India and the World Bank

By Jochen Kraske

I. Introduction

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

The relationship between India and the Bank was not without tension or without ups and downs. There were fundamental differences from the outset. India's attitude towards the Bank was shaped by its colonial experience. At the time of independence, India's new leaders were determined to avoid what they saw as a principal source of exploitation and economic backwardness: the persistent trade surplus which financed a steady transfer of capital out of India. As a result, they rejected export orientation and free trade as suitable strategies to foster the diversification and expansion of production. More generally, they felt the classical capitalist model was unsuitable for developing countries. Instead, India's leaders visualized an activist socialist state that would reform oppressive agrarian relations and help India industrialise rapidly within the framework of a planned economy. As they judged the global economic conditions which led to World War II, capitalism appeared to have failed. Instead, India's Prime Minister Jawaharlal Nehru was greatly impressed by the industrial progress he believed the Soviet Union had achieved through central planning and massive public sector investment, especially in heavy industry. Although the bulk of India's trade and financial dealings were with the

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west, there was instinctive sympathy among much of the political class and press for the Soviet Union, which was identified with anti-colonialism and socialism. With the outbreak of the cold war, therefore, India refused to take sides, chose to remain non-aligned and indeed sponsored and led an alliance among similarly minded former colonial countries.

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

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

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2 Statement by C.D. Deshmukh in the Third Session of the Second Annual Meeting of the Board of Governors in London on September 15, 1947
As a result, the Bank assumed an importance in the public perception which was out of proportion to reality.

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

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

II. Evolution of Relations between India and the World Bank

There were, broadly speaking, five phases in the relationship between India and the Bank. The first started with the creation of the Bretton Woods institutions and the modest expectations India initially associated with them. There followed a period of limited interaction and getting acquainted slowly, after India’s independence. The Bank and other outside observers were impressed with the way India’s leaders approached economic development. Economic planning and a strong leadership role for the government were regarded as essential prerequisites for successful economic development, by the Bank as well as by India. The focus on infrastructure and basic

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3 The responsible official in the India Office reacted to the invitation to attend the Bretton Woods Conference “India’s attitude to proposals of this kind [a United Nations bank for reconstruction and development] is likely to be one of general sympathy with the international approach, offset by suspicion of any concrete proposals, particularly from the point of view of their effect upon India’s political and economic autonomy.” He correctly anticipated Indian sentiments when he complained about the proposal “There is an altogether excessive regard for the susceptibilities of private investors and an almost complete absence of regard for the need to plan on a broad basis. The fact that the controlling power is bound to be vested almost entirely in a few powerful countries will strengthen India’s suspicions.” Letter by K. Anderson, India Office, addressed to E. Rowe-Dutton, Treasury, dated February 23, 1944
industries in the investment strategy seemed appropriate. The Government's conservative fiscal and monetary policy was praised by Bank economists: "few countries can match India's record in monetary policy." The Bank's President Eugene Black on the conclusion of his first visit to India, said the First Five Year Plan was "well thought out" and "well within the capacity of the country." He declared he was ready to recommend that the Bank "make a further substantial investment in India." In an address to the University of Minnesota he praised India's policy of using export taxes to stabilize jute, burlap and cotton prices and concluded: "This adjustment to an inflationary situation is evidence of maturity in economic thinking - greater maturity than has been shown in many countries with far more experience in managing their own fiscal affairs."

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

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

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4 IBRD: The Five Year Plan of India and India's Creditworthiness, R-564, dated February 19, 1952, p. 25
5 Statement by Eugene R. Black at a press conference in Bombay on February 22, 1952
6 Eugene R. Black: Address to the National Conference on Savings, Inflation and Economic Progress, Minneapolis, May 15, 1952. The Indian Executive Director, B.K. Nehru, confessed that he was "considerably flattered" by this reference to the economic sophistication of his government.
Memorandum from B.K. Nehru to Leonard B. Rist, then the head of the Bank's economic department, dated May 14, 1952
overcome, and that India, graduating from the need for external assistance, would soon be able to extend advice and help to others.

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

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

Till then, the Government did not try to mobilize and coordinate external assistance. Whatever program existed was focused on the financing of individual projects. Once the seriousness of the situation became apparent, a more concerted effort to raise long-term external finance looked essential. According to B.K. Nehru, who was put in charge of the fund-raising operation, “it was decided that this...should not be handled through diplomatic channels in order to avoid any political flavor being brought into it but should be regarded as a simple banking operation.” The Government then asked the World Bank to organize additional financial support. The U.S., anxious to internationalize its large aid effort in India, actively supported a gathering of aid donors.

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7 Memorandum from E.P. Wright to Files: India - Balance of Payments, March 20, 1957
8 Letter from Antonin Basch to Eugene R. Black dated October 30, 1957
Black agreed, and convened the first meeting of what later became known as the Aid India Consortium, on August 25, 1958. At this meeting, the donors managed to cover a short-term gap of $350 million. The meeting not only established a precedent for concerted action by the countries and institutions friendly disposed towards India, it also pioneered the concept of formal aid coordination, which became common practice in the 1960s and beyond and became a precedent applied to an increasing number of needy countries.

The U.S. played a key role in this initial effort. A conference in the spring of 1959 by an unofficial American group, the Committee for International Growth, popularized India’s need for assistance. The speakers included not only liberals like Senator Hubert Humphrey and Ambassador Chester Bowles, moderates like Senator John F. Kennedy, but also Vice-President Nixon, who proclaimed that “it was the task of the United States and other more fortunately placed countries to give massive aid for Indian economic development.” The conference managed to bring together humanitarian concerns about India’s poor, concerns about the survival of India’s democracy, and concern about the threat of Russian influence and expanding communism in the world’s largest non-communist country. The conference succeeded in generating much additional support for India. Earlier, in 1958, Senators Kennedy and Cooper had sponsored a resolution in the U.S. Senate suggesting an international mission of experts to promote joint action in support of India’s development plans. In response to this resolution, Black organized a mission to India by Hermann Abs, Chairman of Deutsche Bank, Sir Oliver Franks, Chairman of Lloyd’s Bank, and Allan Sproul, former Chairman of the Federal Reserve Bank of New York. Black was guided “by the conviction that visits by prominent members of the business and financial communities of the industrially developed countries would help to achieve a wider understanding of the problems confronting the less developed areas of the world.” The “Wise Men,” as the three were commonly referred to, submitted a report which I.G. Patel has characterized as “one of the most heartwarming documents in the annals of international relations.” It endorsed the Third Five-Year Plan and recommended a substantial increase in external assistance. As a result, the members of the Aid India Consortium pledged over $2 billion in 1960 for the first two years of the Third Five-Year Plan and assured continuing support for the rest of the Plan period.

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

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

India was also affected by the change in the views of its supporters. In the early years, the Government had turned to the Bank and to the bilateral donors with self-confidence and in the spirit of offering an opportunity to share in a globally important undertaking. This had now changed. India had become dependent on the support of its

friends not only to realize its dreams for the future but to survive and feed its growing population. This hurt India's pride and self-confidence. Suspicions about foreign interference were enhanced, and any comment on the Government's actions was perceived as a threat to national sovereignty. The sense of insecurity and of beleaguerment was compounded by the military debacle in the encounter with China in 1962 and by the death of Prime Minister Nehru in 1964. The concluding paragraph in a column of the Economic Weekly entitled "Aid and Advice" characterized the mindset at the time:

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

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

The idea that changes in economic policies, if not in development strategy, were necessary to achieve greater efficiency and higher growth now became a central issue. The Bank's department head responsible for India wrote in November 1963: "I am.... convinced that the Bank must use its best efforts to persuade the Indian Government to take a fresh and honest look at policy. I hope the slowdown in the rate of economic

\(^{15}\) Aid and Advice. The Economic Weekly, April 4, 1964, p. 631

\(^{16}\) Letter from George D. Woods to Morarji Desai, dated June 20, 1963

\(^{17}\) Letter from Morarji Desai to George D. Woods, dated July 1, 1963
advance in India and in particular the failure of Indian agricultural policy will mean that India will be more open to persuasion than it usually is. Because of our leadership in the consortium, the size of our lending program in India, and our special relations with the Indian Government, we have certain persuasive forces at our disposal.\textsuperscript{18}

The Bank's operational managers, on the other hand, while noting that India's economic performance was far from satisfactory, were not certain what the reasons for this poor performance were. "In analysing the causes of the recent slow rate of growth, it is particularly difficult to distinguish between such impermanent factors as the weather, the crisis in political leadership and the Chinese attack on the one hand and the more lasting socio-economic obstacles to development on the other."\textsuperscript{19} This sense of uncertainty was attributed to the lack of reliable basic information about the Indian economy. The committee of the Bank's senior economists concluded that "a comprehensive study of the Indian economy was essential to identify the major obstacles to growth, to suggest the lines along which the major problems could be approached, to arrive at a general judgment regarding the economic future of India and, in this context, to appraise the Fourth Five-Year Plan."\textsuperscript{20}

For this purpose, the Bank mounted a large economic mission in the fall of 1964 which was headed by Bernard Bell, a seasoned professional and highly regarded economic consultant. The Bank's attempt to scrutinize India's economic performance was warmly welcomed by the members of the Consortium. The U.S. as the provider of the largest amount of assistance, especially of vital food aid, was particularly concerned about the Indian Government's economic strategy and, with the active involvement of President Johnson, pressed for changes in agricultural policies.\textsuperscript{21} The comprehensive report of the mission turned out to be critical of the Government's policies. Bell admitted that, since the report was written for the President of the Bank, "no pains have been taken to express judgments in the form which would be least bruising and most persuasive to those its actions it criticizes and whose ideas it hopes ultimately will change." As Bell wrote, the report was meant to be critical: "Our mandate was not to record successes but to seek opportunities for greater success. Less euphemistically, our task was to find and to

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\textsuperscript{18} Letter from Escott Reid to Benjamin B. King, dated November 20, 1963

\textsuperscript{19} Memorandum from Department of Operations, South Asia & Middle East, to the Staff Loan Committee: Bank Policies toward India, dated April 28, 1964

\textsuperscript{20} Minutes of the Meeting of Economic Advisors: The Economic Problems of India, dated April 27, 1964

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understand the failures, the deficiencies, and the obstacles to more rapid progress in order
that they might be overcome, that the achievements might be greater, and that progress
might be accelerated. The statement concentrates on these and, therefore, will probably
seem to be an unremittingly critical catalogue of failure.”

The report was undoctrinaire and matter-of-fact. It started from the principal
premises on which the Government’s strategy was based, such as the heavy reliance on
import substitution and the extended role of the public sector. But it exposed the
consequences of this strategic approach, the neglect of exports and pervasive inefficiency.
The highly regulated control regime that governed trade and investment, and the
drawbacks of the command planning system were the focus of the mission’s criticism.
Accordingly, the thrust of the mission’s recommendations was in the direction of
liberalization, relaxation of controls, and greater reliance on market forces in the
allocative process. Heading the list of specific measures suggested by the mission was a
call for a devaluation of the rupee. The report also appealed to the aid donors to increase
the level of assistance for the Fourth Plan, especially the level of non-project assistance to
permit the increase in imports needed to achieve full use of installed capacities. These
recommendations were the logical counterpart to the recommendations addressed to the
Government of India: greater liberalization, especially relaxation of the strict import
controls, would at least initially lead to increased foreign exchange requirements which
had to be met by increased availability of readily usable external assistance.

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

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

New Delhi 1993, pp. 134 ff.; also John P. Lewis: India’s Political Economy, (Oxford University

24 Interview with I.G. Patel, March 8, 1997
The Bell report thus recommended what seemed fairly obvious modifications of policies and procedures which had proven to be a drag on the economy. It also appears that the sweep of reforms recommended was fairly modest and in line with the thinking of a significant segment, if not a majority, of Indian officials and planners. Yet, the report and its recommendations became highly contentious. The negotiations which it triggered became confrontational and charged with polemical argument. The episode proved a watershed in the relationship between India and the Bank.

There are a number of reasons why this intervention by the Bank, directed personally by its President, caused estrangement. The sense of vulnerability prevailing in India at the time tended to exaggerate sensitivities about outside interference. This fired up the traditional opponents of the Bank, but it also alarmed more conservative political leaders intent on their alignment with popular sentiments. Politicians generally were less inclined to probe the origins of some of India’s economic problems and the rationale for policy reforms. Some politicians and the private business interests associated with them may well have derived patronage and rents from the established control regime which they were unwilling to lose. Thus, the only argument that attracted the attention of politicians was the basic but rather simplistic proposition that economic reforms were needed to persuade the Bank to provide the support the country needed. Government officials, even those who understood the need for reform, tended to reinforce this sentiment, if not in their briefings then in their sarcastic remarks.25

The most prominent recommendation of the Bell mission was its call for a significant devaluation. This measure was expected to promote exports and facilitate a relaxation of the stringent import controls; it was also an obvious test of the Government’s openness to policy change. But discussion of a change in the par value of the rupee tended to incite the emotions further. In the days of fixed exchange rates, such an adjustment implied a formal admission of failure and a loss of face. Moreover, nationalistic sentiments were associated with the exchange rate, especially in India, where the value of the Indian rupee was always seen in relation to the par value of the Pakistani rupee. For these reasons, the suggestion to devalue was bound to be highly unpopular and politically controversial. In fact, the 1966 devaluation was widely seen as the main reason for the reverses suffered by the Congress party in the elections in early 1967.

25 L. K. Jha, when asked about the reasons for the devaluation laughed merrily: “Oh, that was what George Woods told us we had to do to get aid.” As quoted by John P. Lewis: India’s Political Economy, (Oxford University Press) New Delhi 1995, p. 136
Having accepted the need for reform, the credibility of the reformers in the Government was linked to the arrival of the promised assistance. The Bank’s economists and Government officials reviewed India’s foreign exchange needs and concluded that $900 million of non-project assistance would be required to support the liberalized import regime. The implication was that this amount of assistance would be sustained over several years.

In June 1966, the Government’s decision to devalue triggered action to mobilize the additional external assistance. But moving the members of the Consortium to come up with the necessary commitments required a protracted effort of pressure and persuasion. It was only in November 1966 that the $900 million package for the first year could be regarded as committed. The difficulties encountered in that first year provided a foretaste of what was to follow: further delays and significant shortfalls from the targets endorsed by the Bank, which themselves had been scaled back from the original $900 million to $750 million. Although Indian Government officials understood that the Bank and bilateral Consortium members could make commitments only one year at a time and that aid flows were necessarily subject to the vagaries of IDA replenishments and of the budgetary process in the donor governments, they regarded the shortfall of aid commitments from the expected level as an act of betrayal. The policy reform measures, in particular the devaluation, had been implemented at considerable political cost. The need for reform had been explained to the political decision-makers in terms which linked them to the essential flow of foreign assistance. The credibility of these officials, not to mention the workability of the liberalized import regime, were now jeopardized. The World Bank and President Woods in particular were blamed for this disappointment. Where earlier the Bank had been regarded as a friend and trusted partner, it now appeared as the purveyor of prescriptions which failed to take account of the country’s circumstances.

The disappointment was compounded by the apparent ineffectiveness of the devaluation. The impact of a second severe drought on the economy overwhelmed whatever stimulating effect should have been expected from the liberalization. Nor was the extent of the reforms introduced significant enough to have brought about a major transformation of the economy. The underlying system of directives and controls had been marginally relaxed, but was basically intact. The amount of the devaluation itself, mitigated by tariff surcharges on traditional exports, was not sufficient to bring about the necessary structural shift in production. As soon as there were indications of unexpected problems, the controls were quickly tightened, moving S. Boothalingam, the Economic Secretary at the time, to observe later that “the devaluation was not allowed to work.”

26 S. Boothalingam: Reflections of an Era, I.c., p. 144
The Indian Government emerged from this episode determined to lessen the country’s dependence on the World Bank and on the flow of foreign assistance. The often proclaimed objective of self-reliance was now pursued with greater vigour. The trade deficit was brought down sharply between 1968 and 1973. Foreign exchange reserves increased to almost twice their previous level in terms of coverage of months-of-imports. There is some evidence that public investment suffered as a result, which prompted the Bank to criticize the Government’s estimates of aid requirements as being too low. The Government’s declared objective to reduce the flow of net foreign assistance to zero at the end of the Fifth Five-Year Plan in 1978/79 would later cause President Robert McNamara to doubt “that India could be able to continue her development efforts at a reasonable pace without a positive transfer of foreign aid.” McNamara was understandably concerned about the impact the Government’s declaration might have on the decisions of IDA contributors.

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

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

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27 John P. Lewis: India’s Political Economy, l.c., p. 155
28 Memorandum from Jochen Kraske to Files: India-Mr. McNamara’s Meeting with Mr. M.G. Kaul, Secretary, Ministry of Finance, dated August 16, 1973
India's agricultural sector became the focus of the Bank's operational action. The relative neglect of the country's huge agricultural sector had been a matter of growing concern even before the calamitous series of bad monsoons in the 1960s. The Bell mission therefore had included a team of agricultural experts whose recommendations expedited the adoption of the new technology that produced the "green revolution." Their recommendations reinforced the work in this field by USAID and by the Rockefeller and Ford Foundations and found a receptive audience with C. Subramaniam, the Minister of Agriculture. Lending for major irrigation schemes, especially command area development, for agricultural credit supporting groundwater irrigation and agricultural mechanization, for seed propagation, grain storage, agricultural markets and rural electrification represented an expanding share of the Bank's activities in India, absorbing close to 40% of total commitments by the mid-1970s.

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

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

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

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

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

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

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

31 The World Bank under McNamara, Economic and Political Weekly, August 3, 1968, p. 1202
Phase four in the relationship between India and the Bank covered the period up to 1991. A gradual shift in the funding of the Bank’s assistance to India from concessional IDA credits to conventional Bank loans took place during this period. This signified a change in the nature of the relationship. The indulgence displayed by the Bank and the bilateral donors in the 1970s gave way to a more hard-nosed, business-like attitude.

Since the crisis of 1958, India had been regarded as only marginally creditworthy for loans from the Bank. Once IDA was created, the bulk of the Bank Group’s assistance was therefore provided through IDA on concessional terms. India received on average over half of the total IDA resources until the Executive Directors decided in 1968 that there should be a ceiling of 40% of total IDA funds on commitments to India, a limit which remained in effect until the People’s Republic of China asserted its claim to a share of IDA in the early 1980s and the crisis in Sub-Saharan Africa demanded a refocussing of IDA’s assistance. In line with the successful increases of total IDA resources throughout the 1970s, annual IDA commitments to India had increased from $184 million in 1969 to over SDR 1,535 million in 1980. From this peak, IDA commitments gradually declined to SDR 830 million in 1990.

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

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

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

Instead of turning to the Bank for advice and assistance with policy reform, the Government decided to turn to the IMF. In November 1981, the IMF approved an extended credit arrangement of SDR 5 billion in support of the Government’s program of structural adjustment with a view to achieving balance of payments viability. This was the largest IMF credit extended to any country up to that time. It gave a boost to India’s morale and standing to be able to access the resources of an institution which served developed as well as developing countries. While India was not in desperate need of the resources, its access to IMF funds was reassuring and encouraged the Government to proceed with further liberalization measures. The Government, however, was severely criticized by the opposition. Prominent left-wing economists prophesied a repetition of the 1966 debacle, that growth would suffer, poverty deepen and the country slide back into aid dependency. As it turned out, the economy grew rapidly, averaging 5.5% per year in the 1980s against 3.5% in the first three decades of independence. More important, poverty began to decline rapidly at the rate of roughly one percentage point a year. Far from sliding into dependency, India did not draw the full amount of the credit and repaid its obligations without difficulty.
This encouraged and improved the image of liberal thinkers in India who had begun to point out the shortcomings of the prevailing control regime and to advocate market-friendly policies. The example and the apparent success of China further suggested a rethinking of the economic strategy. But while academics, Government officials and even Indira Gandhi and later Rajiv Gandhi appeared convinced of the failure of the earlier approach to the management of the economy and the need for change, the necessary political support for dramatic reforms was judged not to be available.

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

Among the changes in India which had a bearing on the functioning of the Government and, in a wider sense, on the effectiveness of the Bank’s work was the growing influence of populist pressures. During the first three decades of independence, the Congress Party had a virtual monopoly on power. Although there was need for compromise to reconcile a diverse spectrum of views, a sense of political discipline usually prevailed. When the Congress Party lost its majority in a growing number of States and ultimately at the Federal level, competition among contending political parties greatly increased the temptation to disregard hard economic and financial realities. The most striking manifestation was the growing subsidies, which rose from the equivalent of 8.2% of GDP in 1977-78 to almost 15% by 1987-88. This had grave macroeconomic consequences. The growth of Government spending accelerated from 13% annually in the 1970s to almost 19% in the 1980s. The resulting deficits were funded by domestic and foreign borrowing, raising the level of debt service in the budget to alarming levels and quadrupling India’s foreign debt from $20 billion in 1980 to $80 billion in 1991. When the Gulf war raised the cost of oil imports and Indian investors overseas began to withdraw their deposits, India’s foreign exchange reserves evaporated rapidly and, in June 1991, covered barely a fortnight’s imports. The need for dramatic reform had become inevitable.

The Bank was at this point much more heavily exposed in India than during the crises of the 1950s and 1960s. Creditworthiness considerations called for a careful reassessment of the level of Bank lending and a link with credible stabilization and further structural reform. What was much more difficult for the Bank to address, however, was the insidious impact of the lack of financial discipline in the institutions which it supported. Agricultural credit institutions, State Electricity Boards, the railways, even the development banks, IDBI and ICICI, whose portfolios suffered as the result of politically imposed lending decisions, all were affected by the pervasive disregard of sound financial and economic standards. This represented a threat not to the Bank’s financial portfolio but to the effectiveness of its lending.

The fifth phase in the relationship between India and the Bank began in 1991 when the Government at last undertook the reforms needed to reduce Government spending, stimulate private investment, and open the economy to foreign competition. The impetus to these reforms was provided by the crisis which ruled out further procrastination and the politicians had to come to terms with the reality of an empty treasury. While the reforms took India in the direction the Bank had long advocated, the Bank had little to do with the decisions which were taken. Once the crisis struck, there was little controversy about the action that needed to be taken. The discussions among academics and Government officials throughout the 1980s had prepared the ground. The input by outsiders relying on the experience of other countries and, in particular, the analytical work of the Bank had contributed to this debate and helped clarify the issues.

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

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

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

III. The Bank in India

As a Lender

The Bank's lending to India has grown steadily and for the past 30 years India has remained the Bank Group's largest borrower. As of the end of June 1996, Bank/IDA commitments to India reached a cumulative total of over $47 billion in support of 373 individual operations. The Bank has been active in virtually all states and territories of India and in all major sectors of economic activity. It thus touched the lives of many of the people living in India. In the circumstances, it is natural to attribute a significant role to the Bank in India and to expect that it made a measurable contribution to the country's development. In fact, the Bank's financial contribution has been small in relation to the size of the economy. Bank Group disbursements averaged around 2.5% of gross domestic investment. The Bank's contribution to the financing of India's merchandise imports typically covered between 7 and 8% of the total. The amounts of commitments and disbursements therefore do not provide a telling measure of the significance of the Bank's contribution.
The importance of the Bank’s financial contribution was less a function of the total amounts it was lending, than of the context in which its assistance was provided. India’s chronic shortage of foreign exchange made the Bank’s assistance more valuable than the numbers alone would suggest. In times of acute crises, the funding of marginal imports could make a difference to the functioning of the economy. The implementation of projects benefitted from the availability of untied, freely usable foreign exchange funds. The fact that the provision of Bank resources could mitigate the constraints imposed by the control system often proved very beneficial. In general, development is about overcoming bottlenecks, about the return on investments, about improvement at the margin; and it is here that the Bank’s money made a real difference.

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

The Bank’s involvement was often resisted because state governments or project agencies felt that the Bank’s rules introduced intolerable complications into the normal rules of government administration. The Bank’s occasional insistence on special institutional arrangements or the recruitment of extra staff often seemed to make Bank assistance very costly. To entice states to accept the Bank’s involvement, the Ministry of Finance and the Planning Commission agreed that Bank resources would be “in addition” to the funds otherwise provided by the Center. This tended to strengthen the relationship between the Bank and the more aggressive and enterprising states, such as Maharashtra,

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33 Letter by K.C. Roy to Eugene R. Black dated October 6, 1949
which took advantage of the opportunity to gain access to additional resources. The trend towards more direct and independent contractual relations between foreign lenders, such as the World Bank, and state governments has since continued and moved some state governments to seek the Bank's financial and technical support in reshaping their budgets and investment programs.

Indian observers commonly attributed much influence to the Bank in the Government's economic and financial matters. The large volume of Bank lending and the Bank's leadership role in the Consortium suggested the presence of considerable leverage. Critics of the Bank did much to raise the profile of the Bank by pointing to the risks associated with outside influence. In fact, the Bank's influence was limited because the sanctions available to the Bank to enforce its views were limited. They were represented ultimately by the threat to suspend disbursements or to cancel a loan or credit, obviously undesirable options for an agency interested in the completion of the ventures it financed. Though covenants attached to the Bank’s lending were often violated, the Bank was reluctant and slow to use the means at its disposal to enforce its conditions. Indeed, it rarely did so before 1991.

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

It was well understood, in other words, that the powerful influence of the Bank on the Government of India was largely a myth.

As Mediator and Advocate
The aspect of the Bank's role in India most widely appreciated was its work as a mediator and advocate. One of the attractions for India in joining the Bank had been the

34 Sunday Indian Express, January 30, 1972
multinational, independent, technical character of the institution. Though many held to
the perception that the Bank was prejudiced in favor of particular economic solutions,
they accepted that the Bank was fair, consistent with the principles it enunciated and in
that sense a trustworthy arbiter in technical, financial and economic matters. This made
the Bank and its experience a reference point in many discussions; in particular, it
couraged India and Pakistan to turn to the Bank to assist in the division of the Indus
basin.

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

The Bank’s persistence and ingenuity eventually brought the difficult negotiations
to a successful conclusion - nine years after they started. The Bank was able to exploit
and strengthen the willingness of the parties to settle. The longer the negotiations lasted,
the more difficult it became for either side to break them off, and the more effective
became the Bank’s intermittent threats to walk away from the process. In the end, the
Bank’s ability to organize the financing of the works needed for dividing the waters
helped bring about the agreement.

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

While the Bank’s role as a mediator of conflicts was somewhat outside of its
usual line of business - and, incidentally, depended much on the personal reputation of

Eugene Black as an international figure - its role as a financial intermediary and advocate came naturally. So, when the foreign exchange crisis in 1958 called for a concerted effort to raise additional resources abroad, the Prime Minister decided to turn to the World Bank as India's international banker, thus avoiding any political flavor in the arrangement. President Black readily agreed to help and the Bank came to coordinate the support of Western donors, not only to overcome the acute crisis of 1958, but also to sustain the Government's development effort in general.

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

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

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

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

As a Policy Advisor

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

At least until 1991, India did not belong to the Bank’s borrowing member countries who were openly seeking the Bank’s advice. Politicians remained suspicious of anything that could be perceived as outside interference, and many government officials were confident that they did not need advice, which they regarded as unnecessary and inappropriate meddling. The Bank’s interlocutors therefore wanted to limit the dialogue with the Bank to project details. This practice was firmly established by B.K. Nehru who during the first ten years represented the Government in its dealings with the Bank. He

37 Times of India (New Delhi), January 8, 1966
"concentrated on getting as much money out of the Bank as possible with the least possible interference by it in our policies or with our freedom of action." This became the operative mode of the Department of Economic Affairs in its dealings with the Bank and with bilateral aid donors. The challenge was to discourage unwanted advice and the perception of interference without giving offense to the well-meaning intentions of friendly donors.

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

A good illustration of some of the more serious disagreements which developed between the Government of India and the Bank, and the Bank's attempt to persuade the Government to modify its position, occurred in 1956. The mission that reviewed the Government's Second Five-Year Plan had expressed the view that "the importance of the private business has not yet been sufficiently recognized and publicized" and recommended "that the private sector be given adequate incentives and resources to enable it to make its requisite contribution." President Black decided to emphasize the point when he wrote to the new Finance Minister: "While I recognize that the Government of India itself must play an important role in India's economic development, I have the distinct impression that the potentialities of private enterprise are commonly under-estimated in India and that its operations are subjected to unnecessary restrictions there." This produced an uproar. The Financial Times observed that "the World Bank has projected itself right into the center of an explosive political controversy. It is no wonder that some sections of Indian opinion have reacted violently to it." The Finance Minister in his reply tried to tone things down: "I am aware that your views and ours about private and public enterprise do not altogether coincide though the differences are not quite as great as seem to appear in public debate."

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39 Letter from Thomas H. McKittrick, the leader of the Bank's mission, to C.D. Deshmukh, dated June 30, 1956
40 Letter by Eugene R. Black to T.T. Krishnamachari, dated September 5, 1956
41 The Financial Times, Editorial, October 12, 1956
42 Letter from T.T. Krishnamachari to Eugene R. Black, dated September 16, 1956
dampen the effect of the controversy and told the Bank’s management “that the policies and procedures regarding private foreign investment were now being reviewed and expressed the hope that as a result a more favorable atmosphere would be created.” In the event, nothing appears to have happened to encourage private foreign investment.

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

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

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

“The fact of the matter is that the Bank cannot force any Government to do anything. We are only an outside agency that has money to lend but even the amount of money that we can contribute to any country is a small fraction of the

43 Memorandum of Conversation: IBRD Assistance in Financing India’s Second Five-Year Plan, dated October 12, 1956

country's own resources. We can only support what the Governments and people themselves are prepared to do. We can help in the process. We have world-wide experience, we have some idea of what works and what doesn't work. In India or elsewhere if these reform programs are not indigenous, they would not survive. The reform programs are fundamentally political; they are economic reform programs but they are essentially part of the political process. No foreign agency can involve itself in such a process.  

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

As an Institution Builder

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

The Bank devoted much attention to this matter. It recognized that "lending for individual projects [was] probably the most effective vehicle for influencing specific..."  

45 Ernest Stern, as quoted in The World Bank in India, published by The World Bank, New Delhi 1993, p. 42
The selection of projects by the Ministry of Finance and the Bank was often motivated by the felt need for the institutional as well as financial support required to assure the success of a venture. The most prominent examples of the Bank's involvement include the railways, ICICI, the power sector, long-term agricultural credit. A complete list would have to include virtually every individual operation supported by the Bank, but these examples may be sufficient to illustrate the Bank's role in this field. The Bank was associated with the Indian railways throughout most of the past fifty years and, in the context of 19 successive projects, contributed to their modernization and organizational evolution. In the case of ICICI, the Bank was involved in its creation and subsequently assisted its growth and diversification through 13 lending operations, as well as through technical assistance. The Bank supported the activities of the State Electricity Boards in all the major states of the Union. It also contributed to the establishment of NTPC and to the construction of many of its power stations as well as to the integration of the country's regional grids. The Bank provided many credits to the Agricultural Refinance Corporation and subsequently to NABARD for long-term agricultural lending by the cooperative banks in the states. Characteristic of the Bank's role in all these institutions was its support of policies that were designed to ensure their financial viability, managerial integrity and organizational autonomy.

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

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

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46 Country Program Paper - India, November 16, 1993, p. 21
But times have changed. The pressure to lend has given way to a much closer scrutiny of the performance of the portfolio. The Bank has come to accept that just as it cannot force countries to adopt policies against their wishes, it cannot expect projects to be build and managed unless they reflect a strong commitment of the beneficiaries, or effective institutions to be established as long as they lack the necessary support of those they are intended to serve.

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

The Bank’s Contribution

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

The Bank assigned many of its best staff and allocated large budgetary resources to its work in India. It extended the benefits of its project lending beyond the successful completion of projects to improvements in implementation capacity, long-term sustainability of projects, and institution building. In the course of its involvement in the design and implementation of projects, the Bank’s technical assistance and policy dialogue extended to issues of general application at the sectoral and sub-sectoral level. The emphasis on command area development, water management, on-farm development and innovative extension services are some of the themes advanced by the Bank through its irrigation lending. The insistence on groundwater discipline, dam safety, environmental safeguards, and resettlement and rehabilitation of displaced families showed the Bank’s attempts to press for improvements.
The Bank played an important role in facilitating the implementation of the projects it helped to finance. It insisted on the essential financial and logistical support by the Government. This was often resented and criticized as an unfair distortion of the Government’s planning process because it came at the expense of other Government projects not financed by the Bank. But it also forced planners to make more realistic assumptions and to confront difficult political choices. Considerable technical assistance was provided by the Bank through its regular and close supervision of project implementation. The Bank’s supervision missions, although sometimes regarded as intrusive, also facilitated coordination and decision-making across the different layers of the center and state administrations.

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

India’s prominent position in the Bank and the eagerness to help India established special, more indulgent norms of treatment. In the 1960s and 1970s there was a widespread feeling that India was treated more favorably than most other borrowers. The Bank’s representative noted the “double standard” applied to India in the 1960s and observed “that the double standard was good neither for India nor the Bank.”48 During the discussion of one of the early program loans to India, one of the Latin American Directors commented sarcastically that an “interesting feature of this collaboration with India has been instead of the Bank imposing on India a certain policy, and requiring India to adjust to the thinking of the Bank, the Bank has been trying to adjust to the needs of India and the problems of the Indian government. When they have a project, you finance the project, and when they don’t have a project, you give non-project loans...."49

48 Communication from Benjamin B. King to Raymond Goodman, dated August 19, 1964
49 Board Meeting, August 10, 1965
Arguably, the Bank might have been tougher but the Bank’s remedies to press its point of view were limited. The threat to abandon a project may be of little help. The Bank’s ability to control the outcome of reforms or of specific projects was always limited. It is the government and the borrower that is in charge of the implementation and responsible for the impact. The Bank can try to chart the direction of the borrower’s actions by establishing indicative benchmarks for performance, but if the actors disagree with the design or change their mind there is little the Bank can do to safeguard the outcome.

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

IV. India in the Bank

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

Shaping the Priorities of the Bank

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

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Bank. Until January 1971, India was the fifth largest shareholder of the Bank and as such entitled to appoint its own Executive Director. The Government was determined to maintain its relative position in the Bank and for this reason insisted on its preemptive right whenever a capital increase was considered to accommodate new members or changes in the shareholding of other members. Eventually, it yielded reluctantly when Japan acquired a larger shareholding and thus the right to appoint its own director. This changed little in substance since India forming a group with Bangladesh and Sri Lanka was assured of being able to elect its own director.

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

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

Although India did not become a borrower from the Bank until 1949, India’s Executive Director noted the exclusive focus of the Bank’s lending on reconstruction


52 A.D. Shroff, another member of the Indian delegation as quoted by M. Narasimhan: Bretton Woods - Forty Years On, 19th A.D. Shroff Memorial Lecture, Forum of Free Enterprise, Bombay 1984, p. 10
projects during the initial years. He pointed out that: “The Articles of Agreement of the Bank enjoin concern with both development and reconstruction. Of course there is a certain degree of priority to immediate problems of reconstruction, which is to bring back the economies of devastated countries to order, but beyond that, and not very far beyond that, lies the problem of undeveloped areas with the required capital to modernize their economies and to increase productive efficiency and improvement in the general standard, which is a rise in the levels of employment and production all over the world.”

Unhappiness over the lack of lending to developing countries was becoming a matter of some concern. The Bank stressed the funding of projects “which promise the greatest increase in productive output in the shortest possible time,” and recognized that “money spent on repairing a damaged source of production will effect greater results, and in a shorter time, than the same amount spent in building an entirely new source of production.”

C.D. Deshmukh, India’s Governor, addressed this issue emphatically in his address to the Annual Meeting in September 1947: “I cannot say that I feel quite easy in my mind in regard to what has been said in the [Annual] Report about the strategic use of funds. I hope it does not foreshadow...in any sense a decision to hold over applications for loans for schemes of development....When we are in a position to apply [for a loan], and if we decide to do so, I hope that no commitments based on notions of strategic use of funds will bar the expeditious and helpful disposal of our application. Usefulness and urgency are attributes that are not confined to schemes that Europe alone can put forward, and productive capacity and skills are relative terms that must have reference to the degree of development aimed at. If it is true that ‘the world cannot be half skyscraper and half rubble,’ it is equally true that it cannot be half skyscraper and half hovels.”

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

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


55 Statement by C.D. Deshmukh in the Third Session of the Second Annual Meeting in London on September 15, 1947
While India played an important role as one of the larger shareholders of the Bank, its influence on the understanding of development issues by the Bank was probably more significant. India was for a long time the Bank's most populous member country and the Bank's biggest borrower. Its problems thus inevitably assumed a central role whether one focused on economic development or poverty alleviation as key Bank objectives or on the portfolio of the Bank. When the Bank entered the business of development assistance in the late 1940s, scholars had hardly begun to study the problems of "economic underdevelopment" - as it was then called - and how to overcome them. The approach to development issues relied heavily on pragmatic involvement and empirical research, which was how the Bank took on the subject. Its unique advantage was close contact with its borrowers and practical experience in the reality of their economic problems. The recognition of the needs of its members and the desire to respond to those needs shaped the Bank's perceptions.

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

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

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

Nowhere was the effect of rapid population growth on economic development more striking than in India. India's population growth rate had been seriously underestimated at the outset of the planning process. It therefore came as a shocking surprise at the end of the 1950s that much of the progress achieved had been offset by the increase in the country's population and that per capita income had hardly grown at all. This knowledge persuaded the Government to initiate an official family planning program - the first among democratic governments to do so. Because of the large numbers involved, India's population growth came to epitomize questions about the sustainability of unchecked population growth and the limits imposed by the available resource base. Although the significance of the population problem was not lost on Eugene Black and George Woods, they were worried by the climate of opinion in the United States on this subject and they were, in any event, dubious about how a financial institution might be able to offer meaningful support in this field. This changed, when under Robert McNamara, the Bank began to address development issues more broadly and to finance activities beyond the traditional definition of "productive" investments.

In the 1950s, both India and the Bank had seen faster economic growth and increasing prosperity principally as a function of the volume of investment. The First and Second Five-Year Plan were cast with this relationship in mind. The Bank likewise linked productivity and production to the amount of investment it supported within the limits of a member's creditworthiness. This belief began to give way to considerations of equity and social justice. India's Government began to adopt more strident socialist

economic policies. The political slogan “garibi hatao” (get rid of poverty) adopted by Indira Gandhi in the early 1970s reflected the realization of researchers and planners that poverty was hardly affected directly by economic growth and needed to be addressed as a distinct problem.

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

Influencing the Terms and Form of Bank Assistance

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

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

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

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

57 Eugene R. Black: Statement to the Executive Directors, February 26, 1958
The foreign exchange crisis in India affected not only the terms of the Bank Group’s assistance, it also shaped the form of that assistance. Concern about the constraints imposed by the shortage of foreign exchange had prompted the Secretary of Finance as early as 1951 to explore the possibility of “an over-all development loan” which would “give the Indian Government more flexibility in the execution of the...development program.”\textsuperscript{60} This early proposal to add program lending to the tools of Bank assistance was quickly turned down with reference to ample opportunities for project assistance. Experience with widespread defaults in foreign lending in the 1920s and 1930s had taught the founders of the Bank that a direct link between foreign loans and productive investment could help prevent profligacy and provide a source of income to facilitate the debt service. This had made lending for specific projects the preferred vehicle of the Bank’s assistance.

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

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

Even though the Bank was thus able to provide what was in effect freely available foreign exchange, the shortage of essential imports became a binding constraint once the Third Five-Year Plan got underway. The Bank’s 1962 economic mission reported widespread underutilization of capacity as a result of the lack of imported materials. In the Consortium meetings, the discussion of the level of non-project assistance, as distinct from the general level of assistance, assumed growing prominence. President Woods was persuaded that lending for new facilities would not help in this situation and agreed “in

\textsuperscript{60} Letter from W. Koster to A.S.G. Hoar, dated November 20, 1951, enclosing his mission’s field report
addition to normal project loans, to make available, in appropriate cases, long-term financing for the import of components and spare parts for industry generally or for some particular segment of industry of special importance to the given economy. Thus, the Bank started to provide funds for raw materials and spare parts to selected industries in India through "industrial import loans," a thinly disguised form of program lending. The major shareholders of the Bank accepted this departure from the established project lending concept with some reluctance, but the need for greater flexibility had been established. The provision of non-project assistance became an important form of Bank assistance in a number of countries, especially after the second oil shock, when program lending in support of structural economic reforms assumed a central position in the Bank's strategy.

**Pressing for Policy Changes**

The Bank was not only willing to change to respond to the peculiar economic and financial needs, it was also prepared to amend its policies to accommodate some strongly held beliefs of its most important borrower. The Bank's procurement rules presented a particular problem for the Government of India, especially when the Bank began to finance contracts with Indian manufacturers and contractors. The Bank had always insisted on open international tendering of the contracts covered by its loans, in order to provide for transparency and to obtain the benefit of competitive prices and conditions for its borrowers. The Government of India, however, was intent on developing its domestic industry and to overcome the dependence on imported goods and services. The Government therefore wanted to maximize the contribution Indian manufacturers and contractors could make to the construction of Bank financed projects and to limit the competition of imports. The Government objected in particular to the Bank's insistence that all contracts associated with a Bank project, irrespective of whether the Bank financed the contract, should be subjected to international competitive bidding. Following extensive discussions, the Bank eventually agreed that international competitive bidding would not be required for contracts financed with India's own resources. The Government welcomed the Bank's willingness to be pragmatic, but this gave rise to protracted haggling over the form of procurement to apply to the various contracts. The process of determining what could be domestically procured and whether domestic suppliers would be able to stand international competition proved time-

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

62 Letter by Morarji Desai to George D. Woods, dated July 10, 1967

63 Letter by J. Burke Knapp to K. S. Sundarajah dated September 8, 1967
consuming, contributed to cost increases and delayed the disbursement of badly needed Bank resources. Although the Government had succeeded in pushing the Bank to accommodate its point of view, little was gained in the process.

The Bank was not unmindful of the need to support the development of the industries of its borrowing member countries. A general preference of 15% for domestic manufacturers was allowed by the Bank’s procurement guidelines. However, this was inadequate so long as the tariffs protecting Indian manufacturers - which had to be disregarded in the evaluation of foreign bids - were significantly higher. The Government therefore argued for a significant increase in the preference granted Indian manufacturers. There was some indication that the Government might be prepared to modify its insistence that anything produced in India had to be reserved for local procurement if a preference of 27.5% - the average level of tariffs - was granted to local bidders. The Bank staff advocated a change in the amount of preference in the hope that this might reduce the administrative interference in project procurement. Yet, the proposal apparently went nowhere. It required review and approval by the Bank’s Board, which in matters affecting the spending of the Bank’s loan proceeds was clearly not exclusively guided by the perspective of the Bank’s borrowers.

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

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

65 Memorandum Jochen Kraske to Files dated October 3, 1972: India - Meeting of Annual Meeting Delegation with Mr. McNamara
A compromise was reached eventually when McNamara submitted to the Board a proposal ostensibly dealing with the "Promotion of Domestic Construction Industries in Developing Countries." It offered a 7.5% preference for domestic contractors in the evaluation of bids. The Executive Directors were seriously divided over this issue and the discussion dragged on for a number of months until the proposal was finally approved in October 1973 in a form which limited the applicability to countries with a low per capita income, which has ever since safely included India.

It is doubtful whether the policy on preferences for civil works contractors had significant effects on the award of contracts, especially in India. Financing of major civil works contracts was no longer the focus of the Bank’s assistance program; the contracts included in command area development, rural works or urban renewal projects hardly attracted the interest of foreign contractors. But India’s intervention was a demonstration of the influence it exerted in modifying the Bank’s policy in a field which, as the discussion in the Bank’s Board showed, was contested by the major donor countries. McNamara’s determination to resolve this issue was obviously crucial; he wanted to press ahead with an enlarged IDA program and India, still the largest IDA recipient, was critical to the achievement of his ambitious lending targets.

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

The Government of India had decided early that, given the size of the fertilizer market, India needed a massive expansion of its fertilizer industry. President Woods, both anxious to assist India and personally experienced in putting together major investment operations, submitted an assessment of India’s fertilizer needs to the Minister of Agriculture. In his confidential covering letter, he described how he thought the problems might be tackled: "In the area of fertilizer production and distribution, the magnitude of the hydro-carbon feedstock requirements so clearly exceeds the prospective domestic Indian supply and the need for speed is so great that every effort should be made to enlist the financial and technical capabilities of the foreign companies experienced in this field and in a position to use the natural gas resources of the Persian Gulf area for Indian purposes." Woods expected that foreign investors would be ready to

66 Considered by the Executive Directors on August 7, 1973
67 Letter by George D. Woods to C. Subramaniam dated February 28, 1966
team up with private partners in India or even with the Government, but did not believe they would be prepared to participate as minority partners. Aware that his proposal was in conflict with the Government’s policy, he suggested that “a modification of this policy is necessary with respect to fertilizers.”

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

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

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

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

V. Some Reflections

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

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

Quite aside from the coincidence of anniversaries, therefore, this seems an appropriate moment to reflect on the significance of the relationship. Those interested in the evolution of the World Bank should study the relationship between India and the Bank with particular attention. The evolution of the Bank, at least during its first three decades, was strongly influenced by its relationship and by its work in India. This does not belittle the influence other developing countries or regions have had. Latin America
and Africa have contributed to the making of the Bank in ways that responded to their particular needs. The problems leading up to the debt crisis in Latin America, for example, strongly influenced the Bank’s emphasis on trade liberalization; and the crisis in Sub-Saharan Africa strengthened the Bank’s focus on public expenditures and governance. India, however, because of its size and diversity, the continuity of its long association with the Bank, and the quality and sophistication of the persons charged with dealing with the Bank left a significant imprint on the Bank. It was not always noticeable, yet the impact on both policies and operations was unmistakable.

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

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

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

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

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

There is, however, little evidence in the first three decades of the relationship that the Bank took a sufficiently assertive view of the role it could play. Internal strategy reviews thought that the Bank’s “leverage to press for fundamental and broad policy change [was] limited.” 71 The management of the Bank concluded that “little would be gained, and a good deal might be lost, by making IDA lending contingent on broad policy improvements.” 72 India’s eligibility for IDA assistance was primarily linked to its poverty and not to its performance. The Bank saw itself principally in the business of transferring resources and as a lender looked with great care at the projects and sectors it supported. Its concerns about the Government’s policies were closely linked to the creditworthiness of the country and to the volume of IBRD loans. Since IBRD lending remained at modest levels until the 1980s, these concerns did not lead to a more stringent assessment of the

71 Country Program Paper - India, November 16, 1973, p. 20
72 Memorandum from Hollis B. Chenery to Robert S. McNamara: Issues Posed by the India SPP, July 18, 1974
policy framework. In any event, except for the crisis which occurred in the early and mid 1960s, India’s economic performance, while it was not spectacular, seemed to warrant sustained, although perhaps unenthusiastic, external assistance and, consequently, did not call for a more proactive role of the Bank.

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

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

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

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

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