No. E-60A
RESTRICTED

This report is restricted to use within the Bank

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

RECENT ECONOMIC DEVELOPMENT IN INDIA

August 12, 1949

Economic Department

Table of Contents

Summary

1. The latest developments in India show a further improvement in industrial production, in rail service and in the labor situation; continued controls on distribution and procurement of food and essential industrial products; a degree of stability in money supply and prices; a tendency towards centralization of the Indian Union's administration, and of development programming; and a clearer realization on the part of both India and Pakistan of the economic issues involved in Partition--although perhaps not yet a meeting of minds. The impact of food imports on the balance of trade has brought about a new drive for self-sufficiency in addition to the long-term food raising program. On the other hand, the Government is faced with serious problems, both in relation to its balance of payments and in relation to the rapid decline of the Indian sterling balances. The reduction of Government owned rupee balances may make the financing of the capital program as at present envisaged somewhat difficult in a year or two.

2. In the first half year, 1949, India is expected to have a trade deficit of Rs. 1,670 million ($507 million) compared to Rs. 690 million ($207 million) deficit for the whole year 1948. The trade deficit with the dollar and other hard currency areas has been, as previously forecast, about $126 million. Since the middle of 1948 India has, however, developed a deficit with the Sterling Area which is expected to reach Rs. 1,280 million for the first six months of 1949.

3. To meet this deficit India had to draw heavily on her sterling balances which have been reduced by £144 million from January-June 1949. In the new agreement between India and the United Kingdom signed July 1949 it was agreed that for each of the years 1949-50 and 1950-51, £50 million would be transferred from the Number 2 to the Number 1 Account with an additional £50 or £60 million as

contingency for meeting contractual imports[1] during the 1949-50 period. It is not unlikely that India will draw on her sterling balances an amount around £ 100 million in 1949-50. This would finance both her sterling and her dollar deficit.

4. The balance of payments deficit with the hard currency countries is estimated at $148 million for July 1949-June 1950, which compares with $223 million deficit for the same period 1948-49. It will be met from the Central Reserves of the Sterling Area so that India will obtain a dollar amount roughly equal to that which she received during the 1948-49 period (around $150 million).

5. At the 1948-49 rate of drawings India would use her remaining balances of £ 630 million in a few years. Consequently, the Government has tightened the liberal import policies introduced in July 1948. This affects her over-all imports both from hard and from soft currency countries. However, a reduction of imports will not be enough and an over-all export increase is necessary to improve the balance of trade. This appears feasible, if it is considered that the export volume has reached only around 60% of the prewar. But the difficulties arise from a number of sources including lower production or slower deliveries in certain fields, greater home consumption in others, and last but not least, present high prices.

6. A new intensive "Grow More Food" Campaign has been launched with the objective of stopping grain imports after 1951. This Campaign is considered as an emergency action and all efforts of the Central and Provincial Governments are focused on it. In addition the Government pursues its medium- and long-term projects towards increasing production of food to meet the long-run problem due to the continuous increase in population. This is designed to reduce the country's foreign exchange needs substantially.

1/ Liabilities entered into under the old Open General License before it was cancelled in May, 1949.

7. According to the 1949-50 budget, the Government is expected to use its rupee balances with the Reserve Bank for capital expenditure to the tune of over Rs. 1,000 million. By the end of the fiscal year 1949-50 the balances are expected to be only Rs. 550 million, so that the Government will be confronted with the important problem of finding means to finance the various development projects. There has been a slight improvement on the capital market in recent weeks, making possible a conversion of a 1949-52 Government loan to the extent of Rs. 320 million and also some small private issues of capital. The Government, however, must continue its efforts to improve the conditions on the capital market. This underlines India's need both for foreign loans and for foreign private investment to assist in stabilizing and developing her economy.

8. A new trade and payments agreement has been signed with Pakistan covering the period July 1949-June 1950 and providing for the exchange of important commodities on both sides. Some improvement has been achieved in India's financial and economic relations with Pakistan but more substantial progress still depends on the final solution of the Kashmir problem. In the meantime prices for jute manufactures have undergone a 20-25% reduction during the first months of 1949 with a slight recovery during the last weeks. A comprehensive agreement between the two countries on the production and supply of raw jute as well as jute manufacture is vitally important in view of the growing and aggressive competition which jute manufactures are encountering, especially in the United States, from paper packaging material.

9. The present difficulties demonstrate that vigorous and comprehensive action by the Government is required in practically all fields to improve substantially the present unsettled conditions, if economic development is not to encounter serious obstacles.

RECENT ECONOMIC DEVELOPMENT IN INDIA

I. Balance of Payments

The Deficit:

1. The balance-of-payments deficit has remained a very important feature of the present economic situation in India. It was substantial in 1948 and reached an extremely high level in the first half of 1949.

2. Figures for 1948 compiled from the Reserve Bank of India Exchange Control Statistics show an over-all trade deficit of Rs. 690 million for 1948, and a balance-of-payments deficit on current account of Rs. 370 million.

Table I

1948 Balance of Payments[1/]
(in Rs. millions)

Receipts		Expenditures			
Exports	4,370	Imports	5,060	Trade deficit	-690
		(of which Govt. food imports)	(1,030)		
Invisibles	1,320	Govt. Expenditures	260		
		Other Invisibles	740	Invisible surplus	+320
Total	5,690	Total	6,060	Current Account Deficit	-370

1/ Compiled from Reserve Bank of India Exchange Control Statistics and excluding payments position with Pakistan.

3. The revised balance-of-payments estimate for the first half of 1949, based on actual results for the period January-April 1949, however, shows a trade deficit of Rs. 1,670 million, which is more than double the deficit for the whole of 1948. Exports covered only about 56% of imports.

Table II

Revised Balance of Payments Estimate[1/]
First Half of 1949
(in Rs. millions)

Receipts		Expenditures		Balance	
Exports	2,140	Imports	3,810	Trade Deficit	-1,670
		(of which Govt. food imports)	(700)		
Invisibles	690	Govt. Expenditures	80		
		Other Invisibles	330	Invisible Surplus	+280
Total	2,830	Total	4,220	Current Account Deficit	-1,390

1/ Based on actuals for the period Jan.-April 1949. Compiled from the Reserve Bank of India Exchange Control Statistics and excluding payments position with Pakistan.

4. The above estimates do not take account of the payment position with Pakistan. It is usually assumed that the 1948 deficit both on trade account and on over-all current account would be about Rs. 300 million greater if the overland trade with the neighboring Dominion were recorded.

5. The substantial increase of the trade deficit is due to the change in the trade position with the Sterling Area and other soft currency countries which has taken place since July 1948. At that time imports from soft currency countries were liberalized in order to increase the supply of goods in the Government's efforts to check inflationary pressure. Thus, whereas trade with the Sterling Area and other soft currency areas showed an export surplus of Rs. 230 million in the first half of 1948, it turned into an import surplus of Rs. 460 million in the second half of 1948. This import surplus is expected to reach Rs. 1,280 million ($384 million) in the first half of 1949. The rapid increase of imports which went far beyond the Government's expectation indicates a strong pressure for large purchases abroad arising from continuing scarcities

of a wide variety of consumer goods, and from shortages of capital goods both for existing industries and development projects.

6. The deficit with the dollar and hard currency area has also almost doubled during the period considered. For the full year 1948 trade with the dollar area showed a deficit of Rs.420 million ($126 million) equal to food purchases in the area. Taking invisibles into account the over-all deficit amounts to Rs.490 million($147 million). During the first half of 1949 only the over-all deficit is expected to amount to $126 million. This trend is illustrated by the fact that U. S. trade statistics show a deficit for India of $40 million during the first five months of 1949 instead of a small surplus ($4 million) during the same period of 1948.

7. Trade with the United States remains of considerable importance. While before the war it only represented 9% on the export side and 7% on the import side, in 1948 it amounted to 19% of seaborne exports and 23% of seaborne imports - second only to trade with the U. K. (23% of exports and 28% of imports). Grain and flour imports from the dollar area represent a substantial proportion of this increase, so does machinery and equipment, vehicles, chemicals and oil. On the export side jute and jute manufactures remain the main items, representing roughly 60% of India's dollar export. There seems to be some hope for a further improvement in this field, given satisfactory business conditions in the U.S.A. Manganese is still a relatively small portion of Indian exports, but improved transport conditions could speed up deliveries substantially. There are also possibilities of an expansion of tea exports to North America.

8. The hard currency deficit in the first half of 1949 was far in excess of the sum of India's remaining dollar balance in the Central Reserves of the Sterling Area at the beginning of the year ($4 million), and dollar purchases from the Fund during the half year period ($32 million). As a result, up to June

1949 India had overdrawn her dollar account with the Central Reserves by $84 million. The soft currency deficit was met by a heavy overdraft on current releases from the sterling balances, which until the end of June 1949 reached £55 million.

9. Thus India's sterling balances have been rapidly reduced, falling by £144 million in the first half of 1949. They stood at £630 million at the beginning of July 1949, and at the 1948-49 rate of drawings India would use the remaining amount in a few years. The Government has realized that this rate of depletion of the sterling balances would be most damaging to the economy of the country, and, therefore, has tightened the liberal import policies introduced in July 1948. Since May 5 soft currency imports under Open General License now have been restricted to about 20 categories, chiefly covering industrial materials and other essentials.

Balance of Payments Prospects

10. With the abnormal use of her sterling balances India has reached a turning point in the development of her balance-of-payments position. Before the recent Sterling Area talks in London the Government prepared a rough forecast of India's balance-of-payments position for July 1949-June 1950, compiled completely on information furnished by various Ministries. According to this forecast, which can provide no more than an indication of India's potential import demand, the trade deficit for this period was estimated at Rs. 1,820 million ($546 million) compared with Rs. 2,440 million ($732 million) for July 1948-June 1949, Rs. 680 million ($244 million) being a deficit with the dollar and other hard currency area as against Rs. 690 million ($247 million) in the previous period, and Rs. 1130 million with other areas, as against Rs. 1,750 million in the previous period.

11. It became clear that such deficit could hardly be met with the available foreign exchange resources of India, which consist of gold reserve of $247 million and the remaining sterling balances of £630 million ($2,520 million). For the release of sterling balances for current use, however, India must negotiate with the United Kingdom. Under the agreement of July 1948 £40 million per year were to be released to her Number 1 Account (for current transactions) during 1949-50 and 1950-51. In view of the Indian overdraft in 1948-49 the new agreement of July 1949 between the United Kingdom and India provides that for each of the years 1949-50 and 1950-51 £50 million would be transferred from the Number 2 Account to the Number 1 Account, with an additional £50 - £60 million if necessary for meeting liabilities entered under the Open General License before it was cancelled in May 1949, during the 1949-50 period. These figures indicate that the size of a possible trade deficit for India during this period may well reach around £100 million. The pounds released for current transactions are also to cover dollars obtained from the Central Reserves of the Sterling Area. Limitations on convertibility of sterling in the Number 1 Account have now been removed in principle beginning July 1, 1949. India has agreed, however, to cut hard currency imports by 25% below the 1948-49 level and she is supposed to maintain such imports at a minimum "without jeopardizing the vital interests of her economy."[1/]

12. In the light of this decision the whole balance-of-payments forecast for July 1949-June 1950 will now be revised by the Government of India. It is understood that India will take a figure of $429 million as a basis for the 25%

1/ See the attached statement of the Finance Minister of India of August 4, 1949.

import cut, thus bringing the dollar imports to around $322 million. Additional dollar imports would be possible only to the extent of India's hard currency borrowing abroad (including borrowing from the International Bank), or as a result of private foreign investment. An important factor in this estimate is the expectation that India will be able to reduce her dollar grain imports from the previously anticipated $138 million to $36 million.[1/] Moreover, with further recovery of production in the United Kingdom and other European countries, India should be able to buy a larger proportion of various import requirements from them than in the past two years.

13. The balance-of-payments deficit with the dollar area and other hard currency countries is estimated at $148 million for July 1949-June 1950 which compares with $223 million deficit (after deducting some offsetting items) for the same period 1948-49. Following the arrangements recently negotiated this deficit will be met from the Central Reserves of the Sterling Area. India will therefore obtain from the Central Reserves a dollar amount nearly equal to that which she received during the July 1948-June 1949 period ($144 million). This alone would absorb about £37 million of her sterling balances. If sterlings which will be needed to meet the Sterling Area deficit increased by the expected switch of food purchases to the Sterling Area and the Soviet Union[2/] are added, it is not unlikely that India again will draw on her sterling balances an amount of about £100 million in 1949-50.

14. The Government of India intends to reduce this abnormal drawings on sterling balances in 1950-51 and hopes to remain within the agreed upon amount

---

1/ This would be due both to decreased grain imports and to an increase in the proportion purchased from the Sterling Area (Australia).

2/ An agreement just arranged with the Soviet Union increases 1949 wheat imports from that country to 400,000 tons to be paid for in sterling.

of £50 million; therefore, the most serious efforts must be made to reduce the trade deficit. Over the past years India has been in a favorable position, being able to use her sterling balances for meeting her balance-of-payments deficit. Insofar as these imports really are helping in rehabilitation, reconstruction and development of Indian economy and in replenishing the stocks depleted during the war, India has been in a better position than many other countries because she has been able to finance her huge trade deficit from foreign assets accumulated during the war and not from borrowings (except for $100 million purchased from the IMF).

15. The 1948-49 experience has clearly demonstrated that much stricter import controls must be exercised over both soft and hard currency imports and that the dollar import restrictions have not been as effective as had been expected. Reduction of imports, however, will not be enough and increased exports are necessary to improve the balance of trade and to supply India with goods which are required for her economic development and her current needs. In 1948 the volume index of exports averaged only 58 (1937 = 100) and reached 60 in the first two months of 1949.[1/] The volume index of imports which was 83 on the 1948 average reached the postwar high with 116 in March 1949. The Government of India has established a special Export Advisory Council which should help in promoting exports and it is its policy to increase exports not only to the dollar area but to all markets. It is steadily expanding the network of commercial treaties and has recently signed commercial agreements with Austria, Poland, Finland, Hungary, Switzerland, Egypt, Iraq and the U.S.S.R. It is endeavoring to find markets for new exports such as for iron ore (Japan), coffee (Finland), sugar (U.K.)

1/ However this index understates somewhat the current volume of exports compared with prewar since exports from Pakistan are excluded after August 1947.

16. To stimulate exports, India must increase production and remove various obstacles such as lack of transportation, export duties and high prices. Transport difficulties have kept certain exports, such as manganese and other minerals, at a low level and current and prospective improvements in rail services will improve her export potential. It is expected that manganese exports will double during the present year and exports of other minerals are also moving at a higher rate. Some of the export duties were abolished in 1948 and others have been reduced or eliminated this year. (For example on manganese, oil seeds, and cotton textiles). Reduction of further export duties requires examination. High prices are undoubtedly also an obstacle to India's exports. This appears clearly if the present Indian wholesale price index (about 3.7 times prewar) is compared to the rises of 90% and 120% which took place in the U. S. and the U. K respectively. But reduction in price does not necessarily mean an increase in the volume of exports. The drop of 20 to 25% recently experienced in jute manufacture prices actually failed to increase substantially exports to the U. S. It rather seems to have prevented a drop which might have been brought about by strong competition from paper and other substitutes at a time of receding business activity.

17. Improving India's foreign trade balance is not an easy task. However, if the Indian Government pursues its present energetic foreign trade policy of fostering exports and curtailing unnecessary imports, and especially if India is able to carry out her new food program, there is a fair prospect that equilibrium in the current dollar payments position may be achieved by 1952.

II. The Food Program

18. In view of the heavy burden imposed on India's balance of payments by large imports of food, the Government of India has declared that it does not intend

to continue grain imports beyond 1951. Increased production of food which is imperative is now highest on the list of priorities. The Government, in addition to pursuing the reclamation of procurable waste land, has decided to concentrate its program on the improvement of yields, especially in areas which have a perennial or assured water supply. Theoretically, the potentialities for an increase in grain production are enormous because of the present low yields in India. Many obstacles must be removed however. Advances in the yields presuppose increased supplies of fertilizers, improved seed and a vast agricultural educational program. The Government is pursuing this objective with the utmost energy. It anticipates that the declaration of no more grain imports after 1951 will force the Provinces and States to increase their efforts towards producing more food and especially will make the procurement system much more efficient.

19. The commissioner of food production has been given special powers to carry out the new program. These include the initiation of measures necessary for coordinating and revising the food plans of Provinces and States, sactioning grants and loans from Provincial and State food production schemes, and making available to Provinces and States all controlled materials as well as other resources for production. A block grant will be placed at the disposal of the commissioner for the purpose of subsidies to Provinces and States for approved schemes of production.

20. To implement the Government's policy, Provinces and States have made the following recommendations: all land reclaimed through Government efforts should be under food crops; further reclamation of waste land should be stimulated by granting land revenue exemptions, provided such land is devoted to food production; farmers should be compelled to utilize all available fallow land for growing food; 10% of the sugar cane area (340,000 acres) should be diverted to

basic food production; provision of supplies of iron, steel, cement and bricks for agricultural purposes should be expedited and the results of agricultural research should be disseminated widely. It may be expected that these recommendations will be accepted.

21. It is too early to assess the scope and probable results of the new "Grow-More-Food" Campaign. The Government is confident that - given favorable weather conditions - it should allow for the cessation of grain imports in 1951, while in 1949 the proposed imports will reach from 3 to 3-1/2 million tons. This is not an impossible target since, besides its present immediate program, the Government continues to follow its long-range food production program, consisting of irrigation of perhaps six million acres over 10 to 15 years as the result of the prepared major multi-purpose projects and the installation of tube wells.

22. This wide and long-range program is due to the fact that in planning for food self-sufficiency, the Government must take into account the growing population of India. In the last four years the net population increase was about 0.8% to 0.9% per annum as compared to 1½% during the 1931-41 decade and 1% during the 1921-31 decade. The population growth will be determined by a number of competing and complementary forces: a decline in the proportion of women in the childbearing ages to the total Indian population, legal restrictions on minimum marriage age, the program of planned parenthood, as well as urbanization and industrialization of the country, will exert pressure in the direction of a somewhat reduced birth rate. On the other hand, improvements in public health should serve to reduce the mortality rate. On the basis of these factors it seems a fair assumption that the population increase will not be more than 1% per annum over the next decade and that the total may reach somewhere between 365 and 380 million, against around 335-342 million today.

23. Through all these efforts it should not be impossible over the next decade to add a further six million tons of grain and substantial quantities of other food to India's normal food output. The increase in food production other than grain must be added which has been continuing in India over the last period

and which is now being pushed ahead much more forcefully. The 1948 grain imports amounted to around 3 million tons for a total consumption of some 42-46 million tons. If the six million target could be reached in 10 years, it would both eliminate the present deficiency and allow for a 10% increase in over-all needs due to increased population on the habit of present diets. Deficiencies would then appear only in case of bad monsoons.

III. Industrial Production

24. The increase in industrial production which began in the second part of 1948 has continued in 1949. A further increase during the first half of 1949 by 12 to 15% over the same period in 1948 has recently been announced by the Ministry of Industry and Supply, and is confirmed by a 14% increase of car loadings on Indian railways for the first three months. The increase in production has been spread over most of India's industries as is evident from the following table comparing production in the first quarter of 1949 with the whole of 1948:

Production in % of 1948 installed capacity	1948	1st Qtr. 1949
Coal	99.1	107.2
Steel	67.5	92.6
Cement	71.65	84.7
Ferro-alloys	52.4	112.
Soda ash	52.2	66.6
Sugar	71.4	83.
Tires	79.5	91.8
Diesel engines	80.3	110.

Increased production was achieved by a better use and by expansion of the existing capacity as well as by the erection of new plants, which continues. The labor situation also showed considerable signs of improvement in the first months of 1949. 1/

25. In the past months foreign capital has become more interested in industrial enterprise in India. Following an agreement of the Government of India with two French firms, a plant for the processing of monazide sands will be established in Travancore with a yearly capacity for processing 1,500 tons of monazide sand. British business is introducing a new production of dyes, of combustion engines for industrial use, and mass production of small and medium-

1/ From January to June 1, 1949, 539 industrial disputes, involving 337,045 workers, resulted in the loss of 2,872,915 man days. During the same period in 1948, there were 851 disputes with 635,346 workers involved and with 5,041,546 man days lost.

sized electric motors. A textile spinning machinery manufacturing plant will be started in conjunction with a British firm. These are only examples of new enterprises started or to be started in India. In recent months the Government of India in its various statements has encouraged such investment and there are indications of growing interest of private foreign investors in India. Private foreign investment could undoubtedly be of significant assistance to India's industrial development.

26. Legislation at present before Parliament is, however, drawing strong criticism from business circles. The Government, pursuing its policy towards the coordination of industrial development and establishment of a system of priorities, has introduced a bill in March 1949 which provides for broad powers of governmental operation including registration of most existing industrial establishments. New industrial undertakings or a substantial expansion of existing facilities would be subject to licenses issued upon agreement to comply with prescribed conditions including location and minimum standards of size, equipment and technique.

IV. Money and Prices

27. Money Volume. Money volume has continued to decline. The total money supply (currency and demand deposits) which was at Rs. 20,550 million at the end of December 1948, dropped to Rs. 19,520 million by the end of June 1949. Currency in circulation shows a decrease from Rs. 11,882 million to Rs. 11,492 million, or by Rs. 390 million during the same period.

28. The table below shows the changes in the important items of the Reserve Bank of India during the period December 31, 1948-July 8, 1949. As the result of the reduction of sterling balances the ratio of gold and foreign securities to liabilities was reduced from 67.59% to 60.70%. As may be seen from the table,

foreign securities held in the Issue Department declined by Rs. 886 million, whereas rupee securities increased during the same period by Rs. 755 million. The previous trend towards substituting rupee securities for foreign exchange in the note cover has thus continued. The effect of the import surplus, (i.e. the use of sterling balances) on the money volume was offset to a substantial degree by the open market purchases of Government bonds. The operation of the Banking Department which lost Rs. 800 million in sterling balances while Government rupee balances declined by Rs. 848 million equally had no deflationary effect and at the same time has removed in part a potential danger of inflationary credit expansion.

Issue Department	(Rs. Millions)		
	December 31, 1948	July 8, 1949	Difference
Notes in circulation	11,882	11,492	-390
Gold	413.5	400	- 13.5
Foreign securities	7,689	6,803	-886
Rupee securities	3,432	4,187	+755
Rupee coins	453	475	+ 22
Ratio of gold and foreign securities to liabilities	67.59%	60.70%	- 6.89%
Banking Department			
Central Government balances	2,145	1,297	-848
Balances held abroad	2,563	1,363	-800
Loans and advances to Governments	70	29	- 41
Investments	967	1,091	+ 74

29. Capital Market. Activities on the capital market have remained hampered by a lack of confidence on the part of the business community. The index of common stocks (1937 = 100) has declined from 140 in December 1948 to 111 in June 1949. The yield of Government bonds has remained around 3% but certainly

only with the help of sizeable open market operations by the Reserve Bank. During the past month however the situation on the capital market seems to have taken a more favorable turn. Stock markets have shown price increases on a broad front. Furthermore, the number and the amount of new issues of capital for industrial purposes has been increasing. This accompanied a sizeable conversion operation. The Government floated a conversion loan for the Rs. 670 million 3%, 1949-52 loan. Bondholders were offered the option of converting their holdings into 2-1/2% loan due 1955, or into 2-3/4% loan due 1962. According to the latest news about Rs. 250 million have gone into 2-1/2% loan of 1955 and Rs. 70 million into 2-3/4% loan of 1962 or a total of Rs. 320 million. It may be presumed that the remainder of the loan is being held by the Reserve Bank or other Government institutions.

30. Prices. The situation on the commodity market remains unsettled. The general index of wholesale prices which dropped slightly from 389.6 in July 1948 (August 1939 = 100) to 383.6 at the end of December 1948 has remained stable around 378-379 during recent months. It was 384.8 on June 25, 1949. In March 1949 the opinion was expressed that a downward trend in food prices could be expected after the spring grain harvest sometime in April. Procurement prices for spring grains in Provinces and States which have fixed such prices were reduced in most cases by 4% to 15%. The wholesale index of cereal prices fell from 468.2 in the last week of March to 458.1 as of April 30. Since April, however, in spite of a fair spring harvest, grain prices have again been creeping upward and the cereal index on June 11, 1949 again reached the March level at 468.9.

31. The cost-of-living index in Bombay has remained stable around 288-290 over the past five months, slightly lower than during the winter months of 1948.

The development of prices of cereals has opened the question as to the ability of the Government to maintain the present ceiling on food prices. The future trend of food prices depends upon the prospect for normal harvests, the effectiveness of food procurement policies, the success of measures to increase agricultural productivity, the level and prices of food imports. Uncertainty on all of these questions makes a forecast of the price trend in foodstuffs, and therefore of prices in general, extremely difficult.

V. Public Finance

32. No fresh funds have been obtained in the market and the Government had to meet its expenditure from current revenue and from its rupee balances with the Reserve Bank. The Government balances with the Reserve Bank were reduced by about Rs. 300 million between April-June. Total drawings on these balances are expected to reach Rs. 1050m. for the budget year 1949-50. If these estimates prove correct, these balances would be reduced to Rs. 550 million on March 31, 1950. Next year, therefore, the Government will be faced with the problem of finding new sources of financing its development expenditures, which were met during the last two years by a substantial use of the accumulated Government rupee balances with the Reserve Bank. Both the pace of development and its inflationary consequences will depend on whether the Government will be able to raise funds in the market. It is difficult to expect that a substantial surplus might be provided in the ordinary budget to finance expenditure on the capital budget, although some reduction in expenditure may be expected from reduced food subsidies because of lower grain prices and smaller volume of imported grain, and furthermore, perhaps also some reduction in defense expenditure as the Kashmir situation improves.

33. At present the Government is engaged in negotiations to work out a better financial coordination between the Centre and Provinces and also to assume

financial control and responsibility in Indian States similar to that exercised in the Provinces. It is anticipated that the integration of State finance will be reached by April 1,1950.

VI. Relations with Pakistan

34. The Government of India, realizing the importance of economic relations with Pakistan, continues its efforts to improve them in order to mitigate various unfavorable short-term and long-term effects of Partition on India's economy, some of which are only now becoming apparent. However, the Kashmir question still hangs like a cloud over relations between the two Dominions and before it is settled a real improvement of the mutual relations appears difficult.

35. The refugee problem, involving questions of resettlement, financial compensation and return of the property left in Pakistan, continues to be a matter of serious concern to the Indian Government.

36. Much attention is being given, however, to the improvement of trade relations with Pakistan. In June 1949 a new trade and payments agreement was signed for the period July 1, 1949-July 30, 1950, providing for the exchange of certain quantities of specified items and anticipating a broadly balanced trade position.[1/] Most important are:

a) Pakistan undertook to export to India 4 million bales of raw jute, 450,000 bales of raw cotton, substantial quantities of hides and skins.

b) India, on the other hand, undertook to supply Pakistan with 2 million tons of coal, 64,000 tons of steel, substantial quantities of cotton cloth, chemicals, vegetable oil, etc.

37. The new payments agreement involves somewhat less flexibility in payments arrangements for India. The provision of the 1948-49 agreement allowing for settlement of balances due in excess of Rs.250 m. from the No.2(blocked)Sterling Account

---

1/ As against a large import surplus into India in 1948 (about Rs.300 million).

has been eliminated; the two countries have now agreed to hold each other's currency up to Rs. 150 million, as heretofore but balances in excess of this amount must be met from the Number 1 Sterling Account. It should therefore be expected that India will attempt to reduce her substantial trade deficit with Pakistan, because otherwise she would have to continue to pay Pakistan from her current sterling balances. No exchange control now exists between the two countries. India has removed her export duty on cotton textiles, and some mutual concessions regarding rebate of excises and the elimination of export duties on a few items has been arranged.

38. In spite of a gradual improvement in the economic relations between the two countries, the fact remains that an old economic unit was split into two parts and that a new trade pattern is emerging, especially in Pakistan. As one of the results of Partition, India's dollar earnings have been reduced by about $50 million yearly. It is most doubtful that close economic cooperation in the form of a customs union could be organized in the near future. The most important problem on which the two Dominions will have to reach an early agreement is the production of raw jute and jute manufactures. Almost three fourths of the jute-growing areas are in Pakistan and all of the jute mills in India. Pakistan has introduced export duty on raw jute (Rs. 6 per bale on cuttings and Rs. 20 per bale on all other grades), which has added to the raw material costs of the Indian jute mills just when the other costs were increasing. In the past two years India made intense efforts to expand her raw jute acreage and the current crop is estimated at about 3.2 million bales compared with last year's production of 2.4 million, but Pakistan is preparing meanwhile to establish her own milling capacity, and is reported now to be negotiating in the United Kingdom for 3 jute mills of 1,000 looms each. If the policy started

in the two countries continues, production of raw jute and jute manufactures may in the near future reach a level higher than required by the market.

39. Substantial changes in the market of raw jute and jute manufactures have taken place in the first half of 1949, during which the price index of jute manufactures declined from 536 (1939 = 100) to 449 in May, and the average price index for raw jute from 534 to 511. During the last weeks, however, the market situation and prices for both raw jute and jute manufactures have somewhat improved. The price reduction for raw jute had met with heavy protest in Pakistan, whose Government is reported to be preparing a price stabilization scheme for this product. The jute industry in India realizes, however, that it will be able to maintain its export volume to the hard currency area only if it can compete with other packing material, especially paper. The jute problem which has already become acute emphasizes the urgent need for an over-all economic agreement between the two countries.

ANNEX

FINANCE MINISTER'S STATEMENT ON THE RECENT INDO-BRITISH STERLING AGREEMENT

Doctor John Matthai, Finance Minister, speaking at a press conference in New Delhi on August 4, 1949, described the terms of the Indo-British sterling agreement reached last month. Matthai stated the effect of the agreement is:

(A) to release £ 81 million for the year 1948-49 for which year the 1948 agreement did not provide any release.[1/]

(B) to increase the annual releases for the 12 monthly periods ending June, 1950 and 1951 from the original amount of £ 40 million to £ 50 million, and

(C) to cause to be released an additional but unspecified sum sufficient to meet liabilities entered into under the old Open General License before it was cancelled.

Continuing, the Finance Minister stated that convertibility negotiations cease to be bilateral and were merged with discussions of the Commonwealth Finance Ministers' Conference. As a result India was re-admitted to all rights and duties of full membership of the sterling area and quantitative limitations on her right to draw hard currency from central reserves were removed. Limitations on her right to spend hard currency are now the same as those which apply to other members of the sterling area as accepted by the Commonwealth Finance Ministers' Conference. The effect of these limitations in the case of India is explained below.

Irrespective of her export earnings, which, however, she has undertaken to increase without limitations as to amount, India is required to limit her imports

---

1/ This is equivalent to settling the overdraft.

from the dollar area to 75% of the amount she spent on imports in 1948. This, however, is exclusive of any imports she may finance by loans from the International Bank for Reconstruction and Development. The dollar area for this purpose is defined as the U.S.A., Canada and Newfoundland and other American account countries which are mostly countries of Central America. The effect of this agreement is that India will have the right to draw central reserves to the extent of about $140-$150 million as compared to $60 million as per the last agreement. Further, it has been agreed that dollar overdrafts of the previous year need not be reimbursed.

Dr. Matthai said the terms of the agreement, both as regards convertibility and as regards sterling releases, are considerable improvement in the present situation. Though our imports from the dollar areas in 1949-50 will be less than in the previous year, the reason for this lies not in the arrangements regarding convertibility but in the heavy fall of our export earning, the consequences of which cannot be ignored. It is hoped, however, that some relief may be given to our dollar import program by switching our wheat purchases from North America to Australia, discussions towards which end are now in progress.

Obligation of full membership in the sterling area, Dr. Matthai added, is a safeguard to increase gold and dollar reserves of the sterling area by taking every possible step to increase exports to hard currency area and keeping import from that area down to a minimum.

Reviewing the Conference of Commonwealth Finance Ministers, Dr. Matthai said that during six months of the current calendar year 1949 a number of causes, the most important of which was the fall of exports from sterling to hard currency areas, resulted in exceptionally heavy drain on central reserves of

sterling areas as a whole. By June, 1949, the position had become so serious that it was clear if the drain continued at current rates reserves would be completely exhausted within not much more than twelve months, leading to the collapse of the sterling area with serious repercussion on world trade as a whole.

The British Chancellor of the Exchequer therefore considered it necessary to consult the Finance Ministers of Commonwealth countries who, accordingly, met in London on July 13, 1949. The Chancellor indicated that if central reserves were to be maintained at adequate level it was estimated that a saving of approximately $700 million on expenditure on imports would have to be effected in 1949-50 as compared with total sterling area imports during the calendar year 1948. This would represent a cut of about 25% on 1948 import figures.

The proposition was discussed at considerable length and Commonwealth Ministers present eventually agreed to recommend to their governments that action should be taken which would be comparable by its results to that already decided upon by the United Kingdom. India urged that in allocating resources, both in dollar areas and in the sterling area, the principle of equality of sacrifice should be borne in mind, that endeavours should be made to meet the cuts which India would have to make in her dollar import program by making available equivalent imports from the sterling area, that standing machinery should be set up by which Commonwealth Governments could be kept informed of each other's requirements and which would enable the needs of countries within the sterling area to be met by resources of the sterling area without the expenditure of dollars, and that a review should take place as soon as practicable in order to determine whether the cuts made could not be restored. These recommendations were in

general accepted and the Government of India have indicated to other Commonwealth Governments concerned that they are willing to accept a 25% cut on 1948 dollar imports provided that other Commonwealth countries also agree to do so.

(Official release of the Indian Government.)