POLITICAL ECONOMY OF EXTERNAL AID: A CASE STUDY OF U.S. AID TO INDIA FROM THE FIRST FIVE YEAR PLAN TO FOURTH FIVE YEAR PLAN (1951-56 TO 1969-74)

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Certificate

*Certified that the dissertation entitled **"POLITICAL ECONOMY OF EXTERNAL AID: A CASE STUDY OF U.S. AID TO INDIA FROM THE FIRST FIVE YEAR PLAN TO FOURTH FIVE YEAR PLAN (1951-56 TO 1969-74)"** submitted by **ASHOK KUMAR PANKAJ** in partial fulfilment of the requirements for the award of the degree of **MASTER OF PHILOSOPHY** of this University, is his original work. This dissertation has not been submitted for any other degree of this or any other University.*

We recommend that this dissertation be placed before the examiner for evaluation.

PROF. BALADAS GHOSHAL	***PROF. MUCHKUND DUBEY***
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Chapter - I

INTRODUCTION

The classical economists had a truly comprehensive and integrated approach to describing economic phenomena and the laws of economics. That is why they did not confine themselves to the narrow limits of 'Economics' but deal with 'Political Economy'. Adam Smith, the real pioneer in this field, went into "An Enquiry into the Nature and Causes of the Wealth of Nations". The approach that he adopted in conducting this "Enquiry" was not only economic but also social, political and philosophical. The other classical economists like David Ricardo, Malthus and James Stuart Mills wrote on the "Principles of political Economy". Making a significant departure from the classicists, and yet firmly rooted in the classical tradition, Karl Marx in his famous work "Das Capital" dealt with the laws of the rise and fall of capitalism, its mode of functioning, its inherent contradictions and the far-reaching consequences of the inexorable functioning of the laws of capitalism. Marx was a pioneer in the tradition of political economists, though his historical perspective of the rise and functioning of capitalism and his vision of the historical consequence of capitalist development were dramatically different from those of the classical economists proper.

How have these pioneers and their eminent and worthy followers defined "Political economy"? Here are the examples of a few of the definitions.

According to Lenin, "Political economy is the science dealing with the developing historical systems of social production"[1]

Engels viewed political economy as "the science of the laws governing the production and exchange of the material means of subsistence in human society."[2]

Oscar Lange defined political economy as "the study of the social laws governing the production and distribution of the material means of satisfying human needs".[3]

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1. As quoted in Oscar Lange, *Political Economy* (New York, 1963), vol.I, p.1.
2. Engels, *Revolution in Science* (Moscow, 1934), p.165.
3. Oscar Lange, *Political Economy* (New York, 1963), vol.I, p.1.

And according to Henry George, "political economy is the science that treats of the nature of wealth and of the laws of its production and distribution."[4]

All these definitions are the variations of the central theme

a) that the political economy is a body (or science) of laws and principles;

b) that these laws and principles relate to the *material* means of satisfying human needs;

c) that political economy deals with the *production* and *distribution* of the material means of human satisfaction;

d) that these laws are not only economic but also *social, behavioural, political, moral and philosophical*;

e) and that these laws are *scientifically arrived* at either *deductively or empirically or through experimentation*.

Foreign aid is in the nature of economic transaction as it deals with one of the material means of satisfying human needs. There are laws governing its inherent nature and

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4. Henry George, *The Science of Political Economy* (London, 1932), vol.I, p.52.

flows as well as its production and distribution in the donor and recipient countries. The political economy of foreign aid is a study of these laws.

This dissertation is a study of the laws governing the nature, flows and consequences of U.S. foreign aid to India for the production and distribution of material means of satisfying human needs in both the societies. In Chapter II, arguments for and against foreign aid are summarized and the validity of these arguments are tested both on the basis of deductive logic as well as empirically on the basis of the practical experience of giving and receiving aid.

Chapter III deals with the flow of U.S. aid to India both quantitatively and qualitatively. Quantitatively, the trends in the over-all flows and sectoral distribution of U.S. aid to India are analysed from the time of India's independence until the time when U.S. aid still played a significant role in the Indian economy. Qualitatively, the terms and conditions of U.S. aid to India are analysed in the same historical framework.

Chapter IV deals with the motives behind the U.S. decision to provide aid to India and behind the various forms and terms and conditions of this aid. An attempt has been made to analyse not only the economic motives but also the political ones.

The last chapter contains a summary of the conclusions derived from the analysis in the previous three chapters.

As already stated, the time period chosen is from the date of India's independence to the time until U.S. aid still played a significant role in India's economic development. Thus the date of the commencement of the analysis is the same for the entire study but the date of termination is different, depending upon the aspect of the U.S. foreign aid to India, under study.

For example, the analysis of aid given from the Development Loan Fund and the Technical Co-operation Mission stops at the end of the Third Five year plan because after that date, flow of aid from these institutions totally stopped.

Similarly the figures on terms and conditions of U.S. aid to India and on its sectoral distribution have also been given till the end of the Fifth Five Year Plan because in the Fifth Five Year Plan, the U.S. aid to India declined drastically and became an insignificant part of total external aid coming to India.

Figures for India's dependence on U.S. aid have been given till the end of the Seventh Five Year Plan. From the Fifth Plan, U.S. share of total external aid to India declined sharply. In the Seventh Five Year Plan, it came down to just 2 percent of total external aid coming to India.

Chapter - II

THEORETICAL FRAMEWORK OF THE POLITICAL ECONOMY OF EXTERNAL AID

From Adam Smith to Ricardo, from Mill to Marx, economists have identified capital as a major factor promoting growth and development. Although Adam Smith did not formulate a theoretical growth model; he stated very clearly that specialization and trade, and capital accumulation and increased productivity through technical advance, were the major factors in growth.[1]

For Ricardo, capital accumulation was the key to growth but accumulation had depressing effects, because as growth picked up, profits tended to decline because of a rise in wages resulting from higher food prices as a consequence of expanding population, scarcity of arable lands and the operation of the law of diminishing returns. To Ricardo, growth stopped with the decline in capital accumulation, decline in population growth and subsistence wages.[2]

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1. Adam Smith, *Enquiry into the Nature And Causes of the Wealth of Nations* (London, 1921), vol. I & II.

2. David Ricardo, *Principles of Political Economy And Taxation* (London, 1933), pp. 5-32 & 64-76.

Marx regarded capital as a fundamental plank of modern capitalism. He also said that in the early stage of growth and development, capital exports to the less developing countries were a major factor in increasing productivity. Trade and capital both were promoters of growth in the developing countries.[3]

Among the neo-classicists, Marshall underlined the importance of capital and free trade, besides other factors, as promoters of growth. According to Marshall, the willingness and ability to save, improved transport, external economies, increasing returns and the existence of extensive markets were the major influences on growth.[4]

In the post-Keynesian revolution period, development economics acquired a definite shape and a radically new approach. By the 1950s and later on, development theory had started pin-pointing capital as a primary and major

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3. See Joseph Shumpeter, *Capitalism, Socialism and Democracy* (New York, 1950), p.21. See also his *History of Economic Analysis*, p.573. See Benjamin Higgins, *Economic Development, Problems Principles And Policies* (New Delhi, 1990), pp.76-87.

4. See Raymon F. Mikesell, *The Economics of Foreign Aid* (London, 1968), pp.28-30. See also, Alfred Marshall, *Principles of Economics* (London, 1920), p.91.

determinant of growth. The Harrod-Domar growth model identified capital as the single most important factor enhancing growth and development.[5] W.W. Rostow propounded historical stages theory in which the pre-condition of take-off, and take-off, were two important stages from the point of view of developing economies. And for an economy to move out form the pre-condition of take-off to a take off stage, massive capital was required to be invested.[6]

According to the critical rate of growth and minimum effort thesis as propounded by Leibenstein and Nelson, there is a minimum critical level of per capita income which must be reached in order for sustained growth to take place.[7] And this sustained growth can be achieved only by escaping the

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5. Harrod-Domar growth model is a combination of two models presented separately but concurrently. R.F. Harrod, *Towards A Dynamic Economics* (London, 1948); Evsey. D. Domar, *Essays In The Theory of Economic Growth* (New York), 1957.

6. W.W, Rostow's historical stage theory divides development history of any society into five stages : the traditional society : the preconditions for take-off, take-off, the drive to maturity and the age of high mass consumption. See W.W. Rostow, *The stages of Economic Growth: A Non-Communist Manifesto* (Cambridge, 1961), pp.1,2.4.

7. Raymond F. Mikesell, *The Economics of Foreign Aid* (London, 1966), pp.46-48. See R.R.Nelson, "A Theory of Low Level Equilibrium Trap", *American Economic Review* (December 1956), pp.894-908.

low-level equilibrium trap, which can be done only with the help of excess investment demand in the economy.

Similarly, the big-push theory of Ragnar Nurkse made out a case for massive capital investment to break out of the vicious circle of poverty, low income, low saving, low investment and low production.[8]

Arthur Lewis, in his absorption of surplus labour theory argued that the draining of surplus labour from the rural sector would not affect agricultural productivity, since its marginal productivity is zero or negligible.[9] But as the underdeveloped economies face the problems of low savings, low capital formation and low investment, capital imports into these countries are an inevitable necessity to expand the industrial sector, which will absorb surplus labour from the agricultural sector.

External aid is widely treated as a source of capital formation which supplements and complements domestic capital formation. In various growth models, capital is identified

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8. See Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (Oxford, 1953), p.5.

9. W.A. Lewis, *Economic Development with Unlimited Supplies of Labour* (Manchester, 1954); See also Michael P. Todaro, *Economic Development in the Third World* (New Delhi, 1987), pp.67-82.

as one of the most important factors of production; economic aid since identified with capital formation, is treated as a major causative factor to promote growth and development.

In the 1950s and 1960s, well-known champions of external economic aid, Mrs Barbara Ward, W.W.Rostow, Professor Max F. Millikan, J.K. Galbraith, Raul Prebisch, Hans Singer strongly argued that the less developed countries could easily pick up higher growth rates and move to self sustained growth provided they received extra savings from outside. The low level of capital formation was identified as the single most important constraint to rapid economic growth. This deficiency could be removed only by supplementing domestic capital formation by extra savings from outside.

EXTERNAL AID AND ECONOMIC GROWTH : A POSITIVE CORRELATION

There are three basic approaches to analyse the proposition that external aid is positively correlated to economic growth.

(A) The Savings-Investment Gap Approach

(B) The Foreign Exchange Earning-Expenditure Gap Approach

(C) The Capital Absorptive Capacity Approach.

All those economists who support external aid have used one or the other of these three approaches, or a combination thereof, or a variation of these approaches, to justify their points of view.

A) The Savings - Investment Gap Approach

This has been propounded by Max Millikan, W.W.Rostow. P.N. Rosenstein Rodan, Chenery and Strout etc. The savings-investment gap approach identified low savings and low capital formation as a major constraint to growth. According to this approach, with the help of external aid an economy can achieve a higher rate of growth than permitted by its domestic savings rate.[10] Since it is assumed that in less-developed economies, marginal propensity to save is greater than average propensity to save, any further increment in income would lead to increment in savings rate as well. And this will further propel the growth rate. As a result, the economy will attain a self-sustaining growth more quickly than it would have without external aid.

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10. The savings-investment gap approach basically relies on Harrod-Domar growth model and Cobb-Douglas production function. Max Millikan and W.W. Rostow are most prominent proponents of this approach. See, Max Millikan and W.W. Rostow, *A Proposal: Key to Effective Foreign Policy* (M.I.T, 1957), Chapter V & VI, pp.1-73.

B) The Foreign Exchange Earning-Expenditure Gap Approach:

Ronald I. Mckinnon is the most prominent proponent of this approach.[11] The foreign exchange earning-expenditure gap approach is based on a number of assumptions. Firstly, it is assumed that there are many goods which have strategic importance for growth but cannot be produced domestically at the early stage of development and therefore have to be imported from outside. Secondly, it is assumed that domestic resources and external resources have imperfect substitutabilty. Thirdly, it is held that these import goods are major obstacles to growth and development. And lastly, it is assumed that in the absence of these strategic goods, the economy is not operating at its optimum level.[12]

The proponents of this approach further argued that foreign exchange could be obtained only by foreign aid because of the inherent limitations of export promotion at the early stage of development.

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11. Ronald I Mckinnon, "Foreign Exchange Constaints in Economic Development and Efficient Aid Allocation", *Economic Journal*, June 1974, pp.388-409. See also J.M. Healey, *The Economics of Aid* (London, 1971), pp.31-50, Raymond F.Mikesell, *The Economics of Foreign Aid* (London, 1968), pp.73-74, 89-91.

12. ibid.

Raul Prebisch advocates the theory of the secular trend of decline in the terms of trade of primary products and argues that the long-run terms of trade would inevitably move against the exporters of primary products.[13] This is because the price elasticity of demand for primary products is always less than one; there is therefore an inherent limitation to the earning of foreign exchange by the country exporting primary products. Secondly the domestic supply condition is itself inelastic and, therefore, even exportable surpluses have limited capacity to expand.

But since, as already noted, there is imperfect substitutability of domestic resources with external resources, foreign exchange earning is an inevitable necessity to achieve a higher growth rate in the early stage of development. Besides, the strategic goods without which even domestic capacity cannot be utilized fully, have to be imported at any cost. Moreover, if inspite of good savings rate the growth rate is low only due to foregin exchange constraint, it is important to obtain foreign exchange to exploit the domestic economic potentialities. Therefore,

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13. Raul Prebisch, *Towards a New Trade Policy for Development* (U.N. 64 II, p.4).

Raul Prebisch suggested that the primary products exporting under-developed countries should move out of primary production into import substitution industry as rapidly as possible, with the help of external aid.[14] Similarly Ronald I. Mckinnon strongly pleaded for external aid to remove the foreign exchange bottlenecks in the early stage of growth and development.[15]

C) The Capital Absorptive Capacity Approach

The capital-absorptive capacity approach has been propounded by Edward S. Mason, John Adler, Max Millikan, W.W. Rostow, P.N. Rosentein Rodan etc. Capital absorptive capacity can be defined as more or less absolute limit to the amount of capital, domestic or external, that can be productively employed in the sense of giving net returns over and above depreciation.

Economists and policy planners who don't agree with the savings-investment gap approach or foreign exchange

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14. ibid.

15. Ronald I. Mckinnon, "Foreign Exchange Constraints in Economic Development and Efficient Aid Allocation", *Economic Jounal*, June 1974, pp.388-409.

earnings-expenditure gap approach, go in for this approach to determine the amount and nature of external aid. This approach is based on the assumption that non-economic factors, mainly cultural institutional bottlenecks, lack of entrepreneurship, social impediments to technological changes and innovation, low level of education, rapid population growth, immobility of productive factors etc, are major obstacles to growth and development.

Therefore, this approach formulates a non-economic model of external aid in which the overall emphasis is given on specific programme or project based aid which would remove the non-economic bottlenecks to growth and development. Programmes relating to education level improvement, specific areas development programmes are the types of assistance which can deal with the non-economic constraints to growth.This is expected simultaneously to improve the overall economic returns in other sectors as well by conferring the benefit of external economies. The result would be the full utilization of domestic capacity as well as the optimum utilization of foreign resources.

Apart from the theoretical rationale for external capital, there is also empirical evidence of the efficiency of foreign capital in promoting growth. In the early 1950s, a massive economic assistance programme was launched by the United States to bail out nineteen European countries facing the problems of low productivity and stagnant growth. This external assistance programme, popularly known as the Marshall Plan, continued for a decade and in some cases less than a decade. The successful implementation and termination of this programme is a further evidence to suggest that if the critical element of additional savings is injected from outside, the process of accelerating growth would be expedited.

EXTERNAL AID AND ECONOMIC GROWTH: A NEGATIVE CORRELATION

There is a school of thought among economists and policy makers which is critical of external aid and rejects the hypothesis that external aid is positively correlated to economic growth.[16] The argument of these economists and policy makers is based on both theoretical proposition and practical experiences of aid receiving countries. The following are some of the arguments advanced by these economists.

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16. The Chief propounders of this school of thought are P.T. Bauer, B.R. Shenoy. T.J. Byres and Michael Lipton.

They argue that all the above-mentioned models of external aid are biased towards capital intensive growth strategy. Definitely, capital is one of the most important factors which can help in stimulating growth in any economy. But the problems of less-developed economies go beyond either savings constraint or foreign exchange constraints. For example, problems like colonial and semi-colonial dependence on the North; profits and capital gains returning to the metropolitan investors; time-lag between inventions and discoveries and their application etc, constitute important bottlenecks to development in under-developed countries which cannot be sorted out simply by external aid. Similarly the socio-cultural impediments to growth; structural rigidities; low-level of technology; poor banking and financial institutions; wrong government policy; overloaded primary sector are other bottlenecks which cannot be removed just by pumping extra capital from outside.

P.T. Bauer, a major critique of external aid totally rejects the notion that external aid can help achieve self-sustaining growth in less-developed countries.[17] He

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17. Barbara Ward and P.T. Bauer, *Two Views on Aid to Developing Countries* (Bombay, 1968), pp.40-46.

identifies major determinants of development and points out that these determinants of development cannot be affected favourably to any substantial extent by external aid. People's beliefs, economic qualities and attitudes, their values and objectives and their social and political values are major determinants of development; these are not influenced by foreign aid. Further, he identifies two important factors, natural resources and external market opportunities, and holds that the latter is more significant from the point of view of develpment than the former. To support his argument, he gives the historical evidence of Japan, Belgium and Holland, all deficient in natural resources, but which have nevertheless made significant progress in economic development by exploiting external market opportunities.[18]

P.T. Bauer further gives the historical evidence of countries which made material progress without any external aid and of countries which could not develop substantially inspite of huge external aid. He quotes the example of Hongkong, Japan, Malaya and many other developed countries of the West, which have made substantial progress in

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18. ibid., pp.46-48.

economic development without any government to government aid. On the other hand, there are a good many countries which have not made any substantial progress inspite of huge external aid given to them. He quotes India as one such country which has been unable to make sufficient progress inspite of huge external aid given for a long period. Referring to the year 1964-65, P.T. Bauer writes

> "Thirteen years after the beginning of Western aid and the inception of the Five Year Plan, the country experienced in 1964-65 the most acute of its recurrent almost annual food and foreign exchange crises".[19]

To the protagonists of external aid, the experience of Marshall Plan is the most effective example to support the proposition that external aid has demonstrated its capability to enhance growth and development. However, this common analogy of external aid with Marshall plan is based on a number of false notions.[20]

Firstly, whereas the economies of the Western Europe had to be restored, those of the underdeveloped countries have to be developed. The Western European countries had

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19. ibid., p.47; See also P.T. Bauer, *United Stats Aid and India's Economic Development* (Washington, 1959).

20. ibid., pp.48-49.

already entered the take-off stage, and the post-Second World War stagnation was a mere aberration in the growth path, but the less developed countries have yet to enter into the take off stage.

Secondly, in the post-Second World War period, the Western European Countries faced the problem of shortage of raw materials, food stocks and to an extent capital; but they had well-developed human capital; highly developed scientific and technical manpower; developed infrastructural and other facilities and, of course, well-organized industrial sector. But the problem of the less-developed countries is to build these human capital and other infrastructural facilities. And, therefore, external aid as suggested by savings-investment gap approach is not a sufficient solution.

Coming back to the more general arguments against external aid, it is stated that imports of resources from outside through external aid has another implication for the aid receiving country. When the resources are produced indigenously, the country concerned has the opportunity of learning and developing the process of production, new skills and technology. But when the resources are imported,

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the opportunity of leaning, developing and exploiting the resources is lost. This loss of opportunity in terms of development process enhances the aid receiving country's dependence on external sources.[21]

Another very serious problem related to external aid is lack of discipline in maintaining balance of payment position. More often than not, external aid is geared to meeting the shortage of foreign exchange. But the problem lies in the way in which the recipient country policy makers utilize this shortage as an argument for getting aid from outside. In the process, there is a tendency for this shortage to be perpetuated and no effort being made to maintain discipline in the management of foreign exchange.[22]

Another effect of foreign aid, according to the critics, is that the government of the recipient country will always engage in ambitious planning which is beyond the resources it can mobilise locally. Paucity of fund is utilized as an argument for aid form outside. This thwarts

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21. See. P.T. Bauer and B.S. Yamey, "The Pearson Report; A Review" in T.J. Byres, (ed.), *Foreign Resources and Economic Development* (London 1972), pp.41-71.

22. ibid.

motives for mobilising domestic resources and often leads to deficit financing. The result is prevalence of inflationary tendencies in most of these countries.[23]

Yet another argument against foreign aid is that it is generally provided by the donor countries to the central government of the recipient countries. This results in an increase in the centralisation of power in the recipient countries. An adverse implication of centralisation is that it leads to an ambitious expansion of public sector undertakings which more often than not have turned to be uneconomic in operation.[24] This happened particularly in India where the Constitution gives the central government the sole power to enter into international agreements for capital borrowing.

Food aid was a very important component of external aid to India in the 1950s and 1960s. American P.L. 480 food aid was the most important food-aid programme for India. But critics of external aid are of the view that food aid has done a lot of harm to the Indian economy. B.R. Shenoy is one

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23. ibid.

24. ibid.

of the most well-known critics of food aid to India.[25]

Food aid has an adverse repercussions on agrarian economy in three ways.[26] Firstly, it adversely affects the price level of the agricultural commodities. Secondly, it creates conditions for the decline of output by price-effects. And thirdly, it leads to shifting of the pattern of crop cultivation which is often not economical.

As a country receives food-grains from outside, there is an artificial supply of extra foods-grains in the economy. This extra supply may depress agricultural prices in the short run. In the long run, this depression in agricultural price may affect overall production. Not only that, the farmers will also start substituting products which will give them comparatively high prices. In that case the prevailing cultivable area under food-grains may be shifted to cash crops. This will lead to overall reduction in the production of food-grains.[27]

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25. B.R. Shenoy's two books on the subject are *P.L. 480 Aid and India's Food Problem* (New Delhi, 1974) & *India's Economic Policy* (Bombay, 1968).

26. ibid. Also see A.J. Fonseca, *Food Aid for Relief and Development* (New Delhi, 1983), pp.97-110.

27. V.K.R.V. Rao and Dharam Narain, *Foreignd Aid and India's Economic Development* (New Delhi, 1963), pp.1-13. Also see A.J. Fonseca, *Food Aid For Relief And Development* (New Delhi, 1983), pp.97-110.

These adverse effects of food aid can also be empirically demonstrated. Taking the example of India, in the pre-P.L. 480 aid period (before 1952-53), the price of wheat in India was at its normal position midway between rice and jowar. But in post P.L. 480 period, the price of wheat declined; and this decline in wheat price was noticed when there was inflationary trend in general commodity prices. This sort of situation continued till 1962-63 when wheat import constituted on average 103 per cent of the domestic marketable surplus. However from 1967 onwards, when P.L. 480 assistance started declining, wheat imports dropped sharply from 230 per cent to 170 per cent and later on to merely 50 per cent of the total domestic marketable surplus. Correspondingly wheat price started picking up and just in few years it got its normal price restored midway between rice and jowar.[28]

The fact that during the period of food aid wheat cropping was substituted by other crops is demonstrated by the following figures. In 1956-57, Indian farmers produced 74 per cent of total supply of wheat. This declined to 62

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28. ibid.

per cent in 1964-65, and further declined to 54 per cent in 1965-66, the peak period of food aid under P.L. 480.

B.R. Shenoy is also of the view that P.L. 480 counterpart fund was expansionary in effect. In the case of P.L. 480 food aid, the payment out of counterpart fund had to be made in Indian currency. This fund was used to be spent by the U.S. Development Officer posted at the U.S. embassy. But the proceeds from the sales of wheat was inadequate to reimburse the total cost of wheat import. This was due to the sale of wheat through public distribution system under subsidised rate. To meet the resultant deficit in payment to the U.S. Govt., the Government of India started borrowing money from the Reserve Bank of India, which led to extra liquidity in the market. This additional liquidity induced inflationary situation in the coutury.

Thus we see that external aid has been regarded both as an engine of growth and development as well as an obstacle to growth and development. The protagonists of external aid proceed on the assumption that the main problem of the less-developed countries lies in poor capital formation, and if this poor capital formation can be supplemented from outside in terms of external aid, the country will very soon obtain self-sustaining growth rate. On the other hand, the critics of external aid argue that the less-developed countries face many institutional bottlenecks like poor human capital, low level of technology, poor infrastructural facilities, and other socio-cultural bottlenecks, which do not permit the economy to move to a take-off stage. In such a situation absorption of external capital is unlikely to prove productive.

It is clear that external aid can be no substitute for domestic resources. It can only supplement domestic capital formation. Besides, human capital and necessary infrastructure must be built for making proper use of external aid. Though external aid itself can help in this process, there is no substitute for domestic efforts in these areas. And, finally, external aid should never be allowed to become a soft option, an excuse for not taking the measures that are required for resource mobilisation and for the proper management of balance of payments.

Chapter - III

TRENDS IN THE INFLOW OF U.S. AID TO INDIA

Till the Fourth Five Year Plan (1974-79), the United States was the largest contributor of external aid to India. The share of the U.S. aid which stood at 58% of total aid in 1950-51 and 1965-66 came down to 49% during the three Annual Plans (1966-69).[1] In the Fourth Five Year Plan, the share further declined to 27%. And from the Fifth Plan, there has been drastic decline in the U.S. aid to India. Whereas in the Fourth Plan, it stood at 27% of total aid, it was merely 5% during the Fifth Plan and 3% during the Sixth Plan. In the Seventh Plan, the share remained just 2% of total aid.

On the other hand, the share of multilateral institutions in total aid to India increased significantly from the Fourth Plan onwards. For example, the World Bank and the International Development Association (I.D.A)

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1. The Third Plan was completed in 1966 and the Fourth Plan was scheduled to commence from 1966. But on account of Indo-Pak conflict of 1965 and thereafter two successive drought years, the Fourth Plan was postponed. Instead three Annual Plans were implemented.

provided 15% of total external aid till the Fourth Plan. Their shares increased to 30% in the Fifth Plan, to 53% in the Sixth Plan and to 58% in the Seventh Plan.

The shares of other bilateral donors have remained more or less constant and in some cases they have increased. For instance, the U.K. provided 9% of total aid at the end of the Fourth Five Year Plan. Its share remained at 9% and 8% during the Fifth Plan and the Sixth Plan respectively. West Germany provided 8% of total aid upto the Fourth Plan, and its share was maintained at 8%, 6% and 5% during the Fifth Plan, Sixth Plan and Seventh Plan respectively. A comparative picture of the shares of different donors is presented in the Table No. I.

Table - I

Share of Different Donors in Total Aid Utilized (1951-52 to 1989-90)

Financial Aid givers	Up to the Fourth Plan 1951 to 1974		Fifth Plan 1974-79		Sixth Plan 1980-85		Seventh Plan 1985-90	
	Rs crores	%	Rs. Crores	%	Rs crores	%	Rs crores	%
USA	5321	45	292	5	309	3	423	2
UK	1034	9	568	9	869	8	806	4
W Germany	909	8	470	8	650	6	1226	5
USSR	703	6	228	4	278	3	984	4
Japan	539	5	391	7	462	4	2069	9
I.B.R.D	1786	15	1786	30	1632	15	7758	34
I.D.A.					4180	38	5444	24
Consortium Members	19098	92	4469	74	9893	91	20352	90
USSR & E. Europe	869	7	349	6	278	2	1048	4
Others	135	1	1226	20	732	7	1330	6
Total	11922	100	6044	100	10903	100	22700	100

1. Consortium members include Austria, Belgium, Canada, Denmark, France, W. Germany, Italy, Japan, Netherlands, Sweden, U.K., U.S.A., I.B.R.D., and I.D.A.

2. East European Countries include Bulgaria, Czechoslovakia, Hungry, Poland, U.S.S.R and Yugoslavia.

3. Others include the rest of the donors.

Source: Government of India, *Economic Survey*, Various Issues.

PLAN WISE ANALYSIS OF U.S. AID TO INDIA

The U.S. aid to India came in three forms: grants, loans and food aid. And there were three main channels to give aid to India.

A. Agency For International Development (A.I.D.) (The earlier Technical Co-operation Mission and Development Loan Fund were merged in 1961 to form A.I.D.)

B. The Export-Import Bank

C. The P.L.480/665 Programmes.

D. Others

A.a.1. Technical Cooperation Mission (T.C.M.)

The Indo-US Technical Cooperation Mission Agreement was signed in 1952 to provide loans and grants to India for mutually agreed projects. It was the first agency to channel U.S aid to India, and till 1955 the only agency to do so.

Three loans agreements were signed under the T.C.M; the first loan worth 30.73 million (Rs 14.63 crores) was granted in the First Plan and the two more loans worth $ 57.96 million (Rs 27.59 crores) were provided duning the Second plan. The Indian railways were given the major share of the total amount. Then came the agreements for the purchase of steel, and fertilizers, for malaria control, for community development etc. Railways were given $45.11 million (50.7%); $10.4 million and $8.85 million were allocated for the purchase of steel and fertilizers respectively. For Malaria control, $9.53 million was given, and for the manufacturing of cement, $6.23 million was given. The rest was allocated for community development programmes, Delhi Thermal Power Plant, rural electrification and other projects. The loans under these agreements carried 4% rate of interest and its maturity period spread over 37 to 40 years.

T.C.M. agreements also provided grants for various purposes worth Rs 147.28 crores upto March 1966. Out of this Rs.86.16 crores were given for the First Plan; Rs.44.11 crores for the Second Plan and the rest Rs.17.10 crores for the Third Plan.

A.a.2 United States Development Loan Fund (D.L.F.)

The Development Loan Fund was established by an Act of the US Congress in 1957. It started its aid programme in India in June 1958. Upto October 1961, D.L.F. provided

28 loans to India amounting to $487 million. D.L.F basically provided loans for industrial development. The industrial sector was given loans worth Rs.111.40 corers; the power sector was given loans worth Rs.66.57 crores and the rest Rs.64.36 crores were given to the transport sector.

Table - II

Authorisation of D.L.F. Loans to India

(Rs. Crores)

Sector	Second Plan	Third Plan	Total
Industry	94.74	16.66	111.40
Power	38.10	28.47	66.57
Transport	60.97	3.39	64.36
Total	193.81	48.52	242.33

Source: Government of India, *Economic Survey*, 1966-67.

The loans provided by D.L.F. were generally untied till 1959. But in 1959, the D.L.F. inserted a "Buy American Clause" and thereafter all loans were tied. The interest rate charged by D.L.F. varied between 3.5% per annum and 5.35% per annum. However, loans provided to the public sector carried lower rate of interest, generally 3.5% per annum. The maturity period varied between 5 years and 20 years. But the grace period was very short, generally one year but in some cases even six months.

A. United States Agency for International Development (U.S.A.I.D.)

The Agency for International Development aid programme to India started in the Third Five Year Plan. During this plan period, the Agency entered into 35 loan agreements amounting to $1376.31 million. A major share of this amount was non-project aid which was to be utilized for the import of commodities, equipment and components. Sectorwise, industry got $994.44 million, the power sector got $ 232.44 million and the transport sector $149.6 million.

During three Annual Plans, 1966-69, the total aid provided by the U.S.A.I.D. was 897.97 million out of which the industrial sector got the largest amount $870.85 million, power projects got $ 17.47 million, and the rest was given for miscellaneous purposes, such as higher education and family planning programmes.

In the fourth plan the U.S.A.I.D. provided loans worth $423.79 million. The major part of this amount was allocated for industrial development and the rest for debt relief. The industry got $ 370.86 million and for debt relief $ 52.93 million was allocated.

In the fifth plan the U.S.A.I.D. provided just $ 45 million and that only for debt relief.

Table - III

U.S.A.I.D Authorised Loans to India [million dollars]

Sector	Third Plan	Three Annual Plans	Fourth Plan	Fifth Plan	Total
Industry	994.44	870.85	370.86	-	2236.15
Power	232.44	17.47	-	-	249.71
Transport	149.61	-	-	-	149.61
Debt Relief	-	-	52.93	45.00	97.93
Miscellancous	-	9.25	-	-	9.25
Total	1376.29	897.57	423.79	45.00	2742.65

Source: Government of India, *External Assistance*, 1974-75, pp.108-115.

From the table no. III, it is also clear that the major chunk of the U.S.A.I.D. aid was given for the development of industrial sector. The power sector got the second priority and the transport sector the third priority. The amount of the U.S.A.I.D aid gradually declined from the Third Plan to the Fourth Plan. In the Fifth Plan, it was a meagre allocation and that too for debt relief.

The terms and conditions of the U.S.A.I.D loans to India hardened form 1967-68 onwards. Upto 1963, the rate of interest charged on 22 loans was just a token figure of 0.75% per annum. But from 1964 onwards, the maturity period was bifurcated into two parts; one part with low rate of interest, and the other with a high rate of interest. From 1964 onward, for the first 10 years the rate of interest remained at 0.75% per annum, but for the remaining period i.e. 30 years, it was increased to 2% per annum. Again this was changed in 1965, 1967 and 1968 as 1% and 2.5%; 2.0%, 2.5%; and 2.0% and 3% respectively for the period of 10 years and 30 years respectively.

Generally the repayment was spreads over 40 years and 10 years were given as the grace period.

B. Export-Import Bank

The Export-Import Bank started giving aid to India in the Second Five Year Plan. During this period, it provided

$215.52 million, entirely for industrial development. In the Third Plan, it provided $ 189.32 million, out of which $138.99 million was for industry and the rest for transport. During the three Annual Plans, it provided total aid worth $59.67 million of which 21.92 million was alloted for industry and the rest for transport In the Fourth Plan, it provided 42.35 million for transport development and 15.52 million for industrial development. In the Fifth Plan, industrial development programme got merely $1.93 million and the rest $29.64 million was given for transport development.

Table - IV

EXPORT-IMPORT BANK AID TO INDIA
(Million Dollars)

Sector	Second Plan	Third Plan	Three Annual Plans	Fourth Plan	Fifth Plan	Total
Industry	215.52	138.99	21.92	15.52	1.93	392.88
Power	-	-	-	-	-	-
Transport	-	50.33	37.75	42.35	29.64	160.77
Miscellaneous	-	-	-	-	-	-
Total	215.52	189.32	59.67	57.87	31.57	552.95

Source: Government of India, *External Assistance*, 1974-75, pp.120-125 & 1977-78, issue, pp.180-186.

Generally the EXIM Bank provided aid on hard terms and conditions. The Bank extended aid on the conditions that the projects or programmes to be financed should promote the trade interests of the United States. The rate of interest charged by the EXIM Bank varied between 5.5% and 6% per annum, and the maturity period varied between 5 years and 12 years. The grace period was generally short and in some cases it was just six months.

C. Food Aid Under Public Law 480; Food for Peace Programme

P.L.480 or Agricultural Trade Development and Assistance Act of 1954 was passed to provide commodity assistance to friendly countries. P.L.480 had four titles - Title I, Title II, Title III and Title IV.[2]

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2. The Agricultural Trade Development and Assistance Act of 1954 (Public Law-480) had four titles. Title I of P.L. 480 Act provided for the sale of agricultural comodities in return for payments in the currency of recipient country. However, in 1966,its terms were changed and the repayment was provided to be made partly in recipient country's currency and partly in convertible currency. Title II authorised the President of the U.S. to provide emergency assistance to foreign countries affected by famines or other difficult problems. Title III provided for double use of agricultural commodities aid; one was to be used in exchange for strategic materials and the other was provided to be used as a donation to non-profit valuntary agencies who cared for needy persons both in the U.S.A. and outside the U.S.A. Title IV provided long term credit to friendly centuries for economic development.

Title I: Title I was a concessional aid repayable in local currency. However, from 1966 the terms of Title I was changed and repayment was to be accepted in dollars only P.L.480 Title I aid to India started in 1956 and it continued till 1971. Under this title, India imported 60 million tonnes of foodgrains and other commodities worth Rs.2557 crores out of which Rs.314 crores were repayable in dollar. The maturity period spread ever 40 years with a grace period of 10 years. Under rupee payment provision, 17 agreements worth Rs. 2282.00 crores were signed. The planwise break up is as follows:-

Table - V

P.L. - 480 Title I Aid (Rupee payable)

Period	Number of Agreements	Total Value Thousand Dollars	Ruppee Value (in crores)
Second Plan	5	2337303	1113.00
Third Plan	4	1334863	450.63
Post-Third Plan	8	1682600	718.37
Total	17	5354766	2282.00

Sources: Government of India, Economic Survey, 1966-67.
Government of India, External Assistance, 1974-75.
U.S.A.I.D., Fact Sheet on U.S. Economic Assistance to India, New Delhi.

Under the convertible currency provision, the following agreements were signed:-

Table - VI

P.L. - 480 Title I Aid (Dollar Payable)

Date of Agreements	Authorised Total Values (in 1000 Dollars)
June 24, 1967	24,200
September 12, 1967	19,000
December 30, 1967	46,900
December 23, 1968	71,600
April 25, 1969	35,600
October 13, 1968	114,900
April 1, 1971	128,300
Total	4,40,500

Source: U.S.A.I.D., Fact Sheet on U.S. Economic Assistance to India.

When we analyse all these agreements under P.L.480 Title I commoditywise, we find that food-grains dominated the commodities procured. Wheat was the most important item which accounted for three-fourths of the total value. Rice, Cotton, and vegetable oil were other important items claiming major shares in total commodity import:

Table - VII

Commodity-wise Break-up of P.L. - 480 Title I Agreement Signed upto 1st April 1971

Commodities	Authorised Quantity in thousands of metric tonnes	Value in million dollars
Wheat	52233.2	3185.8
Sorghum/Maize	5542.3	278.8
Rice	1848.1	225.9
Cotton	4059.6	464.1
Tallow	170.0	28.7
Tobacco	7.4	17.3
Milk/dry/nonfat	24.9	4.6
Oil-Soyabeans/ Cotton seed	506.7	124.4
Milk/evaporated	13.0	4.1
Milk dry	0.23	0.3
Cheese processed	0.08	0.1
Fruit tinned	0.40	0.1
Total	64405.91	4334.2

Source: Government of India, External Assistance, Various Issues.

Title II: Apart from Title I agreement, India also got aid under P.L.-480 Title II. Title II aid provided to India was worth $824.4 million (Rs.618.3 crores) between 1955 and 1973. Title II imports were given to India to meet famine situation or to create a buffer-stock of food-grains to stave off any starving situation.

Title III and Title IV: India didn't get any aid under Title III of P.L.480. However, under Title IV of P.L.-480, India got some amounts. The first agreement under Title IV was signed in March 1976 which was followed by two agreements signed in May 1976 and February 1977. The total amount was of the order of $237 million.

D. Other Forms of Aid

i) Wheat Lean Under India Food Emergency Act:

It was the first Act of the US. Congress for providing food aid to India. In 1951, under this Act, the US Congress authorized a wheat loan of $189.7 million (Rs. 90.31 crores) for the purchase of two million tonnes of wheat. It carried an interest rate of 2.5% per annum and the repayment was to be made in dollar.

ii) Asian Economic Development Fund Assistance:

Under this programme, the U.S. provided an amount of $18.4 million to India in 1958, which was to be utilized for the development of iron-ore mines in Rourkela and to improve the port facilities at Vishakhapatnam.

iii) Public Law-665 Aid:

In 1955, Public Law-655 Act was passed by amending the Mutual Security Act of 1951, so that India could be supplied agricultural commodities like wheat and cotton. Under this Act India was provided development assistance partly as loans and partly as grants. The repayment was to be made in rupees. The total value of commodities aid under this programme was $67.67 million out of which wheat import was worth $52.18 million and cotton import was worth $15.49 million. Under this programme aid to India was provided till the Second Plan.

iv) U.S. Banks Assistance:

Apart from the above mentioned agencies, the different banks of the U.S. also provided loans to India from time to time. These banks basically provided commercial loans on hard terms. Upto the three Annual Plans, India got assistance from these banks. In the Second Plan, when these banks started giving loans to India, loans worth $12.40 million were provided, which increased to $41.96 million during the Third Plan and to $44.50 million during the three Annual Plans. All these were spent on purchasing Boeing aircrafts. The rate of interest of these loans varied between 5% and 8% per annum and the maturity period ranged between just 3 years and 10 years.

GRANTS AND LOANS IN U.S. AID

The United States provided aid to India both as grants and as loans. However, the share of loans has been more than 97% of total aid authorized till 1979-80, and that of grants just 2.9%. The share of grants was a bit larger in the First Plan, constituting 41.4% of total U.S. aid, which declined drastically to 2.9% of total U.S. aid in the Second Plan. In the Third Plan, the share of grants further declined to 1.3%. Though it improved marginally to 2.1% during the Fourth Plan, it again declined to just 0.2% in the Fifth Plan.

The trend of a steady increase in the share of loans is also evident in the external aid received by India from all other sources. During the First Five Year Plan, grants constituted 34.8% of total external aid; this declined to 11.2% in the Second Plan and 3.7% in the Third Plan. It was at the level of 6.96% in the three Annual plans and then declined to 3.28% in the Fourth Plan.

Table - VIII

Share of Loans and Grants (in %)

Period	Total External Aid		U.S. Aid	
	Grants	Loans	Grants	Loans
First Plan	34.8	65.2	41.4	58.6
Second Plan	11.2	88.8	2.9	97.1
Third Plan	3.7	96.3	1.3	98.7
Annual Plans	6.96	93.4	0.4	99.6
Fourth Plan	3.28	96.72	2.1	97.9

Source: Government of India, *Economic Survey*, 1975-76 and earlier issues.

SECTORAL DISTRIBUTION OF U.S. AID

The United States has provided aid to different sectors of the Indian economy. The industrial sector got the lion's share of the total U.S. aid, followed by the agricultural sector. But the major part of aid which went to the agricultural sector was in the form of food aid under P.L. 480/665 agreements. Infrastructural development programmes also got a considerable amount of U.S. aid. When we analyse their percentage shares in total U.S. aid, we find that industrial development got 57.1% of total U.S. aid provided to India upto 1979.80. The agricultural sector, including food aid under P.L.-480/665 assistances, got the second highest share of 21.1% of total U.S. aid to India during the same period. The transport sector was the third largest recipient of U.S. aid in the same period. Transport development including purchase of Boeing and loans to railways accounted for 9.1% of total U.S. aid in this period. Power projects were other important recipients of U.S. aid, taking a share of 8.0% of total U.S. aid. Steel and steel projects got 1.3%, debt relief 2.5%, Orissa iron one projects 0.3% and others 0.6%.

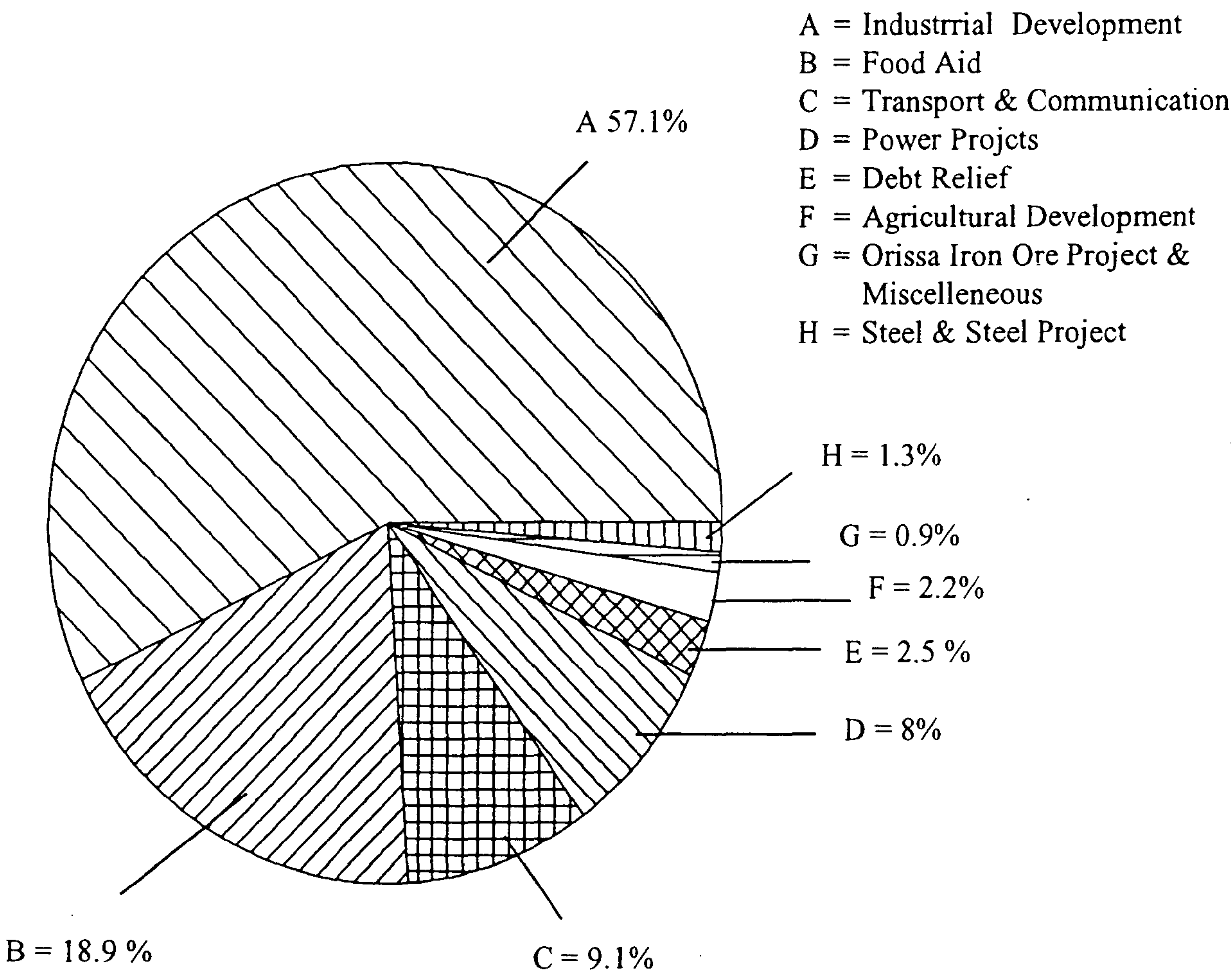
Table - IX

Purpose-wise Utilization of U.S. Aid upto the Fifth Plan

	Purposes	As Percentage of total U.S. aid
1.	Transport and communication	9.1
2.	Power Projects.	8.0
3.	Steel and Steel Projects	1.3
4.	Orissa Iron ore Projects	0.3
5.	Industrial Development	57.1
6.	Agricultural Development	2.2
7.	Food Aid Including Wheat Loan of 1951	18.9
8.	Debt-Relief	2.5
9.	Miscellaneous (Family Planning, education etc.)	0.6
	Total	100.00

Source: R.B.I. Report on Currency and Finance, Bombay, 1966-67, 1973-74, 1978-79 and other issues.

Diagram I: Sectoral Distribution of U.S. Aid to India; 1950-51 to 1979-80



Source: RBI Report on Currnecy and Finance, Bombay, 1966-67, 1973-74, 1978-79 and other issues.

The distribution of aid from all sources also follows a similar pattern. Out of the total external aid received upto 1974-75, industrial sector got the lion's share, with 62.8% of total aid, followed by transport and communication, with a share of 12.0% of total aid. Steel and steel projects got 6.5% whereas power projects got 5.1%. Food aid got 4.8% and agricultural development 3.1%.

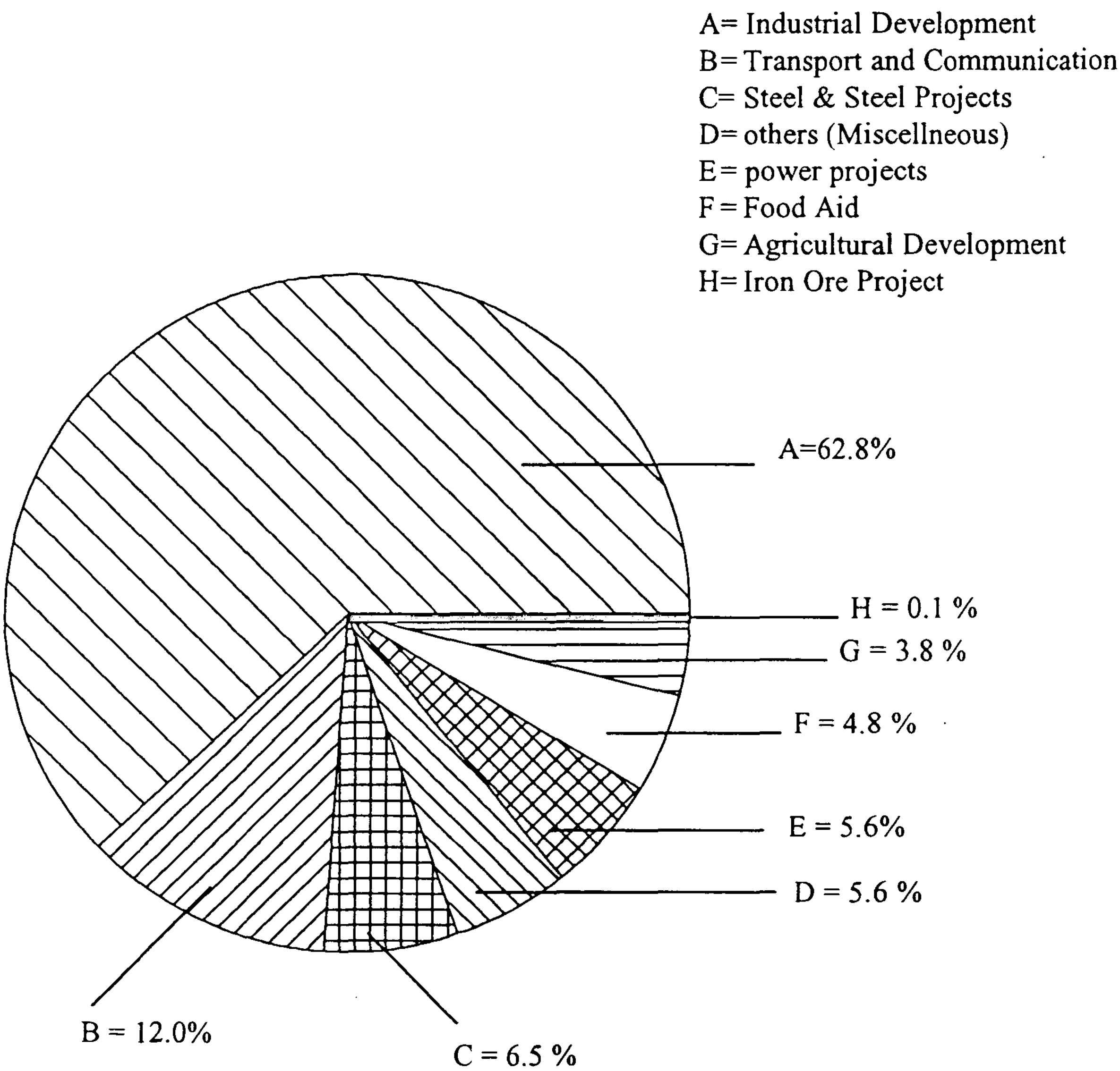
Table - X

Sectoral Distribution of Total External Aid Utilized upto 1974-75

Purpose	As percentage of total external aid
1. Transport and Communication	12.0
2. Power Projects	5.1
3. Steel and Steel Projects	6.5
4. Iron ore Projects	0.1
5. Industrial Development	62.8
6. Agricultural Development	3.1
7. Food Aid	4.8
8. Others	5.6
Total	100.0

Source: R.B.I. Report on Currency and Finance, Bombay, Various issues.

Digram II : Sectoral Distribution of Total Aid to India, 1950-51 to 1974-75



Source: R.B.I., Report on Currency and Finance, Bombay, 1966-67, 1973-74, 1978-79.

Table - X

Project and Non-Project Aid From U.S. up to 1979-80

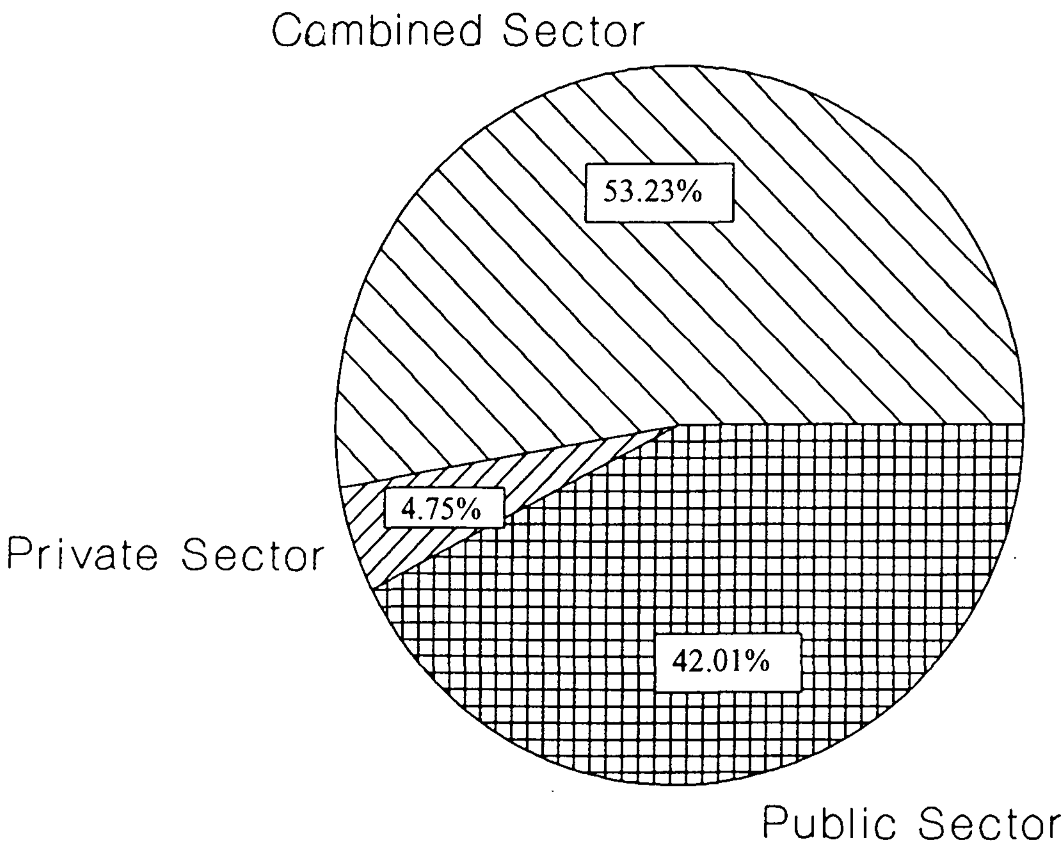
Period	Project Aid		Non-Project Aid		Total	
	In Million Dollars	In %	In Million Dollars	In %	In Million Dollars	%
Upto the Second Plan	477.22	49.5	486.47	50.5	963.69	100
Third Plan	678.10	39.5	1020.37	60.5	1698.47	100
Three Annual Plans	309.66	26.3	865.06	73.7	1174.72	100
Fourth Plan	73.34	9.9	673.41	90.1	746.75	100
Fifth Plan	31.57	8.7	336.96	91.03	368.53	100
1979-80	90.00	100.00	-	-	90.00	100
Total	1659.89	32.92	3382.27	67.07	5042.16	100

Source: Government of India, External Assistance, various issues.

PROJECT AID AND NON PROJECT AID FROM U.S. TO INDIA

From 1950-51 upto 1979-80, of total American aid to India, about one third was in the form of project aid and about two-thirds in the form of non-project aid. 1979-80 is the only exception when the entire American aid was given

Digram III : American Aid Received by Public, Private and Combined sector, from First Plan to Fifth Plan



Source : R.B.I., Report on Currency and Finance, Annual, various issues.

for project financing. However the trend in the inflow of project and non-project aid indicates a rising share of non-project aid. Upto the Second Five Year Plan, the share of non-project aid was 50.5% of total American aid which increased to 60.5% in the Third Plan, 73.7% in the three Annual Plans. In the Fourth Plan, it shot up to 90.1% which marginally increased to 91.3% during the Fifth Plan.

U.S. AID AND ITS DISTRIBUTION TO PRIVATE, PUBLIC AND COMBINED SECTORS

The public and combined sectors received the major part of U.S. aid. Except in the Third Five year Plan, the share of private sector in total U.S. aid was very law. Upto the Second Plan, the public sector received 72.40% of total U.S. aid, the private sector got 2.25% and the combined sector got 24.92%. In the Third Plan, the share of public sector declined whereas that of the private sector and combined sector increased to 10.58% and 62.87% respectively. During the three Annual Plans, the Fourth Plan and the Fifth Plan, the share of public sector was 30.54%, 43.81% and 87.96% respectively, whereas the share of private sector was 4.19%, 1.68%, and 2.11% respectively The combined sector received 65.25%, 54.46%, and 9.95% during the three Annual

Plans, the Fourth Plan and the Fifth Plan respectively. The overall share of public sector was 4.75% and that of combined sector 53.25%.

Table - XII

Share of Public Sector, Private Sector and Combined Sector in Total U.S. Aid Received by India

Period	Public Sector		Private Sector		Combined Sector	
	Rs Crores	%	Rs Crores	%	Rs Crores	%
Upto Second Plan	177.6	72.40	5.5	2.25	60.8	24.92
Third Plan	209.7	26.54	83.6	10.58	496.8	62.25
Three Annual Plans	243.2	30.54	33.4	4.19	519.6	65.25
Fourth Plan	407.0	43.81	15.7	1.68	506.3	54.46
Fifth Plan including 1979-80	233.1	87.96	5.6	2.11	26.4	9.95
Total	127.6	42.01	143.8	4.75	1609.9	53.23

Source : R.B.I. Report on Currency and Finance, Annual, various issues.

RATE OF INTEREST, MATURITY PERIOD AND GRACE PERIOD OF U.S. AID TO INDIA

The rate of interest, maturity period and grace period are important determinants of the softness or hardness of external aid. Higher rate of interest is generally identified with harder aid terms whereas longer maturity and grace periods are factors making for soft aid.

The U.S. aid to India was both of soft character and hard character. Some of U.S. aid was given at a very low rate of interest, 0.75% per annum, and some of it was given at a high rate of interest, ranging between 5% and 8% per annum. The plan-wise analysis indicates that the average rate of interest worked out as 4.2% per annum upto the Second Plan; it then came down to 1.9% during the Third Plan. After the Third Plan, again it started rising. In the three Annual Plans, it was on an average 2.8% per annum which rose to 2.9% during the Fourth Plan and 3% during the Fifth Plan. The last three are relatively low rates of interest.

In terms of percentage, 19.45% of total aid was given at an average rate of 4.2%; 34.29% was given at an average rate of 1.9%; 23.72% was given at an average rate of 2.8%; 15.07% was given at an average rate of 2.9% and the rest 7.44% was provided at an average rate of 3.0%.

Table - XIII

Interest Rate on U.S. Aid To India

(million dollars)

Rate of Interest	Upto Second Plan 1951-1961	Third Plan 1961-66	Three Annual Plans 1966-69	Fourth Plan 1969-74	Fifth Plan 1974-79
0.75	-	803.15	-	-	-
1.69	-	286.90	-	29.34	45.00
1.72	-	-	-	23.59	-
2.13	-	247.55	498.26	-	-
2.38	-	-	294.10	-	-
2.75	-	-	263.15	653.95	233.96
3.50	242.70	70.02	14.44	-	-
4.00	130.31	-	-	-	-
5.00	20.29	13.02	-	-	-
5.25	185.49	8.34	-	-	-
5.50	21.68	34.71	-	-	-
5.75	170.49	184.52	-	-	-
6.00	3.07	19.00	32.75	25.58	-
6.50	-	-	26.92	14.29	8.64
7.50	-	-	9.50	-	-
8.00	-	-	35.00	-	-
Total	963.69	1698.47	1174.72	746.75	368.53
Average Interest Rate	4.2	1.9	2.8	2.9	3.01

Source: Government of India, External Assistance, various issues.

Table - XIV

Maturity Period of U.S. Aid to India

(million dollars)

Maturity Period in Years	Upto Second Plan	Thrid Plan	Three Annual Plans	Fourth Plan	Fifth Plan	Total
Below 10 Years	51.87	71.95	69.74	32.29	10.57	236.38
10 Years to 15 years	288.46	176.97	59.67	25.58	21.00	566.68
15 yrs to 20 yrs	200.64	78.26	-	-	-	278.90
20 yrs to 35 yrs	74.51	-	14.84	34.89	45.00	169.24
35 yrs to 41 yrs	348.21	1376.29	1030.51	653.99	291.96	3700.96
Total	963.69	1698.47	1174.72	746.75	368.53	4952.16
Average Maturity Period	24.5	35.5	36.6	36.9	35.3	33.82

Source: Government of India, External Assistance, 1974-75 & 1977-78.

As against the increasing rate of interest of U.S. aid, which made it progressively harder, the maturity period showed a trend of increase which gradually made it softer. The average maturity period of all U.S. aid upto the Second Plan was 24.5 years, which increased to 35.5 years during the Third Plan. In the Annual Plans, it was 36.6 years on an average, which marginally increased to 36.9 years during the

Fourth Plan. In the Fifth Plan, the maturity period was 35.3 years on an average.

A major proportion of total U.S. aid has had a maturity period between 35 years and 41 years. For example, 74.7% of total U.S. aid had the maturity period of 35 years to 41 years, and the rest of the aid had the maturity period of less than 35 years. This is an indicator of the softeness of U.S. aid to India.

Table - XV

Grace Period of U.S. Aid to India

(million dollars)

Year	Upto Second Plan	Third Plans	Three Annual Plans	Fourth Plan	Fifth Plan	Total
1	395.54	106.80	-	13.58	-	516.32
2	-	85.55	34.67	18.00	-	138.22
3	-	-	-	-	-	-
4	213.24	129.13	35.00	14.29	-	391.66
5	164.85	-	-	-	8.64	173.49
6	189.66	-	-	12.00	22.93	224.59
7	-	74.44	25.00	29.34	45.00	173.78
8	-	1302.55	1080.05	659.54	291.96	3334.10
Total	963.69	1698.47	1174.72	746.75	368.53	4952.16
Average grace period year	3.3	8.4	9.5	9.3	9.3	7.87

Sources: Government of India, External Assistance, 1977-78 & 1978-79 earlier issues.

Besides rate of interest and maturity period, grace period is another important determinant of the softness or otherwise of aid. The grace period of U.S. aid to India increased since the Second Plan. It was just 3.3 years on an average during the Second Plan, which increased to 8.4 years during the Third Plan, 9.5 years during the three Annual Plans, 9.3 years during the Fourth Plan and 9.3 years during the Fifth Plan. In terms of percentage 67.32% of total U.S. aid had a grace period of 8 years and the rest had a grace period of less than 8 years.

Chapter - IV

ECONOMIC AND POLITICAL MOTIVES BEHIND THE UNITED STATES AID TO INDIA

External aid is widely regarded as an instrument of foreign policy. It has been systematically used to promote the national interest of the donor country. This national interest may be as diverse as keeping a particular regime in power, ensuring access to strategically important places, procuring strategic and other important raw materials, getting a favourable vote in a U.N. forum, serving ideological purposes like containing the spread of communism, promoting trade and investment, selling surplus commodities, and forcing macro-economic policy packages on the recipient countries like structural adjustment programmes, liberalisation etc which have the effect of opening up the markets of these countries. The US aid to India was also designed to promote aims and objectives of the U.S. foreign policy. As usual, these aims and objectives were widely clothed in terms of promoting U.S. national interests. And these national interests, to quote Nelson, were, "as humanitarian as relieving poverty and disease; as manipulative as attempting to influence the outcome of an election; as ephemeral as concern over the tenor of remarks of tomorrow's U.N. General Assembly session; as long run as investment in a country's capacity to maintain growth without external aid".[1]

The U.S. aid policy towards Third World countries in general was evolved during the Truman regime through his "Point-Four Programme" of 1949, in which he promised to assist developing countries to fight against hunger, poverty, desperation and political instability. In case of India, the 1951 Emergency Food Act is the beginning of U.S. aid programme. Subsequently, U.S. aid policy towards India developed gradually and only by 1956-57, there was a clarity of vision regarding the U.S. aid to India. The question of giving aid to India has been always an issue of debate and discussion inside the U.S. Congress as well as outside the Congress.

Edward S. Mason has pointed out that there were three motives of the U.S. behind giving aid to Third World Countries in general and to India in particular. These motives were - humanitarian, economic and strategic.[2] With

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1 John M. Nelson, *Aid Influence And Foreign Policy* (New York, 1968), pp.1-30.

2 Edward S. Mason, "United States Interests in Foreign Economic Assistance", in Gustav Ranis (ed.), *The United Sates and the Developing Countries* (New York, 1964), pp.13-23.

slight modification these three motives can be put as follows:-

a) Political and strategic

b) Economic and Commercial

c) Humanitarian and others

a) Political and Strategic

Political and strategic motives were in general determined by the politics of the Cold War period. India being an important country of Asia couldn't be neglected by the U.S. Administration. The significance of India to the U.S. Cold War politics derived from several factors. Firstly, India's population at that time (about 400 million) constituted 40% of the population of the Third World countries living under non-communist regime. Secondly, India was a nascent democracy with a strong constitutional framework providing a liberal political system. The third factor was India's geo-strategic location. The two great communist countries were lying along the northern boundary of India and with one of the two, India shared a long boundary. Fourthly, India was the leader of the Third World and its leaders commanded great respect in the Third World countries. Fifthly, India's natural resources, reasonably developed infrastructure, and vast man-power resources held out promise for its developing into a dynamic free market economy. And, lastly, if India succeeded in economic development, it could set an example to the newly emerging Third World countries that democracy and development could go together. This would effectively challenge the Communist model of economic development. The United States political and strategic motives behind giving aid to India can be analysed under the following sub-headings.

Containment of Communism

The containment of communism was one of the most important objectives of the U.S. foreign policy in the beginning of the Cold War. This objective was being promoted by various instruments of diplomacy like entering into treaty, making alliances, forging military pacts etc. Economic aid was a new instrument of diplomacy for the containment of communism.

India was a newly independent state facing a lot of economic and political problem. The hasty partition of the country had created a serious shortage of food stocks and other resoures. The food crisis was aggravated by the failure of the monsoon in 1950-51. By 1950-51, India started facing the problem of continuous decline in dollars reserves. At the same time, the communist movement was gaining ground in the country and in the Telangana area of Andhra Pradesh it had already taken a violent turn. In the first general elections, held in 1952, the Communist Party of India (C.P.I.) emerged as the second largest party in the Lok Sabha. Other socialist parties also performed well in the first general elections.[3]

The ascendency of the Communists continued in the second general elections as well held in 1957. In the second general elections, the Communist Party of India not only increased its tally of seats and voting percentage but also emerged as the single largest party in the state of Kerala and formed a communist government there. As against 3.3% of total votes polled by the C.P.I. in the 1952 general elections, in the 1957 elections, it improved it to 8.9% of the total votes. In terms of seats, the tally increased from 16 to 27 seats.[4]

Apart from these developments, even the behaviour of the Congress Party also displayed pronounced leftist leanings. In

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3 V.B. Singh and Shankar Bose, Elections in India, *Data Handbook on Lok Sabha Elections, 1952-85* (New Delhi, 1984), pp.26-27 and 660.

4 ibid, pp.26-27.

1955, at the annual session of the Indian National Congress held at Awadi, it was declared that the establishment of a socialistic pattern of society would be the goal of planned development. Immediately after that, on the 6th April 1956, a new Industrial Policy Resolution was adopted, the tenor of which was more or less socialistic.[5]

Similarly, the Second Five Year Plan draft which was formulated at that time overemphasized the public sector at the cost of the private sector. The following extract from the Second Five Year Plan is relevant in this context:

> If development is to proceed at the pace envisaged and to contribute effectively to the attainment of the larger social ends in view, then the public sector must grow up not only absolutely but also relatively to the private sectors.[6]

Outside India, the developments which were taking place were not conducive to the U.S. foreign policy objectives. In 1949, another big Asian Country, China, fell under the control of communism. With this, communism came to the Asian mainland. In the Korean War, the U.S. was facing reversal at the hands of the communists. The Soviet Union by that time

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5 Ruddar Dutt and K.P.M. Sundaram, *Indian Economy* (New Delhi, 1994), pp.136-137.

6 *Second Five Year Plan*, Planning Commission, New Delhi, p.23.

had successfully demonstrated to many newly independent Afro-Asian states that the road to communism was a road to prosperity, industrialization and rapid economic development. These newly independent countries were making experiment in democracy but poverty, stagnatism, hunger, malnutrition, political instability and weak domestic institutions were not conducive to the development of liberal democracy. Communism or socialism held out better prospects. India was the leader of Afro-Asian countries and if India would have gone the communist way, the others would have followed suit. At least this was the U.S. calculation.

These developments had convinced U.S. policy makers that the spread of communism to Asian mainland had to be stopped at any cost. And this policy of check on the spread of communism practically meant the check on the spread of communism in India.

But the question was how to stop this spread of communism in Asia in general and in India in particular. By 1954-55 when the U.S. put in place the S.E.A.T.O. and C.E.N.T.O. pacts, it became clear that India was not going to be dictated by the U.S. foreign policy. The Bandung Conference of 1955, in which India played a leading role, further convinced the U.S. foreign policy establishment that India could be approached through another diplomatic instrument and that was foreign economic aid.

Highlighting the importance of foreign aid in checking the spread of communism, John D. Montogemery maintains:

> The fact that foreign aid may relieve some of the distress of poverty encourages the hope that it may also reduce the appeal to communism.[7]

The idea appealed to the U.S. policy makers and massive foreign assistance programme to India was launched through the P.L. 480 food aid programme. There were three ways in which foreign aid could have checked the spread of communism in India:

First, by maintaining the liberal political regime of the Congress Party;

Second, by assisting India in its objective of rapid and planned economic development;

Third, by matching or surpassing the Soviet Union's economic aid by U.S. aid, the influence of Soviet Union over India could be counterbalanced.

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7 John D. Montogemery, *Foreign Aid in International Politics* (Bombay, 1969), p.4.

Inspite of the differences over various international issues, the U.S. wanted to see the Congress Party remain in power in India. It is true that the U.S. never liked India's leadership in Non-Aligned Movement (N.A.M.), India's promptness in recognizing Red China, India's attitude over the Korean War and India's behaviour inside the U.N. General Assembly. Yet, the U.S. was very much reconciled to the idea of India being ruled by the Indian National Congress. And whenever any situation arose which was to the disadvantage of the Congress Party, the U.S. Administration displayed alacrity in rescuing the Indian National Congress Government mainly through its economic aid programmes.

In 1949, Jawaharlal Nehru made a visit to the U.S. for the obvious purpose of economic aid form the U.S.[8] The food situation in India was serious and the foreign exchange balance was insufficient. Since 1947, the dollar trade had been declining. However, Jawaharlal Nehru's posture on international issues angered the U.S. Congress and the request for the food aid was turned down.

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8 Michael Brecher, *Nehru: A Political Biography* (London, 1959), p.419.

In 1949, the Communists captured power in China and in 1950-51, the U.S. was facing a reversal at the hands of the Communists in the Korean War. In India itself, the communist movement took a violent turn by 1950. Because of the failure of the monsoon in 1950-51, India faced a food crisis. Discontent was growing in the country and there was a need for immediate help to bail out the Indian government. The U.S. Administration, therefore, changed its posture. On the 15th December 1950, India once again made a request for food aid to the U.S. through its Ambassador, Mrs. Vijaya Laxami Pandit. She requested the State Department of the U.S. for a loan of a million ton of grain on a long term basis. The U.S. Administration gave a sympathetic consideration and promptly pledged food aid worth 189.7 million to purchase two million tons of food under the India Emergency Food Act, passed on the 15th June 1951.[9]

The U.S. concern at the spread of communism in the Third World and its conviction that foreign aid can be used as a potent instrument for containing communism is very clearly reflected in President Eisenhower's message to the Congress

9 *Fact Sheet*, No.22, United States Economic Assistance to India, June 1951 to July 1970 (New Delhi, U.S.I.S.), p.4.

on the U.S. Mutual Security Program for fiscal year 1958. The President said:

> To Millions of people close to the Soviet and Chinese Communist borders, political freedom is still new. Their need for help is desperate both for technical know-how and capital... their moderate leaders must be able to obtain sufficient help from the free world to offer convincing hope of progress. Otherwise people will surely turn elsewhere.[10]

Even the Secretary of State John Foster Dulles, testifying before the Foreign Affairs committee of the U.S. Senate Said, "it would be a calamity for the United States if India goes communist".[11]

As a result, a massive economic assistance programme to India was launched under the Agricultural Trade Development And Assistance Act of 1954, popularly known as P.L.-480. However, the actual flow of food aid under this Act started coming in only from 1956-57 and it continued until it was wound up in 1971.

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10 U.S. Senate, 85 Congress, 2 Session, Committee on Foreign Relations, *Hearings*, Mutual Security Act of 1958 (Washington, 1958).

11 *Foreign Relations of the United States*, 1955-1957, vol.8, South Asia.

In 1959, China entered into border skirmishes with India over the Ladakh territory. President Eisenhower paid a visit to New Delhi in 1959 and promised to help India in this difficult situation. In 1962, China launched a massive attack on the Indian territory. This put the leadership of the Indian National Congress to a great test. The leadership of Nehru came to be seriously questioned both inside the Parliament and outside the Parliament. U.S. also became suspicious of China's design. And therefore, inspite of the differences over India's forceful liberation of Goa in 1961, the U.S. Administration decided to bail out the Congress Party and promised to help India in this difficult moment.

There were severe droughts in India in 1965-66 and in 1966-67. Mrs. Indira Gandhi paid a visit to the U.S. and discussed with President Lyndon B. Johnson the acute food shortage of India. The U.S. Administration responded to Mrs. Gandhi's request to help and on the 27th May 1966, the two countries signed an agreement in New Delhi under which the United States undertook to supply India 3.5 million tons of food-grains, 7,00,000 U.S. bales of cotton and other commodities valued at $ 313.48 million.[12] When the monsoon

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12 *Fact Sheet*, no.22, United States Economic Assistance to India, June 1951 to July 1970 (New Delhi, U.S.I.S.).

failed again in 1966, the U.S. Adminstration instead of responding with food aid, declared a plan for making a survey of the Indian food situation. This provoked The New York Times to say in its editional of the 29th November 1966: "The new drought may increase the need for American grain. It certainly cannot reduce it".[13]

Seeing the difficult position of the Congress Party inside the country, the U.S. Administration finally agreed to help Mrs. Indira Gandhi's regime and on the 12th September 1967, the U.S. Ambassador to India, Chester Bowles and the Secretary to the Ministry of Finance of the Indian Union. P.Govindan Nair, signed an agreement in New Delhi for the supply of one million ton of American wheat and milos as well as for 70,000 tons of vegetable oil and 30,000 bales of extra long-staple cotton under the P.L. 480 programme.[14]

The second part of the U.S. strategy of the containment of communism was concerned with the rapid economic development of India. It was believed by many Congressmen and policymakers in the United States that if India emerged as a

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13 *New York Times*, 29 November 1966.

14 *Fact Sheet*, no.22, United States Economic Assistance to India, June 1951 to July 1970 (New Delhi, U.S.I.S.).

successful democracy with sufficient growth and development, it could set a model to many of the countries of the Third World which gained independence in the post Second World War period.

China was making rapid growth after the Communists came to power. The U.S.S.R. had already demonstrated that a communist regime was coterminus with rapid growth and development. The newly independent countries of Asia and Africa were fascinated by the Russian and Chinese models. Even India under the leadership of Nehru appreciated the Soviet Union model of planned economic development. The Indian Planning Commission was established in 1950. By mid-1950, it also became clear that India was also moving at least partly if not fully, towards the Soviet planned economic development model.

The U.S. Congress and Administration felt concerned by these developments and thought it better to help India in her development efforts by providing economic assistance. For example, Chester Bowles, the American Ambassador, to India remarked:

> If the democratic government fails in India, the entire free world will suffer a catastrophic setback all through Asia. The setback will be even

> greater in my opinion than that which the free world suffered when China was conquered by the communist.[15]

Similarly, Millikan and Rostow maintained:

> Even if economic development lags, an early communist take-over is exceedingly unlikely. What is likely over the years, if development loses its momentum, is increasing conflict and confusion within the Congress Party, a resurgence of sectional and linguistic interests perhaps breaking into violence, a heightening of the political and social tensions created by mass unemployment; in short, a reversion to the kind of political and social instability which tempts otherwise moderate persons to support anyone who can maintain order. While there is no communist inspired crisis at present, the prospects are poor for stable and effective government if the present development programme fails.[16]

Thus according to Millikan and Rostow, though there was no immediate threat of communist take-over, the social tensions and instability that were likely to follow the failure of the development efforts were conducive to creating a situation for a communist take-over in the medium and longer term.

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15 Quoted by Sushila Agarwal, *Superpower and the Third World* (Jaipur, 1985), p.61.

16 *Foreign Affairs*, XXXVI, April 1958, pp.431-432.

Emphasizing the importance of economic development in keeping communism away from less developed countries, Eisenhower remarked in his message to the Congress on the Mutual Security Programme for fiscal year 1958:

> Unless these peoples can hope for reasonable economic advance, the danger will be so acute that their governments will be subverted by communism. Lacking outside help, these new nations cannot advance economically.[17]

Similarly, President L.B. Johnson in his message to the Congress in 1964 remarked:

> We must strengthen the ability of free nations everywhere to develop their independence and raise their standards of living and thereby frustrate those who pry on poverty and Chaos.[18]

Thus, inspite of having strained political relations with India, the U.S. financed a major part of the financial requirements of the various plans of India. Till the end of the Fourth Five years plan, the U.S. was the largest foreign aid contributor to India. Even the sectoral distribution of the U.S. aid was in match with the Indian strategy of

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17 *Message of the President to Congress on the Mutual security programme for Fiscal year 1958.*

18 *Message of the President to Congress*, 1964.

development of different sectors. In the Second and Third five year plans, the development of industrial sector, power projects and infrastructural facilities was given priority. The U.S. aid to India was distributed to the different sectors but the aid allocation to the industrial development and infrastructural development was given priority. Most of the U.S. aid was allocated either to the public sector or to the combined sector, notwithstanding the differences over the priority that should be attached to the private sector vis-a-vis the public sector. Generally, the U.S. foreign economic policy emphasized the importance of the private sector but in the case of India it was the public sector and the combined sector which got the largest share of the U. S. aid. The U.S. Administration wanted to see the success of the Indian development planning and the ideological differences over the public vs private sector were not allowed to become a hurdle in this respect.

The objective seemed to be to enable India to emerge as a strong economy while retaining a stable democratic political system. This, according to the Americans, was the most effective way to counter the Soviet and Chinese models of development without democracy. If the Indian model delivered the goods, many of the Third World countries could have been persuaded to go to the Indian way of development with democracy rather than the Soviet and Chinese models of development without democracy.

The third part of the strategy of the containment of communism was concerned with counterbalancing the U.S.S.R. aid to India by U.S. aid. The idea was that if the Soviet Union provided aid to India, this should be countered by more and more of U.S. aid. If the terms and conditions of the Soviet aid was soft, then the terms and conditions of the U.S. aid should be made softer. The result would be that the political and psychological leverage which the Soviet Union would have got through its aid would at least be counterbalanced, if not negated. J.W. Fulbright, the Chairman of the Foreign Relations Committee, during the testimony of Mr. David E. Bell, administrator of Agency for International Development, before the Committee remarked: "Countries which are politically reasonably strong such as India, while it is undoubtedly the motive of the Soviets in providing economic assistance there to give themselves a position from which they can exert political leverage".[19]

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19 *Foreign Assistance 1964*, 88th Congress, Second Session, Washington, 1964.

In 1949, when the request of Nehru for food aid was rejected the Soviet Union voluntarily offered food aid in March 1951.[20] This along with other considerations, led the United States to adopt the India Emergency Food Act on the 15th June 1951. In 1955, Nehru paid a visit to the U.S.S.R.and Mr. Khruschev and Bulganin returned the visit the same year. In the year when the U.S. refused to finance the Bhilai Steel Plant, the U.S.S.R. accepted the request of the Indian government to finance the project without any stringent conditionalities. On the 2nd February 1955, an agreement was concluded for the establishment of a steel plant at Bhilai. This also formalized the flow of U.S.S.R. aid to India. The U.S., even though belatedly, tried to counterbalance the influence thus gained by the Soviet Union by helping India indirectly in getting aid for a steel plant at Rourkela from W.Germany, in June 1955, and for another steel plant at Durgapur from Great Britain, eight months later.

When in 1955-56, the U.S. aid to India dropped sharply, the American Ambassador to India, John Sherman Cooper warned the U.S. State Department that any new reduction in American

20 *New York Times*, 2 May 1951.

aid would immediately be compensated for by the Soviets. The State Department took this message very seriously and decided in favour of a moderate increase in aid to India, particularly by way of loans through the then created Development Loan Fund (1957) and of the continuation of food aid granted since 1956 under P.L. 480.

From 1959, the Soviet aid commitment to India increased. In 1960, Dr. Rajendra Prasad, the then President of Union of India and Mr. Morarji Desai, the then Finance Minister visited Moscow and the U.S.S. R. promised to give 500 million roubles for the Third Plan, besides the 1.5 billion roubles, a promise of the preceding year. In 1960, U.S.S.R. offered an additional loan of $ 122 million. On February 20, 1961, the Soviet Deputy Premier, Kasygin, arrived in Delhi to discuss with the Planning Commission the utilisation of the $ 122 million for an oil refinery in Gujarat, oil exploration in Cambay, a hydroelectric plant near Bokaro in Bihar, a refractories plant near Bhilai in Madhya Pradesh, and a washery for coking coal at Kathura in Bihar. On May 25, 1963, an agreement was signed for the expansion of Barauni and Koyali refineries. In 1965 again, the Soviet Union promised aid worth $ 800 million.

This preponderance of Soviet aid in the development of heavy industries in the public sector was balanced by that of U.S. aid in the field of food aid. The spurt in Soviet aid activities was countered by new Foreign Assistance Act of 1961 passed by the U.S. Congress. The Agency for International Development was set up in 1961, and in the very first year, the amount of aid to India was doubled. President Kennedy and his successor President Johnson continued to increase the amount of aid to India inspite of pressure to the contrary by the Congress because of India's purchase of Mig 21 from the U.S.S.R. in 1961, and the forceful liberation of Goa by the Indian Army that year. In the Indo-Pak war of 1965, aid was suspended, but the continued aid policy of the U.S.S.R. forced the U.S. Administration to resume its aid very soon after the Tashkent Declaration of January 1966.

Strategic Motives

The geo-strategic location of India was very important for the U.S. in the Cold War period. India is a part of South Asia and South East Asia is very close to India.

Any political instability in these two regions would have imposed on the United States an extra burden of military expenditure. Highlighting this point, the then U.S. Secretary of State, John Foster Dulles, Stated:

> With these programmes, we are enabled to spend far less on our own military programmes to achieve far greater security than would otherwise be the case.[21]

Besides, had India fallen under the Soviet influence, the latter would have got access to the warm waters in the Indian Ocean. To Check this, the need was to bring India under U.S. obligation, and if that was not possible, then at least to keep India away from the Soviet influence.

But the most significant part of the U.S. strategic motive was getting access to certain strategic materials found in India. In 1950, most of the basic materials needed for American industries were imported and most of these came from underdeveloped countries. India was also an important source of supply of certain strategic materials. According to the Commodity Research Bureau of the United States, the percentage of the U.S. imports from underdeveloped countries in 1949-50 were as follow.[22]

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21 *The Mutual Security Programme*, Fiscal Year, 1958, Department of State, Department of Defense, International Cooperation Administration (Washington, D.C., 195), p.4.

22 Commodity Research Bureau, 1950, *Commodity Book* (New York, 1951), p.42.

Items	Imports from underdeveloped countries as percentage of U.S. Total imports
Natural rubber	- 100
Chromium	- 83
Tin	- 74
Manganese	- 77
Bauxite	- 70
Lead	- 19
Copper	- 25
Zinc	- 6
Iron	- 2

India's Share in U.S. total imports of manganese and mica was as follows:[23]

Manganese	- 27%
Mica	- 88%

Manganese and mica are very important minerals for the iron and steel industry, for arms and ammunition manufacturing and for electronics products including avionics industry. USSR, the principal supplier of manganese to the U.S. in the pre-cold war period refused to supply it any more during the Cold War period for strategic reasons. At the same time, demand for manganese increased significantly due to the Korean War.

As a result, the significance of Indian manganese and mica increased. President Truman appointed a high level Inter

23 ibid, p.42.

Departmental Manganese Co-ordination Committee to explore all possible sources of supply. The committee referred to India as the greatest potential supplier. Senator Hickenlooper and George Allen, Assistant Secretary of State for Near Eastern, South Asia and African Affairs, exchanged views in the course of hearings on technical and economic assistance to India and on Emergency wheat Loan Act of 1951, which went as follows:

> Senator Hickenlooper: "Do you know of a single dollar's worth of contribution that India has made to the U.S. from her resources?"
>
> George Allen: "Senator, a part of this involves matters that I am sure you are aware we should not speak of... But I can say this: in many fields of economic endeavour and access to raw materials we have had very good and effective co-operation from the Government of India".[24]

In the course of another hearing, Allen said that India supplied ever 40% of American's imports of manganese in 1954.[25] The process of supplying manganese and other materials to the U.S. was accelerated after the negotiations on the Wheat Loan and other forms of aid. In 1949, when India approached the U.S. for wheat loan, the U.S. also started negotiations for an increase in India's manganese export to

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24 U.S. Senate, 84 Congress, I Session, Sub-Committee of the Committee on Foreign Relations *Hearings*, Technical Assistance Programme (Washington, 1955), p.113.

25 ibid, p.529.

the U.S. A few days after, a special American mission visited the Indian capital and discussed with the Indian authorities the questin of export of certain strategic materials, particularly manganese, mica, beryl, and monazite. An Indian delegation visited Washington in September 1950 to pursue the negotiations, which led to the supply of five hundred tonnes of monazites to the U.S. Later, when India started exporting thorium nitrate, a strategic material, to China, the U.S. threatened that it would stop all forms of aid in accordance with the Battle Act passed in October 1951.[26] India was made to promise to the U.S. that it would make preemptive pruchase of thorium nitrate. The export to China was stopped.[27] Moreover, on June 15 1951, the Government of India signed a contract with the U.S. Export-Import Bank to facilitate the immediate and continuing transfer to the U.S. of strategic materials at such prices, at such times and on such terms as may be mutually agreed upon. In 1949, India had supplied 25% of the U.S. total imports of manganese, but in 1954 it increased to 40% of total U.S. imports. Apart from that, India

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26 *Foreign Relations of the United States, 1955-1957, South Asia* (Washington, 1987), vol.8, p.278.

27 ibid.

was an important supplier of manganese also to the West European countries and Japan which were the allies of the U.S.

b) Economic and Commercial Motives

Expansion of trade, promotion of private investment and disposal of agricultural surplus commodities were in general the main economic and commercial motives of the U.S. aid policy. Section 2 of the Mutual Security Act highlights the objectives of P.L. 480 programme in the following terms :

> To expand international trade among the United States and friendly nations, to facilitate the convertibility of currency, to promote the economic stability of American agriculture and the national welfare, to make maximum efficient use of surplus agricultural commodities in furtherance of the foreign policy of the United States, by providing a means whereby surplus agricultural commodities in excess of the usual marketing of such commodities may be sold through private trade channels, and foreign currencies accepted in payment thereof... to use foreign currencies to expand international trade, to encourage economic development, to purchase strategic materials, to pay United States obligations abroad.[28]

Similarly, in a message to the congress, President Eisenhower stated:

28 Agricultural Trade Development And Assistance Act of 1954, as amended in 1955, P.L.480 (83rd Congress, Session 2), Quoted in *American Foreign Policy*, 1950-55 (Washington, 1957), vol.2, p.2941.

> We have an economic interest in promoting the development of the free world. In the years to come, the increased economic strength of the less developed countries should prove mutually beneficial in providing growing market for exports, added opportunities for investment and more of the basic materials we need from abroad.[29]

The successful completion of the European Recovery plan, started in 1948 as the Marshall Plan, made it necessary that economic aid be extended to developing countries as well. Given the open nature of the Western economies, their recovery was contingent upon the expansion of their trade. South Asia was one of Western Europe's important trading partners. In 1948, merchandise exports from South Asia to West Europe amounted to $ 1.8 billion or 7% of West Europe total imports. Europe's main source of supply of rubber, tin, tea, jute, copper etc was South Asia. Moreover, South Asia as a whole was an important market for West Europe's products. In 1948, West Europe exported to South Asia goods worth about $ 2.2 billion or about 12% of its total export. The recovery of West Europe required that imports of the above mentioned commodities should be continued at less prices and at the required time. The expansion of West Europe's exports called for an

29 Message of the president to Congress on the Mutual security programme for Fiscal year 1959. Quoted by S.Chandrashakar, *American Aid and India's Economic Development* (New York, 1966), p.50.

enhancement of the incomes of their regional trading partners. Thus, the very success of the Marshall Plan depended to a considerable extent on the economic development of South Asia, in which economic aid programmes to India and other South Asian countries, played an important role.

Promotion of private investment and making the economic conditions in India conducive for U.S. private capital investment was another important economic motive of the U.S. aid policy. In a sense, Nehru's statement on foreign capital investment placed before the Indian Parliament on the 6th April 1949, would appear to be designed to prepare the ground for the American food aid. In that statement Pt. Nehru, welcoming foreign capital to India, assured them :

- against any discrimination between foreign and Indian undertakings in the application of general industrial policy.
- reasonable facilities regarding remittances of profits and repatriation of capital consistent with the foreign exchange position of the country.
- fair and equitable compensation in the event of nationalisation.

American private investment which stood at just Rs. 11 crores in 1948 went up to Rs. 109 crores at the end of 1962.[30] Pandit Nehru's assurances would have certainly played a role in that.

As already stated, promotion of trade including disposal of surplus agricultural commodities was the other motive behind the U.S. aid to India. Firstly, it was through the disposal of surplus agricultural commodities. The U.S. economy was facing a serious problem of surplus food production in 1950-51. In 1951-52, the harvest was again very good. But the demand for these surpluses outside the U.S. was contracting. As the European Recovery plan picked up momentum, these European countries stopped importing food from the U.S. Rather they developed interest of their own in the export of these commodities. As a result, the U.S. agricultural export which was valued at about $ 4 billion in 1951-52, declined by 30% during 1952-53. A principal motive behind designing the P.L. 480 food aid programme was to bail out the U.S. agricultural sector. India was the largest recipient of the P.L. 480 food aid programme and in this way it helped the American

30 Government of India, *Economic Survey*, New Delhi 1963-64.

agricultural sector in getting out of the depressionary conditions.

Apart from that, aid-tying led to the enhancement of exports of American goods and services to India. Till 1959, most of the U.S. aid to India was untied. But after the introduction of "Buy American" policy in October 1959, most of the U.S. development assistance was tied to the source of supply. In 1951-52, the U.S. accounted for as much as 36% of total imports. It declined to 32% in 1960-61, but further increased to about 40 percent in 1965-66 largely due to food-grains imports. In 1969-70, it was at the level of 35 percent. As late as in 1975-76, the U.S. share of India's total imports was 25 percent. These data reveal that there was a positive correlation between the flow of U.S. aid to India and the U.S. share of India's imports. In 1965-66, the flow of aid was the maximum, when the share of the U.S. of total Indian imports was also at the maximum level of about 40 percent. In 1970-71, the U.S. aid to India declined, at the same time the U.S. share of India's imports also declined to 27.7% as compared to 35% in 1969-70.[31]

31 Government of india, *Economic Survey*, Various issues.

Apart from the promotion of trade, the U.S. aid to India also provided employment to a large number of Americans. It is estimated that nearly 600000 workers were employed indirectly in the U.S. because of the internal demands generated by the production of goods and services, financed by the U.S. aid. The U.S. Aid Administration employed a large number of technical and scientific experts, general administrators, financial experts etc in India. It is estimated that about 3000 American experts and administrators were employed in India for aid projects and other related purposes. And by a projection it was estimated that average annual cost per U.S. consultant posted in India was $ 25000 to 30000.

The United States derived yet another economic benefit from its foreign aid programme. The P.L.480 agreement provided that fifty percent of the total tonnage of the commodities be exported in the U.S. vessels; and generally the freight charges of these vessels were higher than the international freight charges. This benefitted the U.S. shipping industry.

c) Humanitarian Motives

Certain sections of the American society as well as some outsiders have believed that the United States economic assistance to India was motivated by humanitarian purposes.

The statements made by the U.S. political leaders, policymakers and diplomats have included the moral or the humanitarian purpose among the motives for providing assistance to India. Referring to the motives behind the U.S. aid programme, President Eisenhower observed in 1954 :

> I can see no great evidence of intelligence in sneering at dogooders, if their dogoodings help America at the same time it helps our friends.[32]

Similarly Chester Bowles in his Ambassadors Report 1954 pointed out :

> Assistance was offered not as a charity, not to instil a sense of gratitude or obligation. It was given because it was the decent thing to do.[33]

In 1963, President Kennedy, replying to the critics of foreign aid reminded the people of his country :

> Let us not be weary in well doing for in due season we shall reap it if we faint not.[34]

J.J. Fulbright, once Chairman of the Foreign Relations committee remarked that "there is moral as well as practical case for aid".[35]

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32 *New York Times*, 26 February 1958.

33 Chester Bowler, *Ambassador's Report*, New York, Harper and Bros, p.322.

34 *New York Times*, 9 November 1963.

35 *New York Times Magazine*, 21 March 1965.

President L.B. Johnson called aid as one of the most Christian acts. He realized that aid policy was designed to serve the interest of American security and welfare but much of it had come from moral ground. He said that aid is given because it is right that " the strong should help the weak and the wealthy should help the poor".[36]

However, whenever critical moments came and a choice was to be made, it was seen that political, strategic and economic interests superseded the moral or humanitarian purpose. In 1949, when India was facing an acute problem of food shortage resulting in starvation, the U.S. was bargaining for the supply of manganese and monazites. As a reaction to the U.S. unsympathetic approach, Pandit Nehru returned to India empty-handed. Michael Brecher wrote in the book "Nehru : A Political Biography" :

> For three weeks he toured the United States and tried to convey the aspirations of Asian's hungry millions to Government leaders and the commonman alike. His pride prevented him from begging for food aid, though India was in the throes of famine. He sought food -2,000,000 tons of wheat - and capital to help India back cut of economic stagnation. The food came eighteen months later after thousands had died awaiting an act of mercy.

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36 American Efforts Towards World Order, U.S. Department of State *Bulletin*, 3 August 1964, p.298.

The American Congress sought concession from India. Nehru refused.[37]

The agreement to finance the Bhilai steel plant was cancelled because in the perception of the United States, it did not serve its interest. Similarly, the U.S. refused to finance the Bokaro Steel plant. In 1965, during the Indo-Pak war, it abruptly stopped all aid to India except a minor quantity of food aid. In 1965-66 and 1966-67, when India was facing the problem of starvation due to two successive droughts, the U.S. Administration decided to appoint an expert committee to examine the drought situation in India, rather than rushing with surplus foodgrains. During the Bangladesh Liberation War, U.S. abruptly stopped aid to India.

And once by the mid-1960's, the United States came to realise it that it was not successful in getting the desired results from its aid, the anti-aid sentiment became dominant in the Congress, Administration and by and large in the country. By the mid-1960s, India's position on major international issues affecting U.S. interests became more stridently against the U.S. interest than it was ever before. In 1964, India bought military equipment worth $ 130 million

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37 Michael Brecher, *Nehru: A political Biography* (London, 1959), p.419.

from the Soviet Union. Additional equipment worth $ 140 million was promised by the U.S.S.R. during the then Prime Minister, Lal Bahadur Shastri's visit to Moscow in 1965. A Trade Agreement was signed between India and the U.S.S.R. for doubling the 1964 level of trade by 1970. In the Indo-Pak war, India got additional supplies of weapons from the U.S.S.R. In 1966-67, these supplies were multiplied. These friendly postures of the U.S.S.R. culminated in the signing of the Indo-Soviet Treaty of Peace, Friendship and Cooperation, on August 9, 1971.

Besides, India fought two wars with one of the closest allies of the United States, i.e. Pakistan in 1965 and 1971. In the post-1967 period, India became more vocal in criticizing the Vietnam policy of the United States.

Inside India, political development took an adverse turn from the U.S.point of view. In the 1967 general elections, the Congress Party lost its majority in six states. In 1969, Indira Gandhi emerged victorious against the conservative elements in the Congress Party when V.V. Giri lost the Presidential election. The same year, she took the drastic decision to nationalise banks and to abolish the privy purse.

All these developments led to a gradual disenchantment of the U.S. Congress and Administration with aid to India. India's 1965 and 1971 wars with Pakistan led some intellectuals and policymakers in the United States to argue that the U.S. aid helped India in saving the foreign exchange to buy military equipment to fight these wars. By 1971, the situation became so adverse that the U.S. refused to give any more aid to India. The U.S.A.I.D establishment in New Delhi was closed in 1971 and the last economic expert of the U.S. left India in 1973. These events coincided with a widespread sense of general weariness in the developed countries, including the U.S., with aid to developing countries as a whole.

Chapter V

Conclusion

In the earlier literature of development economics, capital was identified as the most important factor in promoting growth and development. External aid was widely regarded as a source of capital formation which needed to supplement domestic savings. At the same time due to the structure of the economies of these Third World Countries which were mostly primary producing, their export promotion effort suffered from certain inherent limitations. This further necessitated the import of foreign capital to meet the requirements of foreign exchange. Besides, the low level of technology, poor skill formation, inadequate managerial capacity and lack of other facilities required for rapid development were the major constrains to development. All these made it an inevitable necessity for the Third World countries to import external capital in order to move to the take-off stage.

There is, however, a school of thought which is critical of external aid and rejects the hypothesis that it is positively co-related to economic growth Following are some of the arguments advanced by this school of thought.

Firstly, most of the developing economies are plagued with the problems of excessive labour supply resulting in unemployment and underemployment. It has also been found that the marginal productivity of labour in several developing countries is zero or in some cases even negative. In that case, a capital-intensive strategy as propounded by those who see a positive corelation between external aid and development, is going to aggravate the problem of unemployment and underemployment.

Secondly, most of the developing economies are faced with a lot of non-economic problems. Socio-cultural impedi ments, including people's beliefs and values, economic qualities and attitudes, low level of technology, structural rigidities, poor banking and other financial institutions, wrong government policies and over-loaded primary sectors are important constraints to the growth and development of these economies. These factors cannot be affected favourably by the mere import of external capital. Besides, problems like colonial and semi-colonial dependence on the North, profits and capital gains returning to the metropolitan countries, will be aggravated by excessive import of capital in the form of aid.

Thirdly, if a country produces goods and services indigenously, the economy goes through the experience of learning and developing professional skills. But if it imports these goods and services in the form of aid, then it deprives itself of this process of learning and developing skills and capacity.

Fourthly, it has been found that government-to-government aid generally leads to an undue expansion of public sector undertakings which more often than not turn out to be uneconomic. And if these undertakings develop or expand through external aid, then the tendency not to put a high premium on efficiency and economy is even more pronounced. A part of the inefficiency arises from the way in which external aid is tied to projects or to supplies of capital goods and technology from the donor countries. Besides, once a public undertaking is established, it is sustained by budgetary sources even if it is uneconomic.

Fifthly, more often than not, external aid is targetted by the donor country to meet the shortage of foreign exchange in the recipient country. As a result, the political leadership generally uses the shortage of foreign exchange as an excuse for getting more external aid. This engenders a tendency not to manage external resources efficiently and to perpetuate balance of payment problems.

Lastly, the food aid which has been an important compo nent of external aid, particularly of the American aid in the 1950s and the 1960s adversely affects the agrarian economy in the recipient country. Excessive supply of food-grains from outside creates depressionary conditions in the domestic food market. As a result, farmers don't get incentive prices, which leads to reduction in the production of food-grains in the short run. In the long run, this depressionary condition leads to the shifting of crop cultivation from food-grains to commercial crops which further aggravates the problem of the shortage of food-grains.

Therefore, external aid is not the engine of growth and development of the developing economies which its protagonists claim it to be. In order to move to the take-off stage, a country has to improve domestic capital formation, and keep its balance-of-payment position under control by promoting exports and by properly managing its foreign exchange re sources. These economic factors conducive to growth need to be supplemented by non-economic efforts like removing structural rigidities, shifting manpower from excessively overloaded primary sector to the secondary and tertiary sectors, development of institutions, development of other infrastructural facilities and, of course, promotion of indigenous research and development capacity in the field of science and technology. External aid can only supplement these efforts; it cannot become their substitute. And external capital is helpful only when the country itself has developed enough capacity to absorb external capital fruitfully and economically.

In case of India, external assistance provided a significant part of the plan outlays in various plan periods. The share of external resources to total plan outlays in various plans ranged between 10% to 28%. Till the Fourth Five Years Plan, the U.S. was providing a substantial amount of total external aid coming to India. After that the share of U.S. aid in total aid coming to India declined sharply and the multilateral institutions considerably improved their shares.

U.S. provided aid to India both in terms of grants and loans. However, the share of loan was more than 97% of total aid authorized upto 1979-80. The share of grants was high 34.8% in the First Five Year Plan, but declined sharply in the subsequent plan periods.

U.S. aid to India was distributed to different sectors of the economy. However, the industrial development cornered the major proportion of total aid. The transport development and infrastructural development were other important recipients of American aid. The agricultural sector also got a significant share of total U.S. aid, but most of it was in the form of food aid or commodity assistance.

The share of project aid in total U.S. aid to India declined from 49.5% upto the Second Plan to 8.7% by the Fifth Plan. The share of non-project aid, however, increased continuously.

The public sector and the combined sector cornered the major share of U.S. aid. The private sector's share was on an average just 4.75% of the total U.S. aid provided upto the Fifth Plan period.

The U.S. aid to India was provided both under soft and hard terms. But on the whole, it was among the softest assistance received by India from all sources. The rate of interest charged on U.S. aid was generally low upto the three Annual Plans, after which it started increasing. However, even during the period when the rate of interest in creased, maturity and grace period remained relatively long.

Though the terms and conditions of the U.S. aid were generally soft fill 1966-67, and the inflow of aid was relatively large, it did not help in any substantial way in improving the economic conditions of the country. Rather this external aid enhanced the vulnerability of the Indian economy. This situation was further complicated by the hardening of the terms and condition of aid by all donors including the U.S. in the early 1970s and the 1980s. For example, the rate of interest of all creditors (average) increased from 2.5% per annum in 1970 to 5.5.% in 1980. This further increased to 5.8% in 1985 and marginally increased to 5.6% in 1990-91. Similarly the maturity period of all creditors(average) declined from 34 year in 1985 to 20 years in 1990-91. The grace period of all creditors (average) also declined from 8.2 years in 1970 to 7.1 year in 1980 to 6.3 years in 1985 and remained at that level in 1991.

The impact of these unfavorable changes in the terms and conditions of foreign aid was aggravated by the failure of the Indian economy in the export promotion front and in the front of domestic resource mobilisation. The increasing dependence on foreign aid only enhanced the vulnerability of the Indian economy. This is demonstrated by the selected macro-debt indicators.

Table

Period					
Macro-Debt Indicators	1980	1985	1990	1991	1992
E.T.D./X.G.S. %	136.,0	263.6	268.0	275.2	279.0
E.T.D./G.N.P. %	11.9	19.3	23.5	29.3	32.3
T.D.S./X.G.S. %	9.3	22.7	26.7	29.0	25.6
Intrest/G.N.P. %	0.4	0.9	8.2	10.6	12.4
Interest/X.G.S. %	4.2	12.6	14.5	14.7	12.8

E.T.D. = External Total Debt
X.G.S. = Export of Goods and Services
T.D.S. = Total Debt Service
Interest = Interest Payment

Source : *World Bank Debt Table*, 1994.

The total debt as a percentage of Gross National Product increased from 11.9 percent in 1980 to 23.5 per cent in 1990. This increased very sharply in the early 1990s. In 1991, it reached the level of 29.3 percent which further increased to 32.3 percent in 1992. The debt service ratio as a percentage of export of goods and services increased from 9.3 percent in 1980, to 22.7 percent in 1985, to 26.7 per cent in 1990, to 29.0 percent in 1991. Similarly interest payment as a percentage of Gross National Product increased from 0.4 percent in 1980, to 0.9, 8.2, 10.6 and 12.4 percent in 1985, 1990, 1991 and 1992 respectively.

The motives of the U.S. aid to India were political strategic, economic and commercial. Politically, the containment of communism was the topmost priority of the U.S. foreign policy objective in the post Second World War period. After the fall of China into the communist orbit, in the American eyes, South Asia became very much vulnerable to the spread of communism. India, the most Important country in this region, with a liberal constitutional framework, vast natural resources and manpower, needed to be maintained as a liberal democratic country.

This policy of the containment of communism was designed to serve its purpose in India in three ways - by maintaining liberal political regime of the Congress Party, by neutralizing the influence of Soviet Union by larger U.S. aid and by demonstrating to the Afro-Asian countries the viability of the Indian model of development with democracy.

Strategically, the geographical location of India was important for the U.S. foreign policy objectives. India was surrounded by two communist countries and its southern boundary is touched by the Indian Ocean. The Soviet Union was looking for hot waters. This could have materialised if India would have come under its influence. Apart from that, India was an important supplier of certain strategic materials like manganese, mica etc to the U.S. and its Western allies. Besides, India had a rich source of monazite, another important mineral of strategic interest to the United States.

The economic objective of the U.S. foreign aid was to expand markets for American goods and services, and for this purpose, to promote free and liberal trade among nations, and orient the economies of the newly independent Afro-Asian countries towards free flow of goods and services. These were, of course, medium to long-term objectives. But the immediate objective of the U.S. foreign economic policy in the post Second World War period, was to dispose of U.S. surplus agricultural commodities in foreign markets in order to stabilise commodity prices, pander to the farmers' lobby, earn foreign exchange and also to gain influence. Promotion of private investment was another important commercial motive of the U.S. behind giving aid to India. The aid tying and the introduction of "Buy American clauses" had the objective of promoting the export of American goods and services.

Certain sections of the American society believed that the U.S. economic assistance to India was motivated by humanitarian purpose. The statements made by the U.S.

political leaders, policymakers and diplomats have included the moral or the humanitarian purpose among the motives for providing assistance to India. However, this purpose was found more in statements and speeches and less in practice and action. Whenever critical moments came and a choice had to be made, U.S. national interest as perceived by the U.S. Administration, superceded the so-called moral and humanitarian purpose.

In 1949, when India was facing an acute problem of food shortage resulting in starvation, the U.S. was bargaining for the supply of manganese and monazites. The agreement to finance the Bhilai steel plant was cancelled because in the perception of the United States, it did not serve its interest. Similarly, the U.S. refused to finance the Bokaro Steel plant. In 1965, during the Indo-Pak war, it abruptly stopped all aid to India except a minor quantity of food aid. In 1965-66 and 1966-67, when India was facing the problem of starvation due to two successive droughts, the U.S. Administration decided to appoint an expert committee to examine the drought situation in India, rather than rushing with surplus foodgrains. During the Bangladesh Liberation War, U.S. abruptly stopped aid to India.

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