grand Trunk Road over much of the distance to the coalfields.

Agriculture

Agriculture is beginning to receive from the Indian planners the attention which its importance demands. A more businesslike and scientific approach to the task of raising agricultural production is long overdue. The effectiveness of government action in this field has hitherto been limited by the diffusion of effort over too wide a field, the confusion of production and welfare objectives and insufficient attention to the technical factors involved. Most schemes for community development and agricultural extension services in many parts of the country betray a lack of expert knowledge of farming conditions and an incomplete understanding of the kind of incentives needed to stimulate farmers to increase their production.

68. The Planning Commission is now examining the implications for agriculture of alternative rates of income growth and is considering how lower rates of growth in agriculture would affect the development of the economy as a whole. With the population growing at the rate of 2½ per cent a year, nothing less than a 5 per cent rate of growth in agricultural output can be regarded as a tolerable long-run objective. Some doubt exists as to the actual rate of expansion achieved during the past ten years. Some estimates put it as low as 3 per cent a year; others as high as 4½ per cent, depending on the base period and the method of calculation adopted. There must anyhow be considerable uncertainty about the reliability of estimates which have to be based on samples collected over such a huge area from widely differing types of farm. The achievement of a 5 per cent growth rate should be technically feasible if available resources of finance and expertise are concentrate
on helping the larger and more efficient farmers to produce more and giving
then the incentive to do so. The necessary expansion certainly cannot be
achieved so long as so much effort continues to be directed to looking after
the less viable sections of the agricultural community, who consist mainly
of very small farmers and agricultural labourers. Politically and in human
terms, this is an extremely difficult choice to make. But policies aimed
primarily at assisting the lowest income groups must inevitably conflict with
the objective of maximising output.

69. One important advance that has been made in the last few years, as
described in the Indian submission, is the establishment of support prices
for cereals as well as for jute. Admittedly, the prices so far fixed for
cereals have generally been well below the prices prevailing in the market
and have therefore had rather a limited impact. Indeed, except possibly
for jute, where the buffer stock scheme is operated by the industry, the
Government does not yet have the organisation needed to enforce an effective
price support policy for these commodities. The number of procurement
points will have to be greatly increased and additional storage facilities
created. The whole question of how far the Government can intervene more
effectively in the distribution and marketing of agricultural commodities
is one deserving of careful study. Attention must also be given to the
problem of the relative prices of different crops. A conscious effort
should be made to bring about through appropriate pricing policies the
changes in cropping patterns that will be required to match the expected
pattern of demand for agricultural products. For example, data on demand
elasticities derived from national sample surveys, admittedly rather sketchy
and out of date, suggest that special efforts will have to be made to stimu­
late production of wheat, cotton and oilseeds at the expense particularly of
inferior grains.

70. The Indian submission contains a general account of the progress of
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follow up of projects leave much to be desired. This is partly the result
of the unsatisfactory division of functions between the Ministry of Irriga­
tion and Power, which is responsible for supplying water for irrigation,
and the Ministry of Agriculture, which is concerned with its use. There has
long been talk of the need to secure closer working cooperation at all levels
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many projects have been started in relation to the resources of money and
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extension services to the practical problems involved in making full and
efficient use of the water supplied. Financial returns as a rule are
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on helping the larger and more efficient farmers to produce more and giving then the incentive to do so. The necessary expansion certainly cannot be achieved so long as so much effort continues to be directed to looking after the less viable sections of the agricultural community, who consist mainly of very small farmers and agricultural labourers. Politically and in human terms, this is an extremely difficult choice to make. But policies aimed primarily at assisting the lowest income groups must inevitably conflict with the objective of maximising output.

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While something like Rs. 850 crores ($1,785 million) have been allocated for investment in irrigation during the Third Plan (11 per cent of the Plan total), some other agricultural inputs have been comparatively neglected. Schemes for soil conservation and improvement, including reafforestation and measures to control waterlogging and salinity, do not appear to have received as much attention as they should, particularly in view of the opportunities for using under-employed rural labour on this type of work. A lot of emphasis has been placed on land reform and the imposition of ceilings on land holdings, but less thought has been given to the possibilities of increasing production through the consolidation of holdings.

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Larger supplies of fertilisers are properly regarded as one of the principal requirements of Indian agriculture, and the serious delays that have occurred in the program for the domestic manufacture of chemical fertilisers are particularly unfortunate. They illustrate the inherent difficulties of working out mutually satisfactory arrangements for the collaboration of Indian and foreign firms in undertaking large industrial projects - difficulties which in this case have been aggravated by uncertainties about government pricing and distribution policies. Pending completion of the fertiliser plants now under construction, one of the most effective forms of external assistance to India would be to provide additional fertiliser imports to help in developing the market and building up knowledge of fertiliser use. At the same time, as supplies are increased, commercial methods of distribution should be encouraged. The present system under which most nitrogenous fertilisers are distributed by the Government to the farmers through cooperatives appears to be cumbersome and inefficient.

The reform of agricultural administration in India is coming to be recognized as a necessary condition of more rapid advance. Farmers have suffered in the past from too much interference by government officials knowing very little about farming. The move should be in the direction of reducing the influence of the general administrator and the revenue officer and enhancing the status of the agricultural specialist. A proposal for the creation of an All-India Agricultural Service was discussed with State Governments two years ago and met with a negative response. Recently, however, there have been signs of greater willingness to accept the idea.

IV. EXTERNAL FINANCE

The official balance of payments forecasts for the remaining years of the Third Plan are shown in the table on the next page alongside the actuals for the first two years of the Plan. The figures show the sharp worsening of the current account position from year to year. The trend is disquieting. If the prospective current account deficit in the last year of the Plan is compared with the estimate of net domestic investment given on page 25 of the Indian submission, it would appear that over one quarter of this investment
## India's Balance of Payments

<table>
<thead>
<tr>
<th>Current Account</th>
<th>Actuals</th>
<th>Forecasts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Imports (f.o.b.)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial a/</td>
<td>1,940</td>
<td>2,075</td>
</tr>
<tr>
<td>PL 480</td>
<td>185</td>
<td>258</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,125</td>
<td>2,333</td>
</tr>
<tr>
<td><strong>Exports and re-exports (f.o.b.)</strong></td>
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<td>1,132</td>
</tr>
<tr>
<td><strong>Visible trade balance</strong></td>
<td>-724</td>
<td>-901</td>
</tr>
<tr>
<td><strong>Invisibles net (excluding official grants)</strong></td>
<td>-17</td>
<td>-11</td>
</tr>
<tr>
<td><strong>Current balance (excluding official grants)</strong></td>
<td>-711</td>
<td>-912</td>
</tr>
</tbody>
</table>

**Capital Account**

|                 |         |           |         |
| Private foreign investment (gross inflow, excluding retained earnings) | 16     | 55       | 55      | 63      | 71      |
| Repayment of other foreign loans | -97     | -78      | -69     | -95     | -113    |
| Other capital transactions net (including errors and omissions) | -18    | +7       | -30     | -42     | -49     |
| **Capital transactions (net)** | -90    | -19      | -102    | -118    | -165    |

| Deficit covered or to be covered by foreign aid/use of reserves | -839   | -961     | -1,296  | -1,335  | -1,387  |

**Financed by:**

|                 |         |           |         |
| PL 480 aid      | 185     | 258       | 361     | 260     | b/      |
| Disbursement of other foreign assistance already pledged | 519    | 674       | 918     | 1,063   | 1,082   |
| Transactions with IMF (drawings +) | 122    | 25        | -50     | -100    | -100    |
| Use of reserves c/ | 13    | 4         | -        | -       | -       |
| **Gap to be covered by disbursements of additional aid requested** | -      | -         | 212     | 405     |

### Source:
Government of India, Ministry of Finance

### Notes:
- a/ Includes that portion of PL 480 freight charges (50 per cent) which is financed out of India's own resources.
- b/ Nothing has been included in the import forecast for 1965/66 for commodities financed in previous years under PL 480. Whether or not a new PL 480 agreement is concluded, the need for these imports will presumably continue. Both the total import bill and the current account deficit in 1965/66 are therefore likely to be considerably larger than shown in this table.
- c/ Including government balances held abroad, in addition to the gold and foreign exchange holdings of the Reserve Bank of India.
will be financed from external sources. This is much the same proportion as at the end of the Second Plan and casts some doubt on the suggestion made in the Indian submission that the gap between investment and savings is being narrowed.

75. It is true that, because of the bunching of starts of new projects in the early part of the Third Plan, there will be a corresponding bunching of deliveries of imported equipment towards the end of the Plan, and this could mean that the high level of imports expected in 1961/62 and 1965/66 turns out to be a hump rather than part of a continuous rise. It is also true that, while domestic savings may not have been increased much during the past two years, taxation has been raised to a new plane, so that if defence expenditures can be levelled off or reduced there might be a margin of additional savings to finance investment. However, there is no assurance that this will happen.

76. If attention is switched from the savings gap to specific foreign exchange requirements, the outlook is equally disturbing. On the basis only of loans committed up to the end of 1963, external debt service payments due during the period of the Fourth Plan are estimated by the Indian Government at over $1,800 million or an average of $360 million a year (including repayment of suppliers' credits). If India goes on borrowing abroad on the same scale and pattern as in recent years, service payments due during the Fourth Plan could reach about $3,000 million. The corresponding figure for the Third Plan is likely to be about $1,300 million. Thus debt service alone can be expected on the assumption stated to cost India roughly $1,700 million more during the Fourth Plan than during the Third. If it is further assumed:

(a) that visible exports rise during the Fourth Plan at the rate of 5 per cent a year (a considerably higher rate of increase than has been achieved over any long period in the past);

(b) that there is no significant change in net invisible receipts (other than debt service); and

(c) that gross receipts of external assistance, including PL 480, are about the same in the Fourth Plan as in the Third

then the implication would be that foreign exchange available for financing merchandise imports other than imports under PL 480 during the Fourth Plan would average about $2,400 million a year. This is somewhat above the 1963/64 level, but less than forecast for next year and about 15 per cent below the forecast for 1965/66.

2/ This is on the assumption that PL 480 imports, or equivalent imports financed in other ways, will continue in 1965/66 at about the same level as in 1964/65.
77. Import requirements for investment are likely to remain high in spite of efforts to develop domestic production of capital goods. The foreign exchange component of the minimum steel expansion program envisaged for the period of the Fourth Plan can hardly be less than $200-250 million a year. Foreign exchange requirements for investment in energy over the same period have been tentatively assessed by the Energy Survey Committee at around $400 million a year. The railways still require imports of over $100 million a year. On top of all this, large amounts of foreign exchange will be needed to develop capacity in such import-intensive fields of investment as heavy engineering, fertilizers and petrochemicals. So far as maintenance imports are concerned, there is reason to believe that, if the present pattern of industrial growth is maintained, there will be increasing rather than decreasing demand during the Fourth Plan for imports of petroleum, steel and non-ferrous metals, notwithstanding the steps being taken to develop indigenous production. The possibilities of reducing imports of cereals and cotton must be regarded at best as highly uncertain. Imports of these five groups of commodities alone are already costing over $1,000 million a year.

78. While it is too early to come to any definitive conclusion, it looks as if it may be necessary to reconsider the pattern of investment envisaged for the Fourth Plan in the light of the balance of payments situation. The continuing prospect of acute foreign exchange shortage underlines the importance for planning purposes of using prices for capital and foreign exchange which reflect their true scarcities. It is equally important that every effort should be made, in planning investments, to find "minimum cost solutions" for expanding production. An appreciable amount of capital and foreign exchange has been misdirected in the past as a result of bad planning - for example, in the development of iron ore and certain sections of the heavy engineering industry. Many other countries waste capital too, but India can afford to do so less than most.

79. Two other conclusions can be drawn from a cursory examination of the balance of payments outlook. The first is that an increase in foreign equity investment is badly needed to assist in financing the further expansion of Indian industry. The second is that everything possible should be done to improve the terms of aid extended to India by members of the consortium. Otherwise it looks as if external debt service during the Fourth Plan will absorb at least one fifth of the country's total foreign exchange receipts on current account, and probably more, depending on how fast exports grow.

Exports

80. An excellent review of exports is given in Part III of the Indian sub-mission. The Government has done a lot in recent years to make Indian industry more export-conscious and it has taken a number of useful steps to promote exports. The benefits of these measures will be felt only gradually. Meanwhile, it is evident that export markets generally are insufficiently attractive by comparison with the home market, and costs and prices of many actual and potential Indian exports are uncompetitive. Various subsidies and incentive schemes have been introduced to deal with this situation.
31. Iron ore exports were originally intended to contribute one third of the total expansion of India's export earnings during the Third Plan. This was without Goa. Now, even including Goa, their contribution is likely to be much less. In fact, export receipts from iron ore have risen very little during the past two years, and the prospect of a major increase during the current year has been disappointed by the unforeseen technical delays encountered at the port of Vishakapatnam. Unless drastic changes are made in the arrangements for developing iron ore exports (see paragraphs 16-17 above), India appears to be in serious danger of losing her chance of establishing herself as a major world supplier. Other countries such as Australia and Malaysia are also building up facilities to serve the Japanese steel industry, which is the most promising outlet for India's exports, and a buyer's market is rapidly emerging. India is handicapped in competing in the Western European market for iron ore by the long sea haul and the heavy incidence of Suez Canal dues.

82. The growth of India's total exports during the past two years has been encouraging. The trend is illustrated in the table on page 102 of the Indian submission which is based on the trade figures. To some extent the buoyancy of exports in 1963/64 may be explained by temporary factors, affecting particularly jute and sugar, and the forecasts for the next two years are quite possibly on the optimistic side. But there are also other factors not yet reflected in the figures which may work to India's advantage in the longer run. For example, a mission from the jute industry which recently visited Eastern Europe was very favourably impressed by the possibilities for expanding consumption of jute goods in this region.

83. An official committee has investigated the problems involved in increasing India's tourist earnings and has put forward a number of recommendations, a few of which have already been acted upon. The expansion of the Indian Airlines Corporation's fleet by the purchase of three Caravelles will do something to improve facilities for internal transport; the new aircraft came into service at the beginning of February. Hotel accommodation is still the main bottleneck, but a few new hotels have been opened recently, and others are planned. Work is even being resumed again on the international hotel started some years ago in New Delhi, and the hope is that it will be ready for occupation early in 1965.

Immediate Import Requirements

84. Unless production in agriculture and industry can be stepped up quickly, plans for mobilising larger domestic resources for investment during the Fourth Plan have little prospect of success. It is essential that larger outputs

1/ The payments figures reproduced on page 20 of this memorandum give a rather misleading impression of export trends in 1962/63 and 1963/64 because there was an unusual hump in export shipments towards the end of 1962/63, after the hold-up caused by the Chinese invasion, and this was not reflected in receipts until the following year.
should be secured from the capital already invested in these sectors. Now that supplies of power and transport are more freely available, larger imports of fertilizers, industrial materials, components and balancing items of equipment would be of the greatest value to the economy. It is not possible to say exactly what the requirements of this or that item are. But there is no doubt at all that production is being held back for lack of maintenance imports, including particularly chemical fertilizers, many types of steel, non-ferrous metals and miscellaneous chemicals. Many of the inefficiencies created by existing licensing controls could be reduced, if not entirely eliminated, if imports of these things could be more easily obtained. Larger steel imports would also make it easier for the Government to relax controls over prices and distribution by reducing the risks of excessive price increases.

External Assistance

85. The position with regard to commitments (or pledges) and disbursements of foreign aid, as estimated in the Indian submission, is summarised in the table on the following page. As this table shows, aid of just under $5,000 million has been promised to India from all sources for financing the Third Plan, including a carry-over of about $800 million from commitments made during the Second Plan. Not far short of $3,000 of this will still remain to be disbursed at the end of March, but practically the whole of this undisbursed amount will have been committed to specific projects and programs. Nearly $750 million of the aid pledged or committed to date is expected to be carried over into the Fourth Plan. Whereas the proportion of consortium aid assumed to be committed over one tenth, the corresponding proportion for non-consortium aid is nearly one third (line 12 as a proportion of line 3). This reflects the comparatively slow disbursement of credits from Eastern Europe which are mostly tied to industrial projects with long gestation periods.

86. Against the aid so far pledged or committed from all sources, the Indian Government is assuming that disbursements during the Third Plan will amount to $4,252 million. It estimates that an additional $571 million might be disbursed within the Plan period from aid to be pledged during the next two years. Even then, total aid disbursements during the Third Plan at $5,869 million would be lower than the aid requirement as originally stated, which was $5,460 million. However, the rate of disbursement would be rising rapidly towards the end of the Plan, largely because of the bunching of deliveries of equipment for aid-financed projects. The Indian estimates also provide for the repayment of $200 million to the International Monetary Fund during the last two years of the Plan. The drawings made by India from the Fund in the first two years of the Plan ($147 million net) helped to bridge over the gap between the commitment and disbursement of consortium aid.

1/ It is indicated in the introduction to Part I of the Indian submission that at the end of last September agreements had still to be signed in respect of more than $1,000 million of the aid pledged by the consortium at previous meetings. It is likely that all but a small part of this amount will be covered by agreements or will be under negotiation by the end of March 1964. 2/ This was after allowing for private foreign investment which was assumed by the Indian Government to contribute $300 million during the Plan.
<table>
<thead>
<tr>
<th>Description</th>
<th>Consortium</th>
<th>Non-Consortium</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Carry-over to Third Plan of aid pledged during Second Plan</td>
<td>560</td>
<td>(265)</td>
<td>(825)</td>
</tr>
<tr>
<td>2. Third Plan pledges to date</td>
<td>3,417</td>
<td>(750)</td>
<td>(4,167)</td>
</tr>
<tr>
<td>3. Total aid available so far of which:</td>
<td>3,977</td>
<td>1,015</td>
<td>4,992</td>
</tr>
<tr>
<td>4. Disbursed in 1961/62</td>
<td>122</td>
<td>95</td>
<td>517</td>
</tr>
<tr>
<td>5. Disbursed in 1962/63</td>
<td>573</td>
<td>101</td>
<td>674</td>
</tr>
<tr>
<td>6. Disbursed in 1963/64 (estimate)</td>
<td>766</td>
<td>151</td>
<td>918</td>
</tr>
<tr>
<td>7. Total disbursements in first three years of Third Plan</td>
<td>1,761</td>
<td>317</td>
<td>2,078</td>
</tr>
<tr>
<td>8. Still to be disbursed after March 31, 1964 (3 - 7)</td>
<td>2,216</td>
<td>568</td>
<td>2,784</td>
</tr>
<tr>
<td>9. Expected disbursements in 1964/65</td>
<td>891</td>
<td>172</td>
<td>1,063</td>
</tr>
<tr>
<td>10. Expected disbursements in 1965/66</td>
<td>906</td>
<td>175</td>
<td>1,082</td>
</tr>
<tr>
<td>11. Total expected disbursements in Third Plan of aid listed above</td>
<td>3,558</td>
<td>691</td>
<td>4,249</td>
</tr>
<tr>
<td>12. Assumed carry-over to Fourth Plan of aid listed above</td>
<td>149</td>
<td>381</td>
<td>530</td>
</tr>
</tbody>
</table>

Source: Government of India, Ministry of Finance

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*The table relates only to aid pledged up to the end of December 1963. Aid under PL 480 is excluded.

b/ Non-consortium aid is taken here to include all loans from the Soviet Union, Czechoslovakia, Poland, Yugoslavia, Switzerland and Denmark; grants from Australia, New Zealand, Norway and the United Kingdom under the Colombo Plan; grants from Germany, the Ford Foundation and the Rockefeller Foundation; wheat grants from Canada; assistance from the United States and Japan for the mining of iron ore in Orissa; loans for Air India International from private banks in the United States; and grants extended by the U.S. Government prior to the formation of the consortium. The amounts of aid pledged or committed by countries which are not members of the consortium are as follows (in million dollars): Soviet Union 648, Czechoslovakia 99, Poland 60, Yugoslavia 60, Switzerland 32, Australia 8, Denmark 2, Norway 2 and New Zealand 2. The breakdown of non-consortium aid between lines 1 and 2 is uncertain.*
87. If the consortium continues to pledge aid to India during the next two years at approximately the same level as during the last three, the carry-over of aid from the Third to the Fourth Plans will probably be over $2,300 million or nearly three times the carry-over from the Second Plan to the Third. This would not necessarily be an abnormal amount to have in the "pipeline" in relation to a steady flow of aid commitments averaging about $1,250 million a year, which is approximately the rate at which aid has been committed during the past few years (including aid from outside the consortium). The relationship between the pipeline and the rate of commitment depends, of course, on the average period of disbursement. Generally speaking, the larger the proportion of project aid to the total, the longer the period of disbursement and the larger the amount of aid in the pipeline at any given time. A pipeline of $2,300 million related to level annual commitments of $1,250 million would imply that on average aid was being disbursed over a period of between 4 and 5 years from the time of commitment (assuming for purposes of illustration that disbursements start in the year of commitment, and that the amount disbursed in each year is the same).

V. CONCLUSIONS

88. India needs all the aid she can get, and on the easiest possible terms, if she is to succeed in carrying on with the development of her economy along the course charted in the Second and Third Plans. The policies which the Government has followed so far have not proved adequate to produce the results expected from the foreign capital invested. A new approach must be adopted if the great talents of the Indian people are to be effectively deployed in a single-minded drive to increase production.

89. The starting point has to be an all-out effort to raise agricultural production and to capture a larger proportion of the additional income generated in the agricultural sector for reinvestment in industry. Simultaneously, both agricultural and industrial development must be geared more closely to the promotion of exports. And the growth of population must be checked somehow.

90. A consideration of the policy action required to achieve this redirection of effort, while economising as much as possible in the use of capital and foreign exchange, should be a major preoccupation of the planning authorities in working out the Fourth Plan. Difficult choices will have to be made if aggregate domestic savings are to be raised progressively to the point where they match the investment needed to reach and maintain a satisfactory rate of economic growth.

91. During the present period of adjustment, the most valuable form of aid which India can receive is aid which can be used quickly to finance additional imports of materials and components for agriculture and industry. The amount of such aid requested in the Indian submission for 1964/65 is about $560 million, but this should not necessarily be regarded as an upper limit. The more aid that is available in this form, the easier it will be for the Government to liberalise maintenance imports and relax controls over internal prices and distribution, particularly in the case of steel.
92. Project aid will be needed during the coming year to enable a start to be made on a number of new power schemes, including improved facilities for transmission and distribution, to provide continuing support for such programs as railways and telecommunications and to finance selected projects for industrial expansion. None of the major Fourth Plan steel expansion schemes will be ready for the placing of orders until 1965/66 - except for additional blast furnaces at Durgapur and Bhilai, on which work could be started in 1961/62. Efforts should be made to see whether any new and well-planned fertiliser projects can be got ready in 1961/62; if so, they may be particularly deserving of consortium support.

93. An assessment of India's aid requirements for the coming year makes sense only as part of a continuous exercise in cooperation between India and the members of the consortium. India's population in three years' time will pass the 500 million mark - an increase of 160 million during the twenty years that will have elapsed since Independence. The fact that, in spite of this increase, the Government has succeeded in bringing about a significant improvement in average living standards without sacrifice of essential political freedoms is perhaps more remarkable than all the shortcomings to which attention has been drawn in this memorandum.

94. India must be given time to reassess her problems and policies and to effect the improvements in the planning and execution of economic development without which no amount of external aid can see the country through. As the Indian submission to the consortium points out, "it is now necessary to conceive of further development in terms of an efficient and economic choice between a number of complicated alternatives", and this choice can only be made "after the most careful consideration of the costs and benefits of different alternatives". If this approach is adopted, there will be every justification for continued support from the consortium at the levels established in recent years.
The Honorable
Morarji R. Desai
Minister of Finance
Government of India
New Delhi, India

Dear Mr. Minister:

Following the meeting of the Indian consortium in Paris on June 4/5, 1963, I am writing to you about some of the points that were raised during the discussion of aid pledges for 1963/64.

As you know, the pledges made at the Paris meeting came to a total of about $915 million, and I am hopeful that this can be raised to at least $1,000 million when the meeting is resumed in Washington next month. This would be a much larger figure than could have been expected on the basis of the original assessment of India's foreign exchange requirements for the Third Plan. The members of the consortium recognised the heavy additional strain imposed on the Indian economy as a result of the national emergency, and there has been general admiration for the courageous action which you took in the Budget to mobilise additional resources for defence and development. Consequently, your Government's statement of aid requirements for 1963/64 was on the whole sympathetically received. Nevertheless, there was also evident concern about the disappointing progress made by the Indian economy during the first two years of the Plan, and several members of the consortium indicated that they would have considerable difficulty in maintaining aid next year and the year after at this year's level.

I would like to draw your attention particularly to paragraph 5 of the report of proceedings of the earlier consortium meeting held in Washington on April 30-May 1. As the report stated,

"there was general agreement that, in the interests of economic development, more energetic efforts should be made to expand foreign exchange earnings and to create a more favourable environment for export promotion. Great importance was also attached by members of the consortium to measures that would encourage private foreign investment in India, to the relaxation of controls over industry, which would help to lighten the load on the administration, and to appropriate pricing policies. The meeting welcomed the statement of the Indian representative that his Government accepted the need for industry to enjoy greater freedom from detailed controls. Other matters on which
the meeting laid stress were the desirability of a gradual increase in interest rates and the importance of not pressing considerations of balanced regional development to the point where they impeded the efficiency of industry. Concern was expressed at the heavy burden of external debt service on India's balance of payments. Action to curb the growth of population in India was acknowledged to be an indispensable condition of satisfactory economic progress."

These were the unanimous views of the ten countries represented at the meeting, and I am in full agreement with them.

It was pointed out at the Paris meeting that, when the consortium first considered the Third Plan, total requirements of external assistance for the five years, including non-consortium aid and private foreign investment, were placed at $5,650 million (Rs. 2,600 crores), of which it was suggested that $4,100 million might be provided through the consortium. Against this, the consortium has already pledged $3,200 million (i.e., about 75 per cent) in the first three years. Yet in spite of the fact that aid pledges from the consortium have exceeded what was originally contemplated, the growth of the economy has fallen far short of Plan expectations, and there is no sign that India's dependence on external support is being reduced.

A further cause of concern for the future arises from the fact that the consortium does not have any clear idea of your Government's programs and policies for the continued development of the economy during the next three years and into the Fourth Plan. A year ago my predecessor, Mr. Black, wrote to you suggesting the need for a thorough-going reappraisal of the investment program as a basis for reassessing the balance of payments for the next few years. Without such a reassessment, there is no way in which the consortium can arrive at a reliable judgement on the amount of additional aid that will be required in the coming years or on the uses to which such aid can be best applied.

I realize that the task of economic planning in India has been greatly complicated by the national emergency, but I think it is essential that, before the consortium meets to consider aid requirements for the last two years of the Third Plan, your Government should provide some sort of outline plan for the development of the economy over the next four or five years - that is, well into the period of the Fourth Plan. This should include a review of economic policy and indicate the steps being taken to improve the organization for the implementation of development programs sector by sector.

The need for continuous forward planning, as distinct from planning at five-year intervals, seems to me all the more urgent in India because much of the aid extended by the consortium, as well as most of the aid from non-consortium sources, is tied to specific investment programs and projects. As
you know, the consortium has laid particular stress this year on the need for non-project assistance, but it is clear that many members of the consortium, including the Bank and IDA, must continue to relate a large part of their aid to projects - and as most of the projects in the Third Plan have now been committed, it is becoming increasingly difficult to find new projects suitable for external financing. This problem will be even more acute next year unless the present system of five-year planning in India is considerably modified, and unless many of the programs and projects due for completion during the period of the Fourth Plan are prepared (and approved by the Planning Commission) well in advance of the time when the Plan is due to start.

When the consortium resumes its meeting in July to consider aid pledges for the current year, it will also discuss the timing of the next round of meetings. In principle, I think we should aim for December 1963/January 1964 or January/February 1964, so that the pledges for 1964/65 can be indicated before the beginning of your next financial year. However, in view of the attitude taken by a number of delegates in Paris, I doubt whether such an early meeting would be fruitful unless your Government is able by then to provide a much clearer indication than we have at present of your plans for the future growth of the economy and of the implications of these plans for the balance of payments. I should be grateful therefore if you could let me have your reactions to this letter before the July meeting, which will probably be held about the middle of the month.

I very much look forward to seeing you here in Washington for the Annual Meeting at the end of September.

Sincerely yours,

(signed) George D. Woods
Dear Mr. Woods,

Thank you very much for your letter of June 20, 1963. First of all, I would like to express my appreciation and gratitude to you and to the officers of the Bank for all that you have done to make the meetings of the India Consortium a success. I would further assure you that, as L.K. Jha said at the consortium meeting in Washington, we shall give full consideration to the suggestions made in the excellent Economic Report of the Peter Wright Mission, and to the views expressed at the consortium meeting to which you have referred.

2. We ourselves have been concerned for some time about the low rate of growth during the first two years of the Third Plan. In general, the increase in industrial production has not been unsatisfactory and the poor performance of the economy is mainly due to the absence of any significant increase in agricultural production. While this has something to do with weather conditions, we are well aware that a great deal has to be done, and done quickly, on the agricultural front. Just at the moment, I feel that there is need also to provide a stimulus to industrial activity in the private sector. While I think it would be a mistake to read too much meaning into the figures of national income for the last two years, there cannot be any difference of opinion regarding the essential point that the performance of the economy needs to be improved.

3. I do not, however, at this stage, wish to dwell on the steps we are taking, or the particular points raised in the Washington meeting of the consortium to which you have drawn my attention. We are, at present, engaged on the mid-term assessment of the Third Five-Year Plan and also taking this opportunity to review our policies and procedures. The acceptance by the leading members of the consortium of our plea, which has also had the full support of the Bank, that credits should not be tied to projects, should be of great help. I shall be writing to you further on the subject at a somewhat later stage and shall anyhow take the opportunity of a personal discussion with you when I go to Washington for the annual meeting of the Bank.

4. Meanwhile, I feel I should immediately let you know that we agree with the main points which you have made about what needs to be done before the consortium meets again. We fully share your view that planning is and must be a continuous process. The Plan which we formulate every five years covers a multitude of things, education, health, social services, problems of resource mobilisation and the allocation of resources and responsibilities between the Centre and the States. At the same time, we recognise the importance of continuous forward planning in certain spheres where, having regard to the long period of gestation, it is always desirable to be looking...
well ahead into the future. In fact, for quite some time now, we have been engaged in forward planning of power, transport, steel and certain other basic facilities and industries and a good deal of preliminary but detailed work has already been done. You may be aware that we have been discussing with the Bank some power projects to be financed out of the current year's Bank/IDA programme which are really intended to augment power supply in the early years of the Fourth Plan. It is indeed our hope that project assistance to be committed during the next two years would relate essentially to what might be called Fourth Plan projects.

5. We were somewhat unhappy about the reference during the recent consortium meetings to the original estimates of the requirements of external assistance during the Third Plan period and the suggestion that only a modest balance remains to be assured in relation to these estimates. Quite clearly, if advance preparation for the Fourth Plan is to take place on an adequate scale and if there is to be no break in the continuity of development, we must seek, from now on, assistance which would be carried over into the Fourth Plan, and the quantum of such assistance would have to be larger than what was available as a carry-over when the Third Plan began. This is particularly necessary, because most countries allocate funds not on the basis of disbursements, but on the basis of commitments.

6. I entirely agree with you about the timing of the next round of consortium meetings. They should be well ahead of the beginning of our next fiscal year in April 1964, and I would assure you that we would be ready to present the kind of data that you have asked for. I think our primary concern during the next round of consortium meetings, apart from covering the immediate requirements of non-project assistance, should be to seek commitments for fresh development in the basic sectors to which I have referred earlier, with the full knowledge that they would be completed after the Third Plan is over.

7. I hope that the July meeting would produce the results which you and your associates are working for. I am looking forward to seeing you and Mrs. Woods in your new home in Washington at the time of the annual meeting.

With kindest regards and best wishes,

Yours sincerely,

(signed) Morarji Desai

Mr. George D. Woods
President
International Bank for Reconstruction and Development
WASHINGTON 25 D.C. (U.S.A.)