Commercial Policy and Economic Development in India
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Commercial Policy and Economic Development in India

V. S. Vartikar

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In this study I have tried to identify and analyze India's commercial policy since 1947. No such account or analysis of this important topic is presently available. Almost all the material in this book was presented, in a slightly different form, as a dissertation for a Ph.D. degree at Wayne State University, Detroit. The dissertation was written under the guidance of Professor I. Bernard Goodman. I have freely drawn on his wide knowledge of international affairs and have derived great benefit from innumerable discussions with him on this subject. However, as this book contains some unorthodox ideas and many value judgments, I would like to emphasize that neither Professor Goodman nor any of the gentlemen mentioned below is responsible for the material in this book.

I wish to express my thanks to three other professors at Wayne State University, H. Peter Gray, Thomas Finn and S. S. Tangari, for reading many drafts of most of the chapters. I am especially grateful to them for their helpful criticism of the theoretical background of this mainly empirical study.

Three of my colleagues at Waynesburg College have assisted me in preparing the final draft. Professor Robert J. Bowden has helped me to weed out the errors in English expression. Professors Edward F. Ambrose and Boris Ivezic, with their intimate understanding of the developing economies, have spent a great deal of time on this work and their constructive criticism has helped in improving this book.
A large amount of statistical work has been done in the preparation of this study. No conclusion has been drawn, or opinion expressed, without my having analyzed the available fragments of the data concerned. The statistical work was done at the computing center of Wayne State University, Detroit, and of West Virginia University, Morgantown. I am very thankful to Dr. Walter Hoffman and Dr. John M. Mattila of Wayne State and to Glen Herndon of West Virginia for extending to me the hospitality of their computing centers.

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V. S. Vartikar

Waynesburg, Pennsylvania
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Commercial Policy and Economic Development in India
CHAPTER 1
THEORETICAL FRAMEWORK

This book is concerned with the identification and analysis of the commercial policy of India since her independence from the British. Any evaluation of a particular commercial policy obviously has to be based on some economic theory. This theoretical framework was evolved while the author was trying to understand and interpret India's commercial policy. This analysis is not meant to indicate an optimum policy for developing countries in general, but it is applicable to some other countries that are not much dissimilar from India, which is the model discussed here.

INDIAN ECONOMY

India is a very heavily populated country. With only 2.3 per cent of the land in the world, India has 15 per cent of the world's population. The total population of India is now over 520 million, and it is rising by about 2.5 per cent every year. The net cultivable land is about 325 million acres, and there is no more land that can be developed for agricultural use. The agricultural land available per head, therefore, is less than 0.63 acre. "The keynote of the whole economic problem of India is at once struck by this simple but terrifying fact."¹ This simple fact is the food problem of India. Even in normal times, most Indians are half-starved. Their diet is not only lacking in terms of calories, it is also hopelessly unbalanced. The main food consists of cereals; consumption of meat,
fruit, milk or vegetables is generally reserved for a celebration. The poverty in India is so overwhelming that one feels like disbelieving the statistical evidence. At the end of three five-year plans, the per capita national income is about $67 a year. The poor, of course, spend most of their income on food, clothing and shelter. Food constitutes about 70 per cent of the total expenditure by rural households; and a typical urban family spends about 60 per cent of its income on food. Income elasticity of demand for food is at least 0.8 on an average, and in lower income groups it is much larger.  

India is a land of small-scale peasant farming. The Indian peasant is intelligent and industrious, but he is unaware of and untouched by modern technology. His scale of operations is so small that he generally has no margin to experiment with, nor does he have surplus to invest in his business. Landlordism is abolished by law, and in most states a ceiling is placed on the acquisition of land even for self-cultivation. The small peasants, the producers of food and raw materials, constitute about 80 per cent of the families in India. India's economic problem, therefore, is an agrarian problem.

As a shorthand expression, an economy like that of India is referred to in this discussion as a "subsistence economy." This term is meant to imply extreme poverty for the great mass of people, overpopulation in relation to culturable land, small-scale peasant farming and, lastly, nonauthoritarian government striving for quick economic development. Such an economy would be much better off if it could increase its rate of investment and decrease its birth rate. Ignoring the latter, the question is, how can such a country use its huge labor force for capital formation?
BARRIER OF WAGE GOODS

In an overwhelmingly poor country, a large part of wage income is spent on food and almost all of it on wage goods. Any rise in wage income is almost immediately spent, and most of it is spent on food. This is true not only of the working and the middle classes but also of the farmers, who are themselves quite often half-starved. Any increase in investment or in production that leads to an increase in wage income, unless accompanied by an increase in food supply, leads to a rise in food prices. It is important to note that the wage income is not spent on "consumer goods" but on "wage goods." The labor employed in the production of cars or cosmetics does not buy these goods but demands food, clothing and shelter. This is the reason why the unemployed people cannot be used for capital formation unless the extra wage income is matched by an extra supply of wage goods.

If prices of wage goods are allowed to rise faster than the money wage, more people can be employed with a given supply of wage goods. Those who were already employed will be getting a reduced real wage, but the previously unemployed will be getting a higher real wage; in effect, the given stock of wage goods will be redistributed in such a way that more people will be productively employed. Such a redistribution of wage goods will be a clear benefit to the society, insofar as a higher rate of investment can be sustained with the same stock of wage goods, and, eventually, when the new investment becomes operative, larger consumption will be possible for the whole society.4

But a nonauthoritarian government cannot effect such a redistribution to any great extent. The discontent of the losers, who were already on the margin of subsistence, explodes and there is no mechanism in the society to balance the discontent of the losers with the gratification of the gainers. On the contrary, the gainers stand to gain more if the articulated discontent helps to bring prices down.
It is for this reason that the newly employed heartily join a street demonstration against rising prices, completely unaware that they are the cause of the trouble. Even the businessman prefers low food prices in order to keep his costs down. More importantly, when food prices are rising faster than income, a larger proportion of income is spent on food and less is left to buy industrial goods.

Not all labor is organized, and even organized labor cannot obtain increased wages in time to neutralize the effect of rising food prices. Because incomes are so low, little scope exists for rearranging the family budget when food prices rise. It is somewhat surprising that equilibrium can be maintained with a huge load of unemployed and half-starved people, but a slightly different redistribution of a given amount of wage goods takes the system to the brink of disaster.

The supply of wage goods, therefore, sets a limit on total employment, and surplus labor cannot be utilized for capital formation. Food is the most important wage good, because it cannot be quickly produced in a subsistence economy. With development and rising income, the diet may change; and if extra income is spent on meat instead of rice, supply may again fall short of demand. It may indeed take a very long time for a subsistence economy to cross this food barrier.5

SAVING POTENTIAL

Saving in a subsistence economy has to be viewed in terms of wage goods. At any given time, total employment is limited by a given supply of wage goods. A subsistence economy, therefore, has to economize wage-earning labor almost as in a full-employment, labor-scarce economy. But this fact is not widely appreciated. Governments often create substandard jobs to give work to unemployed persons, not entirely for political reasons, without realizing, as it seems, that such policy wastes the scarce resources, namely, wage goods. They create special
half-jobs for the underemployed, ignoring the fact that underemployment is only a symptom of over-all unemployment, and resources so wasted could create more jobs, attacking the disease rather than the symptom. The notion that the use of unemployed labor involves no social cost does not take into consideration the diversion of limited wage goods, which could be alternatively used for a better purpose.

The notion of costless labor is also responsible for the fact that luxury consumption is not discouraged. Consumption of nonwage goods amounts to the consumption of scarce wage goods. In a poor country, only a small percentage of the people can afford luxury consumption. If it can be controlled, a larger amount of resources will be available for essential investment. Even the poorest of the poor can be persuaded to save a little, but the main burden of creating savings for development has to be borne by the well-to-do. In many developing countries today, the rich are hated and efforts are being made to equalize incomes. But if one is concerned with raising the rate of investment, equality of incomes may actually become a hindrance; however, equality of consumption accompanied by inequality of incomes is likely to be a useful device for accelerating growth.

In many developing countries today, futile strife is created between the public and the private sector and undue emphasis is placed on the ownership of the means of production. Whether passenger cars are to be produced in a public or in a private sector is hotly debated; the more relevant point, whether they should be produced at all, is nearly ignored. The percentage of income taken out for consumption from the stream of national income is the real measure of economic equality and not just the ownership of the means of production. It is certainly true that inequality of wealth eventually leads to inequality of consumption. But where consumption can be controlled by proper investment priorities, the owners of the means of production become inexpensive managers in the production process. They may derive a psychological satisfaction from building
an empire of brick and steel, but, in effect, they will be less harmful than the highly paid bureaucrats of state enterprises.

As a matter of fact, the developing countries reduce the supply of luxury goods by cutting down imports. However, import restrictions are mainly meant to maintain a favorable balance of payments and not to elicit domestic savings. Import-substitute industries, therefore, soon follow the import restrictions. It is not always realized that diversion of foreign exchange from luxury goods to capital equipment is only one way to create domestic savings and that the domestic production of nonessential goods will undo what the diversion of foreign exchange has achieved. In a subsistence economy, the only difference between the consumption of imported goods and that of substitutes made in the country is that the former increases demand for food and other wage goods via export industries, whereas the latter does it in a direct way. For increasing the saving potential, therefore, it is essential to discourage both the imports and domestic production of as many nonwage goods as possible.

It is, of course, true that shutting off the supply of luxury goods may lead to the increased consumption of wage goods, directly or indirectly, and savings may not be effected to the extent desired. However, such a substitution effect is not likely to be very large as far as goods are concerned, and a family unable to obtain a car is not likely to buy a hundred bicycles instead. Nevertheless, the substitution between luxury goods and services can be very significant, and it may become necessary to block, at least partially, this avenue of consumption also. What is important to note is that the consumption of services, whatever the volume of unemployment, does constitute a drain on scarce resources. Indeed, it is worse than the consumption of expensive goods, because in the case of manufactured goods at least part of the expenditure goes into a businessman’s profits, which are likely to be saved, whereas most probably the expenditure on services will constitute an extra demand for wage goods.
THEORETICAL FRAMEWORK

One way of keeping up luxury consumption without reducing essential investment is to obtain grants of luxury goods from advanced countries, which may be able to afford such grants by using occasional excess capacities in their industries or even by financing exports of secondhand goods. By selling these goods to well-to-do citizens, the governments of the developing countries would be able to absorb enough income to reduce some of the demand for wage goods. Indeed, goods can be chosen for this specific purpose. For example, washing machines and vacuum cleaners should be preferred to cars and air conditioners, because the use of the latter absorbs scarce resources like gas or electricity, whereas the former reduce the necessity of having servants, who can then be employed for increasing essential investment. But such a suggestion is not likely to be considered by either the developing or the advanced countries, because development today is almost equated with import-substitute industrialization.

If it is impossible, for some noneconomic reason, to avoid import-substitute industrialization, it may be worthwhile to select only a few luxury items rather than to spread the investment over the whole range of nonwage goods. In a poor country, the demand for nonwage goods is, almost by definition, very small. If this small demand is diffused over many products, then none of these industries is likely to flourish in the modern competitive world. A large industry, not necessarily large-scale production, generally reaps increasing returns and acquires a comparative advantage in the international market. It will be very difficult, if not impossible, for a newly developing country to build a large industry for an export market; it is much easier to base export industries on the firm base of domestic demand. Even for export promotion, therefore, it is necessary for poor countries to concentrate their domestic demand for expensive products on a few items. It is now generally believed that backward countries can build up exports of modern manufactured goods that are relatively simple and inexpensive. India already exports bicycles,
electric fans, sewing machines, oil engines, and so on. But the reason for such exports may be that these industries are now well established because of a large home market. That they are simple and inexpensive manufactures is incidental; their success as exports is probably due solely to high demand for such goods in poor countries. If the home demand for more complicated goods could be concentrated on a few items and if viable industries were established, exports of complicated and expensive goods would also be possible for these countries. In some countries like India, there is a cheap supply of highly skilled labor, including engineers, electricians, chemists, metallurgists, pharmacists and others. Industries that require ample labor of this kind will also be successful in the export market if they are initially supported by a sizable home demand.

PEASANT AGRICULTURE

One feature of peasant farming is that the farmer produces food mainly for his own family. This is also true, though indirectly, of the cash-crop farmer, to the extent that substitution is possible between cash crops and food crops. Growing cash crops is only an indirect way of acquiring food, and if relative prices are not satisfactory, the cash crop farmer can at any time start growing his own food, unlike, say, a factory worker or businessman. In a subsistence economy, the rural population as a whole is more or less self-sufficient, and sometimes even a small village is a self-contained economic unit relying on the outside world for only minor items of expenditure. Only a small percentage of total food production is sold to the nonagricultural sector, and when agricultural productivity is increased, a good part of increased food production is absorbed in the agricultural sector itself. The net amount of food that the agricultural sector can sell to the nonagricultural sector is known as the marketable surplus. This marketable surplus has to be kept growing, if nonagricultural employment and investment are to be increased.
It is important to note that this marketable surplus cannot be continuously expanded unless the peasant is allowed to increase his income and consumption. This is an essential characteristic of peasant agriculture, that is, predominantly small-scale farming carried on as a family occupation. It is different from capitalistic or collectivistic agriculture in that the consumption unit and the production unit are not separable. Farming in India is rarely a commercial proposition, and the reward for labor is not determined by its contribution to production. On the average, the peasant has enough labor in his own family, and he can use it to the limit where the marginal product of labor is almost negligible; the total income then is jointly consumed, that is, is shared in equal proportion by the members of the family. In other words, the agricultural "wage" is determined by the average productivity of labor and not by its marginal productivity. This is indeed true of most of the production units in a subsistence economy, except, of course, the modern incorporated business.

The growth of marketable surplus depends on agricultural productivity, which in turn depends on the growth of agricultural production over and above the growth of agricultural population. By abstracting from the crucial problem of population growth, we find that a larger marketable surplus can be extracted by not allowing the farmer to consume his own product, that is, by holding down his "wage" even if agricultural productivity is increased. This can be done by moving the terms of trade between agriculture and industry against the former. To a certain extent this practice is ubiquitous. One generally prevalent theory is that agricultural production, and especially food production, is not responsive to price changes. To the extent that the agricultural sector is self-sufficient, this theory may be true; but in that case, reduced prices of food can only encourage the farmers to consume their own production and to reduce the marketable surplus. To the extent that it is possible to break down the traditional self-sufficiency, price incentive is likely to be important. Unless the farmer continues
to earn a rising income, his consumption pattern is not likely to change, and he will always remain self-sufficient, satisfying his meager wants in the agricultural sector itself. For rising agricultural income, however, it is not necessary that prices of agricultural products be rising, because a rise in income depends not only on prices but also on rising production. But if the falling prices offset the rise in income caused by increasing production, there is no reason why the farmer should produce more or sell more, especially if his needs for nonagricultural goods are not significant.

For the same reason, it is also not possible to tax away his extra production. Any perceptible effort to coerce the peasant can lead to agricultural stagnation or the break-up of the peasant proprietary system. In peasant farming societies, it is almost impossible to acquire agricultural surpluses if the standard of living of the peasantry is not allowed to rise. The surest path to economic development in a subsistence economy, therefore, is to stimulate the peasant's desire to acquisition and consumption. Government initiative is required for this purpose. Moreover, the government should not siphon off agricultural income for industrial development. If the peasant is not to waste his extra production on raising bulls for exhibition and horses for racing, or on building castles and temples, he has to be given something in exchange. It is through the changing consumption pattern, and not so much through his savings, that the peasant's contribution to industrialization is to be sought. It is not enough, therefore, to concentrate on wage goods production; even within the wage goods, those which are particularly desired by the peasantry have to be given a higher priority.

**EXPORT PROMOTION**

The supply of wage goods can, of course, be augmented by imports. But if imports are to be paid for by exports, the basic scarcity of domestic resources will not be improved. It is only a question
of choosing between domestic transformation and transformation through trade. The latter indeed should be preferred, because in the export industries the comparative advantage is clearer and more immediate and, therefore, investment priorities are more likely to be correct than in industries mainly based on the home market. To increase the availability of wage goods continuously, continuous expansion of exports is necessary. If this is possible, quickening economic development is not a real problem. The exports of a backward country are likely to be composed of agricultural goods, again making wage goods available through imports dependent on agricultural productivity, though indirectly. If the exports happen to be nontraditional, based on mineral resources or special technical skill, then domestic agricultural development can be bypassed; but in that case domestic industrial development will be dependent on increasing agricultural productivity abroad and on supporting the consumption of farmers in foreign countries. This may be worthwhile on the basis of comparative advantage, but it should be noted that this method of development does not depend on the alleged necessity of depriving the peasant of the benefits of increased productivity. The practical difficulty of a developing economy, however, is that exports cannot increase as fast as is desired and export earnings are not enough to finance importing both producer goods and consumer goods; hence, the necessity of discouraging nonessential consumption and encouraging wage goods production.

It may be possible for some countries to import wage goods without making any payments, and such foreign grants can augment their investment capacities. From a purely economic point of view, there is nothing wrong with such a policy, but two noneconomic considerations are worth noting. It is easy to disturb the equilibrium of the subsistence economy by creating more employment for the previously unemployed or underemployed people. But if, for some reason, the extra supply of wage goods from abroad comes to a stop and employment must be reduced, it is not always easy to re-establish the old underemployment equilibrium. As a general rule, hiring is easy but
firing is difficult, especially on a mass scale, for the obvious reason that alternative jobs are not available and clinging to the present job becomes a vital problem for the worker. Foreign grants, therefore, can create more problems than they can solve, unless they can be relied upon by the planners for the intended duration.

The second difficulty is the possible discouragement of domestic production of wage goods. Once the supply of wage goods is assured, grandiose industrial plans are difficult to avoid and import-substitute industries catering to the influential city populations may not be held back. The new industrial structure will require low prices for wage goods, and especially food, and the lack of price incentive can relegate agricultural development to the background. Grants from the advanced countries may pervert the whole process of development and, in addition, may support import-substitute industrialization which will harm their own export trade. It is, of course, possible that costless wage goods will be properly used for furthering economic development; but many times it is the logic of the situation rather than long-term strategy that shapes the development programs of nonauthoritarian countries. One perhaps should appreciate the generosity of the American people in giving away so much food and cotton to newly developing countries. However, it is very possible, in spite of all the American effort to the contrary, that such grants have hindered the development of the importing countries. Most probably, aid under P.L. 480 has hindered agricultural development and left the concomitant population-control policies undeveloped.

In subsistence economies, paucity of wage goods, not the shortage of foreign exchange, is the main barrier to investment and employment. However, the foreign exchange barrier has been unduly emphasized, and, therefore, export promotion is a watchword of commercial policy in many developing countries. They are all trying to boost such traditional exports as vegetable oils, cotton, tea, coffee,
rubber, jute, spices and so on. In the good old colonial days, exporting raw materials or importing manufactured goods was considered a policy of exploitation of the backward countries. Those days are over. Now the backward countries complain that the demand for traditional exports is not sufficiently expanding. Such exports are maintained and promoted irrespective of the terms of trade, interests of other developing countries exporting the same goods, fiscal burden of the subsidies or even the general effect on economic development. One must remember that exporting cannot be an end in itself; from any one country's point of view, exports are a dead loss. Exports should be maintained only to finance imports which, in turn, are required mainly to develop the economy. In a completely free economy, where price mechanisms alone can be used to achieve and maintain full employment, the device of dumping goods in foreign markets may be a small price to pay to get over a slump, instead of making irreversible changes in the institutional structure of the economy. But when there is full or over-full employment, dumping is indeed a curious policy. A subsistence economy on the path of development must be considered a full-employment economy, because all the employment that is justified by the supply of wage goods has been created and no further employment can be made before more wage goods are produced. Therefore, export promotion, let alone dumping, is not likely to be worthwhile unless export industries use specific resources not needed for the production of wage goods. If the export industries use the same factors as wage goods industries, then the export promotion policy is very suspect and may actually hinder economic development. For example, it is doubtful whether India can export more vegetable oil, sugar, raw cotton and even jute, without affecting her food production.

It may be worthwhile for countries like India to keep down food prices by renouncing the export of agricultural raw materials. Given the rate of foreign exchange, if food prices and, therefore, wages rise, the manufactured goods can be priced out
of the international market. If the rate of foreign exchange is kept freely floating, larger exports can lead only to raging inflation, clogging the whole development process. The real objection to the subsistence economies exporting agricultural raw materials is that a country can block itself not only against exporting manufactured goods but also against industrialization itself.

Another facet of export promotion is to push raw material exports a little further in the production process before they are exported. Thus, Ghana exports processed cocoa instead of cocoa beans and India exports groundnut oil instead of groundnuts. When total possible employment is limited, one cannot be sure that this is the ideal policy for development. The little step toward increasing the export value of traditional goods can be taken any time if such exports are maintained. Meanwhile, employable labor can be used in a more worthwhile way. If a steel factory or fertilizer factory or hydroelectric works cannot be built because of the lack of wage goods, crushing cocoa beans or groundnuts does not seem to be the best way to use scarce resources. Export fetishism is not likely to help the development of a subsistence economy. What is needed is to increase domestic savings and the production of wage goods. Export promotion can be used for this purpose, but not necessarily. Exports can reduce the domestic production of wage goods; export earnings can be wasted on expensive consumption and, worse still, on building import-substitute industries. Export promotion is useful only to the extent that it increases the supply of wage goods and reduces per head consumption by redistributing income through inflation.

**COSTLESS LABOR**

One reason why the developing countries do not seem to be trying to create larger domestic savings is the hard-dying myth of costless labor. There is so much unemployment and underemployment
that any use of labor is supposed to add to the total national output. To the industrial sector, labor supply is said to be infinitely elastic at a subsistence wage, and as the marginal product of labor in agriculture is negligible, any industrial employment is seen as a net social gain. This reasoning involves an incorrect understanding of the subsistence economy.

Those who postulate a perfectly elastic supply of labor to industry at a subsistence wage seem to be implicitly assuming capitalistic agriculture, where the landlord employs labor at a subsistence wage and is under social compulsion to employ almost everybody he happens to know—but only at a subsistence wage. In this situation, the agricultural wage and, therefore, the industrial wage can remain at a subsistence level till the transfer of labor from agriculture to industry brings the marginal productivity of agricultural labor up to the wage level. The landlord now is free to employ labor only if it is justified by the marginal productivity. But in a subsistence economy, with characteristic peasant farming, such mobility cannot be induced by a fixed subsistence wage. Even if the marginal productivity of labor in agriculture becomes equal to the subsistence wage, there is no reason for the "wage" to cease to be determined by the average productivity, unless one arbitrarily postulates some automatic force that "commercializes" agriculture as soon as the marginal productivity ceases to be insignificant and, therefore, the members of the family now become more useful to the peasant than before. 10 To transfer the farm population to industry may possibly require a wage rate rising faster than the rate of agricultural production, simply because reduction in farm population also means increased average productivity in agriculture and, therefore, an increase in agricultural wage.

As a matter of fact, however, the assumption of a perfectly elastic supply at a subsistence wage is quite valid in all the subsistence economies today. This phenomenon is an example of "thinking makes it so." Because of this assumption, any
industrialization seems worthwhile and the available investment is wasted in indiscriminate industrialization, ignoring agricultural development. The vicious circle, then, is completed by stagnant agriculture which can gladly supply extra-cheap labor to industries. But things will be different if agricultural prosperity is made the main plank of economic development. In a poor country, almost all women, young children and old people are in the labor force. One can see women toiling in the fields or sweeping the streets and young children carrying loads or herding cattle. In stark poverty, women have little to do at home, many times not even a chance of cooking a meal; educating children is too expensive a luxury and retirement of the old is rare. With agricultural prosperity, therefore, not only will the agricultural wage rise, but the total available supply of labor also will decrease.

In a subsistence economy, unlimited supply of labor to the nonagricultural sector is a hindrance and not a help in economic development. Given the supply of wage goods, only so much labor can be employed in the nonagricultural sector at a given real wage. This limitation cannot be avoided even if some inflation is allowed by overinvestment, because such inflation only means that the real wage is kept lower than it would otherwise have been. If food is the main wage good, then the larger the part of wages spent on food, the smaller the amount of total employment possible. If for some reason people spend 60 per cent instead of 50 per cent of their wages on food, prices of food will inevitably rise unless wage income is reduced by reducing employment. On the other hand, if the proportion of wages spent on food is reduced, then employment can be increased, assuming, of course, that the rest of the wage goods are in elastic supply. An industrial worker will be spending a larger proportion of his wages on food if he has many dependents seeking factory jobs, or if he has to remit part of his wages to his poor relations in the villages. Agricultural development, therefore, is essential not only to provide food and raw materials to the industrial sector, but also to reduce excessive
migration of labor out of agriculture and to reduce remittances from the industrial to the agricultural sector.

CAPITAL FORMATION

The paucity of investable funds is not a real barrier to capital formation in subsistence economies. It may be true that capitalistic development has occurred in the past because the profits earned by businessmen were reinvested. Landlords and farmers dissipate their gains in unproductive expenditure, but the industrialist, for some reason, which is as yet from clear, reinvests his profits and thus leads development. It is not known whether this is true, especially of small industrial units, in the developing countries today. However, reinvestment of profits is neither a necessary nor a sufficient condition for sustained investment where the supply of wage goods is a crucial factor in development. If wage goods are available in sufficient quantity, say, because of bumper crops of food and cotton, the government can create more money, either for its own investment projects or for loan to industrialists. Such a creation of money and increased investment will, indeed, be necessary if the prices of agricultural goods are not to slump, discouraging a further increase in agricultural production. On the other hand, if wage goods are in short supply, say, because of poor food crops, even the genuine reinvestable funds of the capitalist cannot be used for further investment without creating an inflationary situation.

One of the reasons why a capital-intensive technique of production is supposed to be desirable, even in overpopulated countries, is that it creates larger reinvestable surplus for industry. But this reasoning assumes that the industrial sector directly produces wage goods, including the main wage good, food. But food is produced by the peasants, who have a sufficient supply of labor in their own families. It does not seem desirable to dispense with this labor by using capital-intensive methods
because, employed or not, each member of the family gets an equal share of the total produce, and no extra surplus can be created by dispensing with their services. To create investable funds through larger profits is one way to save wage goods, but if such saving cannot be effected by capital-intensive methods, as in peasant agriculture and perhaps also in small-scale industry, it is no use wasting capital that can be better used by spreading it thinly over a larger economic space. Capital-intensive methods, wherever possible, may be desirable, however, in large-scale industrial production, not so much for creating investable funds out of extra profits, but for reducing the draft on the supply of wage goods.

The fact that capital-intensive methods are not necessary for peasant agriculture does not mean that the peasant must follow age-old, inefficient techniques of production and be denied any benefits of modern technology. Excessive capital intensity may not be necessary, but mechanization of agriculture may be essential before agricultural productivity can be raised. Mechanization, even if it reduces the essential input of labor, may break the vicious circle of inefficiency and poverty. Although underemployment may be increased, the agricultural sector (and, therefore, the industrial sector) will be better off with rising efficiency and production. It is at least doubtful whether the availability of substandard jobs solves or aggravates the problem of rising population and rising underemployment. Moreover, apart from the problem of efficiency, it is urgent in subsistence economies to remove the work animals on farms in order to release the arable land now used for feed. Overpopulation, therefore, is as good a reason for mechanization of agriculture in subsistence economies as the scarcity of labor in advanced economies. Even from the point of view of the health and hygiene of the peasantry, perhaps a necessary condition for continued economic growth, the social benefits of mechanization will outweigh the social costs.14
THEORETICAL FRAMEWORK

It has been pointed out that profit inflation, which reduces the proportion of wages in national income, may be a useful device to elicit essential savings for capital formation. In subsistence economies, however, this may be applicable only to nonwage goods industries. Peasants do not distinguish between profits and wages, and all extra income is equally distributed and consumed. As a matter of experience, if food prices go up, unaccompanied by increased production, marketable surplus can go down, because the peasant's own demand for food goes up because of his increased income. In other words, agricultural profits may actually lead to a reduction in savings. The rising prices of wage goods produced by large-scale industries may lead to the creation of more savings through increased profits. However, if the relative prices of foodstuffs are kept lower than the prices of other wage goods, the substitution effect may create extra demand for food—the wage good in inelastic supply. But the terms of trade between industry and agriculture can be made unfavorable to the peasant only at the risk of reducing the marketable surplus and even agricultural productivity. In a subsistence economy, an inflation affecting the wage goods sector and, therefore, the real wage of the peasant and the factory worker is not likely to be helpful for development purely from the economic point of view, apart from the moral and political issues involved. Profit inflation in nonwage goods industries, however, is neither likely to lead to unrest nor to affect the standard of living of the vast majority. The only fear of such sectoral inflation is that, if there is no control on investments, more and more investment will go into nonwage goods industries because of high profit rates, and if this diversion of investment tends to restrict the production of wage goods, then there will be an over-all inflation, braking the whole development process.

CONCLUSION

The poor, overpopulated, democratic countries with small-scale peasant farming are in great need
of capital formation for improving the standard of living of their teeming millions. The main, if not only, hurdle in the way of capital formation is the lack of sufficient wage goods to maintain high rates of employment. The main wage goods, food and cotton, have to come from the peasantry.

Commercial policy can play an important part in the strategy of economic development. Trade controls can be managed without frequent confrontation of the authorities with the great mass of people and without much administrative paraphernalia. Moreover, necessary flexibility can be introduced into planned economic development by manipulating imports or exports. Even with unlimited investment and most efficient planning, continuously balanced growth of the economy is almost impossible in a more or less democratic society. But an intelligent use of commercial policy can lessen growth pains and help the planners to achieve their goals without sterile intervention in the economy. It is almost true by definition that planning in a subsistence economy will have to be incentive or indicative planning, not totalitarian. It is hard to imagine how totalitarian planning can accommodate the peasant, who is at the center of the economic problem of a subsistence economy. Planning and governmental initiative are indeed required for quick economic development. It is also hard to make a case for pure price mechanism to the exclusion of governmental intervention and initiative. The population problem, the problem of agricultural productivity, the problem of encouraging investment and discouraging consumption, and so on, cannot be solved without governmental initiative. However, if governmental intervention fails to create and foster private initiative, no democratic country can hope to grow.
Export trade is not unimportant for India's economy. However, export industries are not likely to become a leading sector in the development of that country. India's export policies, however, do not seem to recognize this fact. But before evaluating these policies, let us consider some relevant facts about India's exports.

SMALL AND STAGNANT EXPORT SECTOR

The export sector of the Indian economy is small compared with the country's national income. Moreover, with national income rising, the comparative size of the export sector is declining. Before 1956, export earnings were about 6 per cent of the national income; since then the proportion has declined to about 5 per cent. These are gross export earnings. But some export items contain an import component; for example, tea (chests) cashew kernels (cashew nuts), art-silk manufactures (silk yarn), cotton textile (raw cotton and chemicals) and so forth. All manufacturing and processing industries rely on imports for capital equipment, spare parts and oil. Some export industries, such as tea and coffee plantations, jute-manufacturing industries and hydrogenated-oil mills, have significant foreign investment which means that exports (but not necessarily an increase in exports), to that extent, imply repatriation of profits. The import component in Indian exports is not very
large, but the net export earnings, because of this factor, are smaller than those shown in the usual trade statistics. Against this discount, however, one has to balance the extra export earnings that are due to smuggling, underinvoicing of regular exports and incomplete reporting of trade statistics.

The significance of the small size of the export sector is that a small increase in the availability of goods by imports requires a large increase in exports. For example, if the food supply is to be increased by 5 per cent (from 100 to 105 million tons), export earnings will have to increase by over 40 per cent [from Rs. (rupees) 600 crores to Rs. 850 crores].* This fact should dampen the enthusiasm of any export fetishist.

Moreover, in spite of all the export promotion effort, India's exports are not expanding. As a matter of fact, they were absolutely stagnant from 1948 to 1961, when they stood at about Rs. 600 crores per year. Though world trade has been continuously growing, India's share has declined. However, in the period 1962-66, export earnings attained a new level of Rs. 750 crores per year, an increase of over 5 per cent per year, a very impressive rate of growth, though it still falls short of the growth rate of world trade. A part of the increase in the export figures was due to the inclusion of Portuguese possessions in India (Div, Daman and Goa) in the India Union at the end of 1961. Another part of the increase was due to better arrangements for reporting the data. Some increase was also due to higher world prices for Indian exportables, and, therefore, an increase in the quantum of usual export items can be mentioned

*i.e., from $800 million to $1,200 million.*
only as a residual cause. This new growth trend, however, may continue for some time because of the recent liberalization of import policies by the advanced countries and the devaluation of the rupee. Nevertheless, over a longer period, India's exports are more likely to be characterized by relative stagnation than by fast growth. All the usual export promotion devices have already been overused, and there does not seem to be any fundamental change in the character of the export sector.

TRADITIONAL EXPORTS

Another important characteristic of Indian exports is that they are traditional. India still exports the same goods as she did twenty years ago when a serious effort to develop the economy was started by the national government. Before independence, Indians used to resent the exports of raw materials and the imports of manufactured goods. The composition of imports is now completely changed, and India now imports raw materials, intermediate goods and capital equipment; the imports of manufactured consumer goods have been reduced to a trickle. But the corresponding change in the composition of exports has not taken place. The government has encouraged the processing of raw materials before they are exported—India now exports vegetable oils instead of oilseeds and tanned hides instead of raw ones, but this change can hardly be considered a break from the past. However, some nontraditional items have been showing up recently, for example, steel, sugar and the products of light engineering industries. Exports of steel and sugar are only possible because of a temporary surplus which may disappear at any moment. Moreover, heavy subsidies and lengthy negotiations with foreign countries are required before Indian sugar can be made exportable. Products of light industries such as bicycles, electric fans, sewing machines and oil engines are genuine exports that reflect the industrial development of the country, but they earn hardly more than 1 per cent of the total export earnings. Moreover, some
<table>
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<tr>
<th>Year</th>
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<th>National Income at 1948-49 Prices</th>
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<td>15,050*</td>
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<td>806</td>
<td>21,000*</td>
<td>14,490*</td>
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Note: Years are fiscal years ending March 31.
* Estimated.

Source: Statistical Abstract (New Delhi: Government of India), monthly publication.
of these exports go to other developing countries which may soon establish their import-substitute industries.

India has only seven main foreign-exchange earners. In order of importance they are as follows: jute manufactures, tea, cotton textiles, hides and skins, iron ores, oilcakes and vegetable oils, including hydrogenated oils. They generally bring in about 66 per cent of the total export earnings. The first three items are most important, as they count for about 50 per cent of total exports. After these seven, ten more items, each of which has brought in at least 1 per cent of the total export earnings in the last twenty years, can be mentioned. They are tobacco, raw cotton, cotton waste, manganese ore, mica, black pepper, coir manufactures, cashew kernels, coffee and raw wool. In recent years art-silk manufactures have become a significant export item. Adding the following seven items to these almost completes the list of Indian exportables: lac, coal, woolen carpets and rugs, fish, mineral oils, chemicals and the products of light industries. These twenty-five items (plus the two temporary additions—sugar and steel) now account for over 99 per cent of the total export earnings of India.

It is clear from this list that the main items of Indian exports are either mineral or agricultural raw materials or simple manufactures like jute and cotton textiles, of which the significant part of their value originates in agriculture. For all these items, the comparative advantage is mainly due to the climate or other natural resources; neither technical skill nor the broad base of home demand is the reason for most of India's export capacity, excluding, perhaps, cotton textiles. As a matter of fact, India, like many other underdeveloped countries, has an almost segregated export sector in the sense that the production of many items depends mainly, or entirely, on the export market. About 90 per cent of the jute manufactures and 70 per cent of the tea are meant for export.
Almost all shellac and mica go to the export market. Black pepper (50 per cent), coir manufactures (40 per cent), cotton waste (60 per cent), manganese ore (80 per cent) and hides and skins (50 per cent) are significantly dependent on export trade. Even cotton textiles (20 per cent), raw cotton (10 per cent) and tobacco (20 per cent) cannot afford to be indifferent to the international demand. Among the important foreign-exchange earners, the only exception seems to be vegetable oils, 95 per cent of which are required for the domestic market. India, therefore, can be said to have a specialized export sector. This does not, however, mean that she has a monopoly in any of these products, though India is the most important exporter of tea, jute goods, mica, manganese ore, shellac, coir, and cotton textiles. Not having a monopolistic power, India cannot manipulate the external prices of her exportables much, but at the same time, being an important seller of many goods in the international market, she cannot behave as a passive price-taker. Her export policies, therefore, are understandably rather complicated and shifting.

REASONS FOR STAGNATION IN EXPORTS

Export promotion has been the basic tenet of India's commercial policy since independence. In recent years, as foreign-exchange scarcity has created more and more serious bottlenecks in the development plans, it has become almost an obsession. Indian traders are well known for exploiting trade opportunities all over the world. In spite of all these private and official efforts, Indian exports have remained stagnant. There seem to be three main reasons for this phenomenon. Firstly, though world trade in general is rapidly growing, the world demand for many Indian exportables, like jute goods and tea, is only slowly growing or not growing at all. Secondly, though there is sufficient demand for some Indian exportables, India is not able to take
advantage of it because of supply restrictions, which in turn are due to the slow growth in production and to the rapid growth in domestic demand for these goods. Thirdly, India is facing increasing competition from an increasing number of countries in her traditional export markets.

TABLE 2

India's Main Items of Export  
(Crores of Rupees)

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<td>140</td>
<td>152</td>
<td>153</td>
<td>180</td>
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<td>121</td>
<td>128</td>
<td>122</td>
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<td>46</td>
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<td>Art Silks</td>
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</tr>
<tr>
<td>Iron and Steel</td>
<td>10</td>
<td>10</td>
<td>2</td>
<td>4</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Machinery and Equipment</td>
<td>7</td>
<td>5</td>
<td>7</td>
<td>7</td>
<td>9</td>
<td>11</td>
</tr>
</tbody>
</table>

Note: Years are fiscal years ending March 31.

Source: Statistical Abstract (New Delhi: Government of India), monthly publication.
It should be noted that all three factors simultaneously affect different items of exports. All three are important and no single explanation is sufficient. However, the first factor is the most important one, as has been pointed out by S. J. Patel; roughly speaking, two thirds of Indian exports seem to be suffering from stagnation in world demand, and the rest of them suffer from supply restrictions.

Jute, tea, cotton textiles and metallic ores constitute over 60 per cent of India's exports. Some information about the position of these goods in the world market will put in bold relief India's actual and desirable commercial policies in respect to these commodities.

JUTE MANUFACTURES

If one ignores the small but growing quantity of raw jute exported by Thailand and Indonesia, India has only one important competitor in the world market—Pakistan. Even Pakistan exports mainly raw jute, whereas India is a net importer of raw jute and an exporter of jute manufactures. The situation, however, is changing rapidly; Pakistan has now built an up-to-date jute textile industry and India has lost its monopoly of jute manufactures.

Although jute is used all over the world, the main importing countries are the United States, Canada, the European Common Market and Britain. Two important industrialized countries, Russia and Japan, grow their own jute and have their own textile industries. Western Europe imports only 15 per cent of her total requirements in the form of manufactures and the rest is supplied by protected domestic industries importing raw jute from Pakistan. The European Common Market places a 25 per cent duty on jute manufactures and none on raw jute. The low duty on manufactures is deceptive because imports are mainly controlled by
quotas. This leaves North America and Great Britain as India's main customers.

In the highly industrialized countries, jute has been on the defensive for the last twenty years, because of modern methods of bulk handling of commodities such as grain, sugar, potatoes, fertilizers and so on. The use of paper and cotton bags is also increasing. The most important force seems to be consumer packaging done on a large scale at the source of supply. Sugar, potatoes, rice and even vegetables come to the retailers prepackaged, complete with brand names. Jute is neither convenient nor attractive for small packages, and it is, therefore, displaced by paper or cotton bags. The processed, cooked and frozen foods have the same effect. This revolution in retailing is still not complete, especially in Europe, and jute is likely to suffer on this count in coming years. However, new industrial uses are being discovered for jute, such as carpet backing, floorings, safety belts in cars, laminated bags, felts, upholstery material and so on. Most importantly, the backward countries are slowly changing from a subsistence to a market economy and internal trade in Africa and Asia is on the increase. Some crops like cotton, oilseeds, sugar, cocoa and coffee will require jute packing until bulk-handling or consumer-packaging methods take over. That is why Brazil (coffee) and Cuba (sugar) are the largest users of jute in Latin America.

Thus, both negative and positive forces are working on jute demand, and the former seem to have outweighed the latter. World jute exports, therefore, have remained stagnant, hovering around a million tons a year since 1953. Since 1947, the Indian jute industry has suffered from an excess capacity, except during the Korean boom. The main hope for increasing India's exports depends on the policies of the European Common Market. The United Kingdom reduced her jute mill capacity after World War II and now most of her requirement is met by imports from India, though a small domestic
industry is protected by controlling imports through a state monopoly. If the European Common Market can be persuaded to follow a similar course, India (and Pakistan) will be able to expand her exports of jute manufactures without increasing raw jute production. One may even hope that the Japanese could be persuaded to import an unimportant commodity like jute and use their meager land resources for another purpose. It is doubtful that Russians can be so persuaded. As a matter of fact, Russians do buy some jute manufactures from India to use up their rupee reserves. However, subsequently they export their own jute to Western Europe, cutting down India's exports to that market.

Jute is the cheapest packaging material presently available. Demand for packaging material at any one time is not likely to be price elastic. However, because of the possibility of reuse in the short run and alternative handling in the long run, high jute prices are very likely to shrink the demand for jute. In other words, if jute prices rise, export earnings may not increase proportionately, and there is a great possibility that jute prices will rise in coming years. Growing jute and extracting the fiber from the plant are labor-intensive operations. If agricultural wages rise because of agricultural development, jute prices are bound to rise. Moreover, most jute land can also be used to grow rice, which is in short supply both in India and Pakistan, and neither of these countries will ever be able to import enough rice to hold down the relative price of rice. Indian planners expect to earn 50 per cent more foreign exchange on account of jute goods by the end of 1971. This possibility has been already discounted by the jute goods manufactures in India.

The real handicap in future years is going to be the non-availability of adequate jute fibre. [One] million bales of jute fibre [should] be imported to assure good quality fibre. Otherwise, there might be an actual decline in exports of jute goods rather than the contemplated increase.
TEA

Exports of tea are also stagnant because of the lack of growth in world demand. From 1957 to 1966, total world trade rose by 65 per cent, but world exports of tea were stagnant, hovering around 575,000 tons per year.

These exports were regulated by International Tea Agreements and sometimes world exports were even smaller than the total allotted quotas. The main importing country is Great Britain, where per capita consumption is about 5 kilograms (11 pounds) per year. This figure is supposed to represent a saturation point and increasing income is not likely to raise the demand for tea. Tea consumption in Great Britain can now grow only with the population and the British population is not likely to grow fast enough to benefit Indian tea exports. In the United States, income elasticity of demand for tea is negative and the present consumption of 14 ounces per year, per head, is not likely to rise. Australia, New Zealand and Canada are tea-drinking countries, but as the proportion of people of British origin has been falling in these countries, imports of tea have failed to rise. Russia and Latin America grow enough tea for their home markets and, in any case, they are not tea-drinking countries. Japan, China and Indonesia are exporters, though their share of the world tea market is not large. The main competitor to India is Ceylon, and recently East African countries have entered the international market.

However, world tea consumption is bound to increase with rising population and rising income. Tea consumption in presently developing countries, including India, is rising. Tea is the cheapest beverage and will always remain so compared with its nearest substitute, coffee. Coffee beans are fruit, whereas tea consists of leaves; and coffee, unlike tea, erodes and defertilizes the land. However, cheapness is not an unmixed blessing; in high-income groups in poor countries and in
<table>
<thead>
<tr>
<th>Year</th>
<th>World Tea Exports in Thousand Tons</th>
<th>India's Tea Exports in Thousand Tons</th>
<th>Price in India Rs. per 1,000 Jute Bags</th>
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<tbody>
<tr>
<td>1948</td>
<td>400</td>
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<td>1966</td>
<td>564</td>
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</table>

high-income countries of Europe, coffee has snob value. In the United States, on the other hand, the time consumed in the serving of tea seems to be an important factor in the sluggish demand. Now this factor is likely to be eliminated—serving coffee used to be much less messy than serving tea, but with the innovation of tea bags and "instant tea," things are reversed. A spoonful of tea, wrapped in non-soluble paper or aluminum foil, is served with a pot of hot water. Instant tea, like sugar, quickly melts in hot water and no brewing, waiting, straining or cleaning is required. These new methods of serving tea (incidentally, not devised in India), however, have paradoxically reduced the demand for tea and especially choice tea. Broken tea is more suitable both for bags and for instant tea than an unbroken "bud and two leaves." In the old-fashioned tea pot, 1 pound of loose tea would make 260 cups, whereas the same amount of tea in bags can make 320 cups. However, such innovations may raise tea consumption in due course, at the cost of coffee or soft drinks.

In America and in Europe (except Britain and Ireland), coffee is more popular than tea, and there is a scope for export promotion because tea is a more wholesome drink than coffee, but such a change in tastes does not seem to be imminent. New uses of tea as a mixer in liquors and a base for cocktails are not yet well known. But, unlike jute, tea offers some scope for genuine commercial export promotion. Scope for political maneuvering to obtain slightly higher prices for tea is also evident. A lower price is not likely to raise demand, especially in the high-income countries. That is why monopsonistic importers in advanced countries make huge profits. Up to 1963, India used to levy a varying export duty on tea in an effort to bite off some of the profits of monopsonistic foreign buyers. But as tea is sold by auction, it is very possible that the export duty was accounted for in the auction prices obtained by India, and, in effect, the export duty was paid by
the producers and not by the foreign buyers. Seventy per cent of the English market is controlled by only four importers, and tea prices in London are more stable than in Calcutta. India and Ceylon with the cooperation of the governments of the importing countries may be able to remedy this monopsonistic situation. Export promotion for tea, therefore, lies, to a certain extent, also in the political field. India has a large capacity to expand tea plantations without hampering food production, because tea land is not very useful for other purposes.

COTTON TEXTILES

World demand for cotton textile, unlike that for jute and tea, is not stagnant in spite of the growing competition from man-made fibers such as rayon, nylon and other art silks. Nevertheless, import demand is restricted by the protective policies of both the advanced countries and the newly developing countries. The governments of the United States and the United Kingdom have asked the government of India to regulate the exports of cotton textile in such a way as not to hurt their own textile industries. If this enforced self-restraint is removed, the present exports of 1 billion yards (less than 20 per cent of India's total production) can be easily doubled over the next ten years. (However, this will involve larger imports or smaller exports of raw cotton.) In these days of full employment, it should not be very difficult for the advanced countries to make the necessary adjustments in their industrial structure to help the developing countries and to encourage imports of simple manufactures. Such a policy neatly fits into the international division of labor. The recent Kennedy Round of the General Agreement on Tariffs and Trade (GATT) may be helpful to India in this direction.

Because of cheap labor, a huge domestic market, the domestic supply of raw cotton and a long
tradition of textile manufacturing, India seems to be well suited to be a leading exporter of cotton textiles. Japan does not grow cotton and Egypt's home market is not as large. Therefore, given the liberal policies of the developed countries, India seems to have good trade prospects in cotton textiles, if India can increase labor productivity or at least keep wages as low as they are now. Increasing labor productivity in Japan and decreasing willingness of the less-developed countries to import cottons seem to be the main threats to India's exports of cotton textile.

MINERAL PRODUCTS

India is an important exporter of iron ores, bauxite, manganese, mica and coal. Coal goes mainly to Pakistan, but with the slow pace of industrialization in that country India's coal exports are not likely to rise very fast. Demand for mica rises less rapidly than industrial production. India is endowed with huge deposits of good quality bauxite, and exports to Japan and Western Europe are slowly rising. Japan, however, imports bauxite mainly from Malaysia and Australia, and Western Europe imports from West Africa and the Caribbean.

Demand for manganese will rise only slowly. It is mainly used in the production of steel. The U.S.S.R. is the largest producer in the world (about 45 per cent of total world production), and India perhaps comes third, next to South Africa. Russian ores are used in Europe, and India mainly exports to the United Kingdom, the United States and Japan. The United States imports only part of her requirements. American ores, however, are of low quality and, in coming years, imports will rise at a higher rate than that of steel production. But Brazil is the main exporter to the United States. Many countries export manganese ores, such as Morocco, Egypt, Ghana, Gabon, British Guiana and others. India exports ferromanganese instead of ores and thus has some advantage over her competitors. It is not difficult to lose
this temporary advantage over the coming years, and no great increase in export earnings on this count seems possible.

Iron ores are exported to Japan and to Western Europe, and recently to some East European countries. Indian iron ores are supposed to be the best in the world, having an iron content of over 80 per cent. This is important not only for domestic production of iron, but also for exports of ores where transport costs are not insignificant. However, except perhaps in Japan, iron ores are found in almost all countries and low quality is offset by the transport costs of imported ores. The United States imports about one fifth of her requirement from Canada; India is too far away. Canada exports also to Japan and the United Kingdom. African countries are increasing their exports to Europe; and Australia and Brazil are exporting to Japan. Indian exports, however, will rise, but one wonders whether they will rise as fast as the 30 per cent a year envisaged by Indian planners (from Rs. 40 crores in 1965 to Rs. 100 crores in 1971). Unlike the situation in a developing country, the demand for iron and steel does not grow as fast as national income in a developed country, and demand for iron ores lags even farther behind because of the increasing use of scrap iron.

SUPPLY RESTRICTIONS

Not all Indian exports are suffering from lack of international demand. Many raw materials, such as oilseeds, raw cotton, and hides and skins, are unable to earn more foreign exchange because of supply restrictions. India is not able to supply enough quantity because of slowly growing production and rapidly growing domestic demand. The government of India controls the exports of many commodities by quota restrictions, and it is quite obvious that exports can be increased only if supply is more plentiful.
INCREASING COMPETITION

Besides demand and supply restraints, the third factor that adversely affects Indian exports is the increasing competition with other countries. It is hard to see how this can be avoided. Moreover, monopolists are generally disliked by buyers and especially by monopsonistic buyers; the emergence of new sources of supply, therefore, is encouraged by the buying countries.

Such considerations seem to have attracted British investment for developing new tea estates in Kenya, as soon as India and Ceylon became independent. Japan used to import iron ore both from the Indian Union and from Goa, the Portuguese possession in India. As soon as Goa was annexed by India, these two different sources were merged into one, and Japanese interests slowly shifted some of their demand for iron ore to Brazilian sources. Because of such factors and the fact that other newly developing countries are as much in need of foreign exchange as is India, prices for many Indian exportables are not likely to improve; some of them may even deteriorate a little. The new competitors will continue to contribute to the stagnation of Indian exports in two ways: by reducing India's share in the world market and by forcing her to accept lower prices for some of her exportables. India can do very little to remedy this situation.
CHAPTER 3
EXPORT PROMOTION:
POLICY AND PROSPECTS

India has been trying to promote exports since 1947, and in recent years because of excessive shortage of foreign exchange, export promotion has become almost an obsession of the government. In the final analysis, all export promotion amounts to price reduction for the benefit of foreign countries. It is at least doubtful whether such a policy works to India's national interest.

INDIRECT SUBSIDIES

The government of India does not directly subsidize exports, except for a few items like sugar and cement. The State Trading Corporation is given a monopoly on cement distribution in India and "according to the instructions of the Government of India, 50 percent of corporation's remuneration has to be utilized for meeting losses on the export of cement."¹ Exports of sugar are more directly subsidized from the general revenue. However, indirect subsidization is more common. Some exports get exemption from all indirect taxes (handicrafts), some get railway freight rebates (iron ore and bauxite), and some get concessions in income tax.

Another important change is that the principle of taxation on account of business connection has been relaxed in the case of incomes attributable to exports. This means that if a
foreigner, individual or company, enters into purchase contracts in India through an agent or branch office for export purposes, there will be no tax liability on profits made abroad by virtue of this business connection. 2

Some subsidy is given in terms of import licenses. For example, an exporter of nontraditional goods to Afghanistan is given a special license to import fruits and spices from that country. The idea seems to be that the trader will be willing to subsidize exports on his own and then make up the loss by the extra profits in the import trade. Licenses for imports of many capital goods are given to those who can show a good export performance. "The Government of India has introduced in 1959, a special licensing category for capital goods under which import of capital equipment would be licensed against additional exports." 3 These capital goods are not necessarily meant to expand the export industry; it is another way of making exports more profitable than they would be otherwise.

Apart from the merit of the policy of export subsidization, indirect subsidization seems to be inferior to direct support. The cost of such a policy cannot be precisely known; it is unnecessarily discriminatory between similar economic units; it interferes with other economic policies and, most of all, the subsidy is variable from time to time according to freight rates, tax liabilities, demand for imported goods, prices of foreign equipment, and so on. Except for those bureaucrats who like to expand paper work, direct subsidization of exports seems to be preferable to the present methods adopted by the government of India.

OTHER MEASURES

Other measures mainly consist of methods to increase the supply of exportables and to create a
favorable environment for export traders. Banks are encouraged to finance export trade, exporters are exempted from the margin requirements of bank credit, traders are encouraged to offer credit to foreign customers, trade risk is covered by a special corporation established to promote exports, liberal foreign exchange is granted to traders for advertising and for maintaining contacts in foreign countries, and so on.

Export Risk Insurance Corporation follows a market development policy by which it issues policy on behalf of the government to cover 50 percent of the loss which may result if market surveys, stock holdings, advertisement and other promotional schemes do not produce sufficient revenue to defray the costs within an agreed period.

There are about fifteen export-promotion councils for promoting different export items, studying home production and export markets, suggesting and evaluating various devices to promote exports, creating trade contacts in new countries and negotiating new treaties with old customers. Various methods are used to increase the supply of exportables. Imports required for export industries are given an all-out preference. Imports of capital goods that will lead to export promotion are given a priority. Imports of some goods are encouraged for releasing a larger proportion of more expensive exportable substitutes for foreign markets. For example, palm oil is imported and groundnut oil is exported. Import of some goods is tied to export performance, so that home consumption of imported goods is discouraged, for example, cashew nuts and art-silk yarn. A heavy excise duty on sugar certainly helps to create some export surplus. Some educative effort is made by the government to raise the export potential. Recently, the Minister of International Trade has noted:

At present cotton seed is being fed wastefully to cattle instead of
extracting the oil and then using the cake for animal feed; also rice bran is being wasted. A certain amount of educative effort is needed to realize this export potential. . . . With the installation of cotton seed crushing plants, rice bran oil extraction plants and solvent extractive plants, the exports of oil-cakes are showing very substantial increase every year. This method of promoting exports seems to be unobjectionable. In the case of spices, some educative effort to reduce excessive consumption may release a larger surplus for export. In some parts of India, food is almost lost in spices and oils, which is hardly beneficial to health. An educative effort, therefore, may be doubly useful. A discriminatory tax on coffee may release a larger quantity of coffee for export. But such an effort does not seem to have been made; on the contrary, the Coffee Board is trying hard to popularize coffee in India.

PRICE FLEXIBILITY

In India, export subsidy under any guise seems to be unnecessary and undesirable for most export items. Export promotion effort, therefore, is likely to be right only in marginal cases. It is unnecessary because international prices of many of India's exportables are mainly determined by demand conditions. Supply of most of the exportables is price inelastic, at least in the short run, and their prices vary according to the conditions of international demand. Fluctuations in the prices of Indian exportables is indeed notorious, and the possibility that export volume will fall because of high domestic prices is very small.

Exports of hides and skins can serve as a good example of an inelastic supply that is disposed of in the international and domestic markets at the ruling prices and, therefore, without any fear of
being priced out by competitors, as far as the volume of exports is concerned. The supply of hides and skins does not depend on prices nor is it determined by cost conditions. In India, cattle are not raised, as a rule, either for meat or for hides. The raising of cattle is determined by completely different forces such as custom and the need for work animals in agriculture and for dairy products. Slaughtering of unwanted animals is done on a small scale, and about 98 per cent of the supply of hides comes from natural deaths. It is increased in times of famine and reduced in times of prosperity. In famines, prices are also improved because leathers are of better quality due to the lack of fat, wool, or hair. Goats and sheep are raised for meat, and as more than 90 per cent of value fetched depends on meat, the supply of skins does not depend on its own price, though it may vary with the prices of meat and other foodstuffs. A given supply of hides and skins, therefore, is divided between home and foreign markets by pure price mechanism.

The supply of exports as opposed to the total supply may be price elastic, and a tax on leather goods, reducing domestic consumption, may release a larger quantity of hides and skins for export. But the important point is that the exports are not inhibited by high domestic prices, and therefore, there is no need for any export promotion. Most of the exports go to the United Kingdom, but because of inelastic supply and rising home demand, India's share in that market is continuously declining. However, India is still the chief supplier to the British market. This position helps India to get better prices than those given to her competitors. "Imperial preference" also helped to bring 10 per cent higher prices than those given to non-Commonwealth suppliers.

Export promotion will help to earn more foreign exchange if foreign demand and domestic supply are price elastic. Even after assuming elastic supply, in the absence of price elasticity of demand, it is undesirable to accept a deterioration
in the terms of trade. The price reduction, however, may divert the demand from other exporting countries to India; in other words, total demand may be inelastic but demand for Indian exports may be elastic. In that case, export promotion is a price war. Price war is undesirable because it is difficult to win. India is not the only developing country in need of more foreign exchange, and to disregard the interests of other countries is not a very helpful policy in the long run. Price wars, moreover, will have to be severe, as a slight variation in prices is not likely to be effective in international trade. As often as not, trade is governed by traditions, political agreements, guaranteed steady supply, availability of credit, real or fancied differences in seemingly similar products, and many other factors besides prices, even after prices are adjusted for hidden charges or subsidies and transport costs.

EXPORT TAXES

Although India is overindulging somewhat in export promotion, it is not alleged here that indiscriminate export promotion is actually taking place. Export restrictions and export taxes, however reluctantly used, demonstrate the basic futility of export promotion. It is not true that export taxes are levied mainly for augmenting government revenue, as is sometimes asserted by government officials. These duties are varied from time to time and completely abolished whenever they are supposed to hamper exports. Essentially, they are designed to earn more foreign exchange by taking advantage of either temporary or long-term inelasticity of foreign demand for Indian exportables. Mainly because of the heavy export tax on jute during the Korean boom, India earned about two and one-half times the usual amount of foreign exchange in 1952. Moreover, jute goods can be stocked, and, therefore, excessive exports in one year can mean smaller than usual exports in the next year. A commodity whose exports have almost always been
taxed is tea. Tea is sold by auction in India, and, strangely enough, auctions are regularly held in London also. However, it is well known that foreign prices of tea are controlled by the monopolistic importers. If tea prices in the importing countries are reduced, probably, but not necessarily, demand for tea will increase. But if foreign prices are inflexible, there is no point in reducing export prices. India, therefore, taxed exports in a dubious effort to bite off some of the profits of foreign monopolistic importers. In actuality, at least a part of the tax must have fallen on the producers.

Whatever the supply elasticity may be, reduction in export price will not help to earn more foreign exchange unless the demand happens to be elastic, and, within limits, demand for many Indian exports seems to be inelastic. Even if the demand happens to be elastic, the foreign exchange earned will not be reduced by an export tax if the supply is inelastic. The tax will be absorbed by the producer. Only in the rare case where both the demand and the supply are elastic will the amount of foreign exchange earned by the export items decline. If these items are agricultural goods, resources will shift to nonexportables; roughly speaking, this shift will mean that the relative prices of foodstuffs will be higher without changing the absolute prices of food, and such a price incentive may lead to higher food production. In a starving country, this new allocation of resources should not be considered undesirable. An export tax on any agricultural commodity, therefore, is more likely to be right than not.

Even disregarding the export taxes, India followed such a policy by artificially maintaining a high exchange rate. And when, in June, 1966, the rupee was devalued, an equivalent tax was imposed on all traditional exports of India and the devaluation was not allowed to reduce the foreign price of most Indian exportables.
SUPPLY OF AGRICULTURAL PRODUCTS

It is never too soon to realize the fact that it is futile to promote exports of agricultural goods before achieving increased agricultural productivity. It is not helpful to increase the production of some exportables, like cotton or oilseeds, because such exports lead to stagnation or even reduction in the supply of agricultural goods required for the domestic market. Something of this sort seems to have already happened in India. As more and more land has gone into cash crops, food is in short supply, creating difficulties not only for development but also for political stability. India wants to grow long-staple cotton to replace imports, produce more short-staple cotton for export, and also to increase the exports of coarse cloth that requires short-staple cotton. Sugar exports of half a million tons at present are to be raised to 1 million tons a year in the near future. Exports of vegetable oils and oilcakes are to be increased. Jute imports from Pakistan are to be stopped. Fruits and vegetables are to be exported on a larger scale. It is difficult to see how all this can be simultaneously done by a more or less stagnant agricultural sector.

If income elasticity of demand for food is 0.81 and if 62 per cent of total expenditure is on food, half of the increased per head income will be spent on food; therefore, food production has to rise faster than per capita income if population is also rising. If per capita income is rising by 4 per cent per annum, food production must rise by 3.2 per cent per annum, even without population growth. If the rate of population growth is 2 per cent, then, with 4 per cent growth of per head income, food production must rise by 5.2 per cent per year. In the past twenty years, India's food production has increased by less than 3 per cent per annum, and it is not likely to grow more quickly in the next twenty years. India, therefore, will have to accept declining agricultural exports and must be willing to put more land into food crops,
because with rising food prices the comparative advantage of growing exportables is bound to vanish. Furthermore, for the often stated and understandable goal of food self-sufficiency, there seems to be no alternative.

EXPORT OF METALS AND ENGINEERING GOODS

In 1954, Professor W. Arthur Lewis predicted that India, by 1980, would import about Rs. 215 crores worth of food per annum and pay for it by exports of manufactured goods. The first part of the prediction has come true one decade too soon and the latter part still seems to be too optimistic. If we exclude jute and cotton textiles, India now exports about Rs. 30 crores worth of manufactured goods, that is, 4 per cent of total exports. These exports could possibly be increased substantially in the next ten years, though not by 700 per cent as predicted by Professor Lewis. The precondition of such exports is huge industrial investment. For example, India can become an important exporter of aluminum and steel. The aluminum industry requires a large amount of electricity and its capital requirements are high; therefore, not all developing countries can produce aluminum even if they possess bauxite deposits. Canada is responsible for 50 per cent of the world aluminum exports, but her bauxite deposits are not significant. With hydroelectric power, high-grade bauxite, and cheap labor, India has a definite potentiality to become an aluminum exporter. The government has started building four aluminum plants in the public sector and the production may be just enough to stop imports. Demand for aluminum is rapidly increasing and, for many purposes, it is replacing zinc, lead, tin, iron, and copper. India's export capacity in this field depends on her investment capacity.

The same thing is also true for iron and steel. India has already started to export steel, but this export seems to be arising out of a temporary surplus; to become a steady and significant exporter,
a huge investment in this industry is required. In the last ten years some fine planning has been done, and production has increased from 1.5 million tons in 1955 to over 6 million tons in 1965. Now the planned target is 18 million tons in 1971. This rate of growth is very impressive, perhaps a unique achievement, unparalleled by any country at any time. After noting this fact, however, one has also to point out that still better performance would have been possible with more careful planning and less red tape. The government took four years to decide whether to accept the Russian offer to build the Bhilai steel plant; and the government's industrial policy has kept private investment out of the iron and steel industry.

Presently, the government is thinking of allowing private investment in small steel plants. If this policy is implemented, steel production will possibly rise still further than what is planned by the government. Steel production is profitable, and if investors are given a free choice at least some investment will be diverted from uneconomic import-substitute industries to the lucrative export industries such as iron and steel. It takes a long time to build steel mills, and a large amount of steel is required to build iron and steel mills themselves. Indian steel is the cheapest in the world, and if India can make an effort, both private and public, to make enough investment in this field, she will be able to earn much more foreign exchange than she does by exporting iron ores.

The iron and steel industry is the basis for all sorts of engineering industries, and to make a shift from exporting iron and steel to steel-using manufactures should not be too difficult. Even today, India exports some fabricated iron and steel. In the last few years, India has been expanding her exports of bicycles, sewing machines, electric fans, hurricane lanterns, electric lamps, oil engines, sugar-cane-crushing machinery, and some other products of light industry. These exports and their annual percentage increase are well advertised.
The high percentage increase, however, is due to a very small base. The fact is the gains are not quantitatively significant, and they do not account for more than 2 per cent of the total foreign-exchange earnings. But these exports are significant in that they indicate a comparative advantage of India in engineering products. A broad home market for these simple and cheap engineering products seems to be the reason for the comparative advantage in these industries and not, as is generally believed, the simplicity of construction—which seems to be incidental. There is nothing complicated in manufacturing comparatively expensive mechanical toys or in producing canned baby foods, but India still imports them, presumably because the home market is not large enough to sustain these industries. As a matter of fact, the actual and potential supply of skilled and semiskilled people is abundant in India. An American electrician with equivalent skill and efficiency earns about twenty times more than an electrician in India. Therefore, it is very possible that India has a comparative advantage in those products that involve ample skilled labor. The problem is to create a domestic market to sustain these industries without relying on exports, if that becomes necessary.

If S. B. Linder is right, home market is essential to gain a comparative advantage.

Among all non-primary products, a country has a range of potential exports. This range of exportable products is determined by internal demand. It is a necessary, but not sufficient condition, that a product be consumed (or invested) in the home country for this product to be a potential export product.

To attain this goal, the government of India could have concentrated demand for varied modern industrial goods on only a few items. In India, only a
small proportion of the total population constitutes a well-to-do class; these people, understandably, indulge in expensive consumption to demonstrate wealth and modern living. The refrigerator is often kept in the living room so that every passer-by can have a look. More importantly, most of the time it is used only as a cupboard, for electricity is comparatively expensive. There are no frozen foods and everybody has enough time to shop every day, or even many times a day, in the numerous shops. The main use of a refrigerator, therefore, is demonstration. But some prefer air conditioners protruding out of the windows, used rarely for cooling and frequently for airs. It really does not matter whether one gets a refrigerator or an air conditioner, a television or a telephone, a car or a yacht, as long as one gets something. With a little effort, therefore, Indian planners could have built a few large industries instead of many tiny ones; and such a policy would have helped to build exports.

**EXPORTS THROUGH DEVELOPMENT**

Broadly speaking, therefore, India's export prospects depend mainly on investment priorities; investment in agriculture and in metals and engineering goods would help to create an export supply. As agricultural development is a precondition of sustained economic growth, there is no basic conflict in India between economic development and export promotion, if the goals are kept in that order. Fortunately, this is also true in India's industrial sector. The industries with export potentialities—such as steel, aluminum, light engineering products—are also industries required for internal development.

If export markets can be guaranteed, there can be no conflict between export promotion and sustained growth for any country in the world. But, in practice, exports can never be assumed over a long period, and investment in exclusively export
industries can be risky. Brazil's main export earnings are derived from coffee, Ceylon's from tea, Ghana's from cocoa, Zanzibar's from spices, Mozambique's from sugar, Egypt's from cotton, and so on. These countries cannot invest in their export sector as confidently as India will be able to do because, exports or no exports, steel, aluminum, and light engineering industries are required for her basic economic development, and a virtual revolution has to take place in Indian agriculture so that her growing population is fed by normal nutritional standards. Such industrial and agricultural development will lead to an increase in export capacity; the increased exports, in turn, will accelerate internal development.

For a country like India, then, commercial policy is likely to be an exceedingly useful tool of national development, because the coordination of investment priorities at home, on the one hand, and the opportunities offered by the world markets, on the other, promise to yield beneficial results for India. India seems to be fortunate in not being forced to follow either the Russian model of autarky or the Japanese model of desperate salesmanship.

EXPORTS OF PROCESSED GOODS

One facet of India's export-promotion effort has been the encouragement of exports of processed goods in place of raw materials. Exports of raw materials and imports of finished goods have been considered unhealthy by many Indian economists. An effort is made, therefore, to change the composition of export trade by pushing raw materials further in the production process. The government of India encourages exports of leather and tanned skins in the place of raw hides and skins, ferromanganese in the place of manganese ore, cotton textiles in the place of raw cotton, groundnut oil in the place of groundnuts, and so forth.

Addressing the Export Advisory Council the Minister, Mr. Morarji Desai, suggested to the representatives of trade the desirability of changing
the pattern of India's export trade by laying greater emphasis on the export of finished quality goods in preference of raw materials.\textsuperscript{10}

At least since 1950, special attention is paid to the imports of capital goods required to make such a transition. "Since the policy of the government is to encourage exports of vegetable oils instead of oilseeds, imports of oil-crushing and refining machinery have been given due priority."\textsuperscript{11}

At first glance, this policy seems to be desirable, and India has indulged in it with some success. But the quota restrictions on exports are not enough to make such a transition; what is required is investment in the industries that are likely to succeed. India's comparative advantage in leather goods was brought to the government's notice\textsuperscript{12} as far back as 1946. But it was in the early 1950's that India was persuaded to act by the Eastern European countries. Since then, India has been exporting handmade shoes to Eastern Europe, but no special effort seems to have been made to channel investment to modernize this industry or to explore the possibility of manufacturing other leather goods.

However, such an apparently desirable policy can possibly do more harm than good. Firstly, it diverts limited possible investment and employment into comparatively less-important industries. Secondly, such a policy is not likely to be successful unless the country has either a complete monopoly of the raw material concerned or there is international cooperation. In some cases at least, India earned less foreign exchange than she would have earned by exporting unprocessed raw materials. The labor and investment in these industries have most probably been a dead loss, and "value added" in terms of foreign exchange was almost certainly negative. For example, India almost always earned less foreign exchange by exporting groundnut oil and oilcakes than by exporting raw groundnuts. It may well be that the same thing happened occasionally in the case of raw cotton.
From 1950 to 1955, the difference between the external and internal price of cotton was so high that it might have been more profitable for India to have exported raw cotton than to have insisted on exporting coarse cloth.

This is a rather curious phenomenon, and there is a different explanation for different commodities. Short-staple cotton is useful for upholstery stuffing, for sanitary and surgical use, for ropes and twines, and for other industrial uses such as insulation or paper making. It is also more suitable than long-staple cotton for mixing with other fibers. India, however, insisted on spinning it and turning it into coarse cloth.

**TABLE 4**

Exports of Groundnuts, Oil and Oilcakes

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual Export Price of Nuts</th>
<th>Actual Export Price of Oil</th>
<th>Actual Export Price of Oilcakes</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>1,175</td>
<td>2,337</td>
<td>215</td>
<td>-112</td>
</tr>
<tr>
<td>1953</td>
<td>1,077</td>
<td>1,787</td>
<td>385</td>
<td>-131</td>
</tr>
<tr>
<td>1954</td>
<td>1,260</td>
<td>1,925</td>
<td>133</td>
<td>-410</td>
</tr>
<tr>
<td>1955</td>
<td>1,105</td>
<td>1,416</td>
<td>376</td>
<td>-313</td>
</tr>
<tr>
<td>1956</td>
<td>981</td>
<td>1,430</td>
<td>326</td>
<td>-213</td>
</tr>
</tbody>
</table>

Notes: The prices are in rupees per ton, obtained by dividing the total value by the total volume. The data for the rest of the years were not available. The "difference" shows the loss of money per ton of groundnuts that were exported in the form of oil and oilcakes. Following the Food and Agriculture Organization, it is assumed that 10 tons of groundnuts yield 4 tons of oil and 6 tons of oilcakes. The yield of oil under Indian conditions of crushing is possibly lower than 40 per cent and the loss, therefore, could be higher than what is estimated here.

Source: *Accounts Relating to Foreign Trade of India* (New Delhi: Government of India), monthly publication.
### TABLE 5

Annual Prices of Groundnuts, Oil and Oilcakes Quoted in the London Market

<table>
<thead>
<tr>
<th>Year</th>
<th>Pounds per Ton of Nuts</th>
<th>Pounds per Ton of Oil</th>
<th>Pounds per Ton of Cakes</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
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<td>120.9</td>
<td>42.7</td>
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<tr>
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<td>104.2</td>
<td>40.2</td>
<td>12.3</td>
</tr>
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<td>39.8</td>
<td>-2.4</td>
</tr>
<tr>
<td>1957</td>
<td>73.6</td>
<td>132.4</td>
<td>35.6</td>
<td>7.0</td>
</tr>
<tr>
<td>1958</td>
<td>59.8</td>
<td>100.0</td>
<td>31.5</td>
<td>-1.3</td>
</tr>
<tr>
<td>1959</td>
<td>73.4</td>
<td>112.4</td>
<td>36.6</td>
<td>-6.6</td>
</tr>
<tr>
<td>1960</td>
<td>71.6</td>
<td>118.6</td>
<td>35.7</td>
<td>-27.0</td>
</tr>
<tr>
<td>1961</td>
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<td>99.6</td>
<td>37.0</td>
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</tr>
<tr>
<td>1963</td>
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<td>38.6</td>
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<td>1964</td>
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<td>115.3</td>
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<td>1966</td>
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<td>40.1</td>
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**Note:** For the meaning of "difference," see the note to Table 4, p. 52. The first three years in this table overlap with the last three years in Table 4. The discrepancy in data is inexplicable and cannot be solely due to incorrect reporting.

**Source:** Monthly Bulletin of Agricultural Economics and Statistics (Rome: Food and Agriculture Organization).
<table>
<thead>
<tr>
<th>Quarter</th>
<th>Pounds per Ton of Nuts</th>
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<th>Pounds per Ton of Oilcakes</th>
<th>Difference</th>
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<td>Pounds per Ton of Oilcakes</td>
<td>Difference</td>
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<td>68.6</td>
<td>108.9</td>
<td>41.6</td>
<td>-0.1</td>
</tr>
</tbody>
</table>

Note: Out of 44 observations the "difference" is negative in 28 cases.

In the case of groundnuts, the explanation lies mainly in the commercial policies of the importing countries. The European Common Market, for example, levies 15 per cent ad valorem duty on vegetable oils and none on oilseeds. Prices offered for oils, therefore, are relatively lower than those for oilseeds. The increasing use of oilcakes as animal feed also makes it more profitable to import oilseeds than to import oils and oilcakes separately. The existing capacity of oil-crushing industries, a technological change that integrates crushing and processing, and the use of groundnuts for different purposes such as soap, shortening, or margarine—all these and other reasons have increased the preference of industries for oilseeds rather than for imported vegetable oils. Whatever the reasons may be, one thing is certain: India has not gained anything by insisting on exporting oils rather than oilseeds. If trade had been free, traders would not have made such a mistake. But because trade was controlled and international prices were high enough for profits to be earned by exporting either oils or oilseeds, the traders used whatever quotas were released by the government. Had the traders the choice to export either oil or oilseeds, they would certainly have earned more profits for themselves and more foreign exchange for the country. Sometimes, external prices of groundnut oil were not attractive and the export quotas were not used by the traders. In such situations, the government did not accept defeat. Exports of groundnut oil were encouraged by indirect subsidy in the form of an export license for oilcakes for which there was a seller's market. Export promotion, indeed, can be carried too far.
CHAPTER 4 QUANTITATIVE RESTRICTIONS ON INDIA'S EXPORTS

In spite of all the talk of export promotion, India has never followed an unqualified export-promotion policy. Besides taxing exports and overvaluing the rupee, India also regulates exports of some items by quota restrictions. These restrictions seem to be desirable, but they are badly managed.

PURPOSES AND METHODS OF EXPORT RESTRICTIONS

The effective restrictions on exports are those on vegetable oils, oilseeds, oilcakes, chilies, onions, raw wool, raw cotton, timber and wood and household utensils. From the point of view of foreign-exchange earnings, groundnut oil and raw cotton are the important items on this list. It is obvious from various official statements that India has not been able to take advantage of the rising international demand for these goods, and the refusal to export has been mainly meant to guard the interests of the consumers at home.

Owing to the late crop and consequent delays of arrivals in markets and other aggravating circumstances there has occurred a physical shortage of groundnut with the result that the quantity available for
internal consumption and for crushing as well as for export has become small. The Government of India, therefore, is obliged to suspend for the time being all exports of groundnuts.¹

Due to very large exports having taken place of raw wool it has been represented to the government that wool is no longer available for wool-using industries in the country at reasonable prices. It has now been decided not to allow further exports of raw wool with immediate effect.²

The decline (in exports of raw cotton, raw wool, oilseeds and cotton piece-goods) was not due to any lack of demand but because in the interest of our internal economy we found it necessary to place greater restrictions on their exports.³

The quota restrictions are based on the calculation of surplus in the domestic market. The government seems to be calculating this surplus in a simple way. When internal prices of a commodity fall, there is assumed to be an exportable surplus of the commodity concerned, and the surplus is assumed to be dwindling with rising internal prices. Export quotas, therefore, are varied inversely with the internal prices. In 1953, it was announced that the government of India was

concerned about the prevailing high prices of chillies and onions and . . . keeping a continuous watch on the price trend. The new crop is likely to arrive in the market shortly. If the price of these essential commodities does not visibly come down,
even after the arrival of the new crop in the market, the Government of India will be constrained to refuse to allow the export of onions and chillies during the first half of 1954.4

A similar policy was followed for groundnut oil.

The ban on the export of groundnut oil has been continued, particularly on account of the phenomenal rise in its market quotations last year and it is not the intention of the government to release any quota of groundnut oil for export until the market prices rule at a reasonably low level. This restrictive policy continues to be adopted with a view to safeguarding the interests of the consumers.5

In the case of oilcakes,

In all 235,000 tons (of oilcakes) were released during 1955. There is scope for further liberalization of oilcakes, subject to existence of exportable surpluses and the ruling internal prices of these and allied commodities in the country.6

If it is found that the surplus is miscalculated, the quotas are revised or even abruptly canceled.

What worries me is the price of edible oils and in the interest of consumers at home we cannot afford to let prices go on rising. I have therefore decided that the quota of groundnut oil which had been earmarked for release to new-comers this year will not be released. The export of groundnut oil for Jan.-June 1953 which has already been
made valid for shipment till the end of September may well prove to be the total export quota for the whole of this current year, if it is not possible to stop it altogether.\textsuperscript{7} [Emphasis supplied.]

In 1957, the Minister of Commerce and Industry said in Rajya Sabha (Upper House) that the government has been closely watching the trend of prices of Indian cotton during the current year. Due to deterioration in the supply position of Indian cotton, it has been considered expedient to restrict exports. Accordingly, on March 30, 1957, exporters were directed not to enter any fresh commitments for the sale of unsold balances available against their export licenses.\textsuperscript{8}

On the other hand, exports are liberalized as soon as prices decline.

The trends in internal prices were constantly kept under review. . . . As soon as the prices particularly of major oils, showed signs of easing, the first step that was taken was to re-establish the exports of these oils and to re-adjust the export duties thereon. . . . In the month of July, 1954, prices began to decline on the expectation of a good crop during 1954-55. The Government, therefore, immediately released export quotas.\textsuperscript{9} [Emphasis supplied.]

In other words, export policy has been used to stabilize prices. When prices are considered so low that the producers are hurt, export quotas are released to boost the domestic prices. Besides the interest of the producers, the exports are
considered essential, whenever possible, to earn badly needed foreign exchange. As a matter of fact, the government would have gladly done away with the export restrictions in order to earn more foreign exchange. Addressing the Export Advisory Council, the Minister of Commerce and Industry said:

Oils and oilcakes constitute in my judgment a very hopeful source for increasing our foreign exchange earnings. . . . But we have been unable to spare as big a proportion of our production as the world is in a position to absorb. It should, however, be not too difficult for us to step up the production of oil-seeds in the long run and to tighten the belt in the short run. I am treading on rather dangerous grounds in making this observation, but I rely on you to tell us how we can achieve our objective without unduly affecting the interest of consumers at home.10

It is interesting to note, therefore that the administration of export restriction itself has led to some avoidable loss of foreign exchange, besides being unable either to stabilize prices or to guard the interest of consumers.

PREFERENCE FOR LOWER PRICES

In the administration of this restrictive policy, India has lost a chance to earn more foreign exchange than it could have for the same amount of exports within a given year and over the last twenty years. This loss was due to the government policy of reducing exports when export demand was high and international prices were rising and of increasing them in the opposite situation. This perverse behavior was certainly not intended. Export quotas are not changed inversely with the
external prices; they are changed in the opposite direction of internal prices. But, as the internal and external prices almost always moved together and in the same direction, the export restrictions led to the peculiar phenomenon of offering more exports when international prices were low and less when they were high. A detailed examination of the exports of groundnuts and of raw cotton over the period of 1948-66 bears out this point.

In the case of raw cotton, an inspection of data is enough to make it clear that exports changed in the opposite direction of both external and internal prices. However, by assuming linear dependence of one variable on another, \( Y = a + bx \), simple correlations between different variables were statistically checked.

Table 7 shows that the annual exports of raw cotton do not seem to be related to domestic production of that commodity; the simple correlation coefficient \( R \) is found to be 0.08. To take an example, in 1954 exports fell by 40 per cent below 1953, while production rose by about 24 per cent. In three years, from 1957 to 1959, production was more or less constant but exports varied from 73,000 tons to 42,000 tons. The correlation between these two variables is obviously insignificant.

An inverse change in exports with internal and external prices is also obvious. In 1951, external prices were the highest, but exports were the lowest, and the highest exports were in 1955 when external prices were about half of the 1951 level and internal prices were the lowest in fifteen years (1949-63). One can inspect the figures from year to year and see that exports moved up or down in the opposite direction to prices, both internal and external, with the exception of only two or three years.

The simple correlation between exports and external prices is only slightly lower \( R = -0.45 \)
### TABLE 7

**Annual Exports of Raw Cotton**

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports in Thousand Tons</th>
<th>Production in Thousand Tons</th>
<th>Export Price, Rs./Ton</th>
<th>Domestic Price, Rs./Bale</th>
</tr>
</thead>
<tbody>
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<td>96</td>
<td>390</td>
<td>1,744</td>
<td>560</td>
</tr>
<tr>
<td>1949</td>
<td>51</td>
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<td>32</td>
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</tr>
<tr>
<td>1951</td>
<td>28</td>
<td>517</td>
<td>5,249</td>
<td>712</td>
</tr>
<tr>
<td>1952</td>
<td>53</td>
<td>557</td>
<td>2,937</td>
<td>716</td>
</tr>
<tr>
<td>1953</td>
<td>46</td>
<td>568</td>
<td>2,534</td>
<td>710</td>
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<td>28</td>
<td>701</td>
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<td>734</td>
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<td>1955</td>
<td>95</td>
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<td>636</td>
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<td>71</td>
<td>711</td>
<td>2,465</td>
<td>787</td>
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</tr>
<tr>
<td>1958</td>
<td>73</td>
<td>843</td>
<td>2,082</td>
<td>732</td>
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<tr>
<td>1959</td>
<td>59</td>
<td>833</td>
<td>1,900</td>
<td>767</td>
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<tr>
<td>1960</td>
<td>34</td>
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<td>2,400</td>
<td>841</td>
</tr>
<tr>
<td>1961</td>
<td>53</td>
<td>958</td>
<td>2,140</td>
<td>840</td>
</tr>
<tr>
<td>1962</td>
<td>50</td>
<td>802</td>
<td>2,200</td>
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</tr>
<tr>
<td>1963</td>
<td>66</td>
<td>944</td>
<td>2,300</td>
<td>919</td>
</tr>
<tr>
<td>1964</td>
<td>51</td>
<td>550</td>
<td>3,181</td>
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</tr>
<tr>
<td>1965</td>
<td>41</td>
<td>973</td>
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<td>953</td>
</tr>
<tr>
<td>1966</td>
<td>24</td>
<td>847</td>
<td>3,200</td>
<td>972</td>
</tr>
</tbody>
</table>

**Sources:** *Accounts Relating to Foreign Trade of India* (New Delhi: Government of India), monthly publication; *Economic Bulletin for Asia and the Far East* (New York: United Nations); *Statistical Abstract* (New Delhi: Government of India), monthly publication.
than with the internal prices ($R = -0.56$). The latter is a policy decision and the former is the unintended effect of that policy.

More interestingly, the percentage of total production annually exported gives a negative correlation with domestic production ($R = -0.58$), and the inverse correlation with internal prices is improved ($R = -0.77$).

In the case of groundnuts (including oil), exports are correlated with external and internal prices negatively, but the coefficients of correlation are lower than for raw cotton. The $R = -0.35$ for external prices and the $R = -0.44$ for internal prices. However, what is important to note is that the correlation is negative; and there is very little correlation between exports and production ($R = -0.12$). The data concerning groundnuts are given in Table 8.

It should be noted in passing that the low values of correlation coefficients should not be considered encouraging. In other words, the low correlation coefficient does not mean that India's export policy is likely to be correct. India is not an important seller of these commodities in the world market, and international prices can hardly be influenced by Indian exports. One should expect, therefore, that a proper economic behavior for a seller in a large market is to sell more when prices are high and less when prices are low. Thus, there should be a positive and strong correlation between exports and international prices. If there were no export restrictions, such a direct correlation would indeed be inevitable. Instead, the correlation is negative, whatever the value of the coefficient. Only excessive skepticism can make one refrain from concluding a perverse behavior on the part of the exporting country. In other words, the hypothesis that India manages her exports in a normal way and tries to sell more when better prices are offered for her produce has been conclusively disproved.
<table>
<thead>
<tr>
<th>Year</th>
<th>Exports in Thousand Tons</th>
<th>Production in Thousand Tons</th>
<th>Home Price, R./Maund.</th>
<th>London Price, Pounds/Ton</th>
</tr>
</thead>
<tbody>
<tr>
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<td>167</td>
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<td>179</td>
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<td>3,481</td>
<td>245</td>
<td>76.8</td>
</tr>
<tr>
<td>1952</td>
<td>67</td>
<td>3,192</td>
<td>173</td>
<td>59.0</td>
</tr>
<tr>
<td>1953</td>
<td>20</td>
<td>2,929</td>
<td>223</td>
<td>58.4</td>
</tr>
<tr>
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<td>154</td>
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<td>1955</td>
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<td>4,245</td>
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<td>53.5</td>
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<td>1956</td>
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<td>3,862</td>
<td>178</td>
<td>79.6</td>
</tr>
<tr>
<td>1957</td>
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<td>182</td>
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<tr>
<td>1959</td>
<td>56</td>
<td>5,178</td>
<td>205</td>
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<td>1960</td>
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<td>235</td>
<td>71.6</td>
</tr>
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<td>1961</td>
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<td>1962</td>
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</tr>
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<td>1963</td>
<td>101</td>
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<td>230</td>
<td>62.6</td>
</tr>
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<td>1966</td>
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<td>540</td>
<td>66.6</td>
</tr>
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</table>

In the case of raw cotton it can be noted easily by a visual inspection of data that exports vary inversely with external prices even within a given year. In other words, India not only chooses to export more in the year of low prices than in the year of high prices, but also seems to prefer that half of a year when prices are lower. The same preference is shown again between the two quarters of a given six-month period. India makes most of her exports (about two thirds) of raw cotton in a bad quarter of a bad half of a bad year. In other words, she chooses to sell her goods at the lowest possible price. However, the correlation between external prices and exports is not improved by using quarterly data, \((R = -0.41)\); but it should be noted that the level of significance for quarterly data is 99 per cent whereas that of annual data is 90 per cent. Exports are so closely controlled by the government that the impact of the export policy is more certain within a year than between years. That is why the quarterly data show a better correlation between exports and internal prices. The \(R\) in this case is -0.58 at a 99 per cent level of significance.

**SPECULATIVE ACTIVITY**

The perverse behavior described above is, of course, unintended; the government would certainly like to export more in boom periods than in recessions. They are concerned only with internal prices, and there is no obvious reason why internal and external prices should move in the same direction when exports and imports are strictly controlled. Nevertheless, internal and external prices do move, up and down, together. Again, the correlation between external and internal prices is not very high (-0.56) for raw cotton, but it is positive and reliable at a 99 per cent level of significance. The home market is insulated from the international market to a certain extent, but this insulation is far from complete and both sets of prices almost always have moved up and down together.
<table>
<thead>
<tr>
<th>Quarter</th>
<th>Exports in Thousand Tons</th>
<th>Actual Export Price, Rs./Ton</th>
<th>Home Price Index</th>
<th>Bank Advances Against Cotton, Million Rs.</th>
</tr>
</thead>
<tbody>
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<th>Home Price Index</th>
<th>Bank Advances Against Cotton, Million Rs.</th>
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<td>Actual Export Price, Rs./Ton</td>
<td>Home Price Index</td>
<td>Bank Advances Against Cotton, Million Rs.</td>
</tr>
<tr>
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<td>--------------------------</td>
<td>-----------------------------</td>
<td>------------------</td>
<td>------------------------------------------</td>
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<td>636</td>
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<tr>
<td>IV</td>
<td>10</td>
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<td>478</td>
<td>604</td>
</tr>
<tr>
<td>1962 I</td>
<td>19</td>
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<td>496</td>
<td>833</td>
</tr>
<tr>
<td>II</td>
<td>13</td>
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<td>501</td>
<td>763</td>
</tr>
<tr>
<td>III</td>
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<td>551</td>
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<tr>
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<td>IV</td>
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<td>1965 I</td>
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<td>IV</td>
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<td>1,049</td>
</tr>
<tr>
<td>1966 I</td>
<td>8</td>
<td>2,800</td>
<td>570</td>
<td>1,366</td>
</tr>
<tr>
<td>II</td>
<td>7</td>
<td>2,782</td>
<td>570</td>
<td>NA</td>
</tr>
</tbody>
</table>

This price variation is probably due to speculative activity generated by uncertainty about the export quotas. When external prices are rising, the traders try to acquire larger stocks in hope of acquiring an export license. The activity of building stocks itself leads to a rise in internal prices. When internal prices rise, the government reduces export quotas. On the other hand, when external prices are falling, the traders have no incentive to scramble for larger stocks; and when they try to liquidate their stocks, internal prices also start declining. The government then concludes that a larger surplus is available for export and export quotas are duly liberalized. In this way, the traders and the government seem to be unwittingly conspiring to export more when the prices offered are low and less when they are high.

Hoarding and unloading seem to be taking place because of the uncertainty regarding the size and timing of quotas. Once the ball is set rolling by the exporters, others can join the game. For whatever reason, if prices are rising, producers and traders can only hope to gain by withholding stocks from the market; and when prices are falling, it becomes necessary to dispose of the stocks as soon as possible. This subsidiary speculative activity seems to be further aggravating the price fluctuations in the markets subjected to quota restrictions.

In a sense, the export policy is fairly definite and exports and internal prices are varied in the opposite direction. But at what level prices are considered too high or too low is not known to anybody, possibly not even the government. The size of the surplus that can be safely exported is almost always unknown, and the government calculates and recalculates the surplus from month to month, sometimes on the basis of past experience, sometimes in anticipation of favorable events and most of the time depending on the pressure of articulate consumers or traders. Quotas are fixed on a quarterly basis, and many times
even on a monthly basis, and licenses are kept valid only for a few months. Licenses can be abruptly canceled or new quotas suddenly granted. It would be amazing, therefore, if the working of the export policy did not give rise to speculative activity.

The government, of course, is aware of the speculators; indeed, they are usually singled out for blame, both by the public and the government, for all the economic ills of India. In 1953, for example, government officials made a curious complaint against the traders for exporting too much, without bothering to establish whether enough supply was left for the domestic market. At this, the traders rightly retorted that

It should ultimately be the responsibility of the government to assess the surplus that could be exported. It was stressed that the surplus should be assessed at the right time and the quotas should be announced at least for half a year and not for a quarter. It was urged that during the half year there should be no change of policy.11

The government in turn constantly exhorts the traders not to seek speculative profits. The Food Minister declared in June, 1954, that

The prices of groundnut oil were rising mainly because of the increase in internal consumption and partly because of speculation.

I do hope that the indication of the government policy in regard to exports of groundnut oil will give a quietus to the speculative activity in this field in the hope of announcement of a quota for export, notwithstanding the categorical statements of my colleague, the
minister of commerce and industry on this subject.¹²

But the traders knew better. Barely three months had passed after the categorical statements were made, before the government came to the rescue of the traders.

Concerned interests have been exercised by the possibility of a further fall in prices due to producers and traders holding large stocks of groundnuts and in some cases groundnut oil; while government favors stabilization of prices at present levels they do not desire that the prices should go down further. With this object in view, it has been decided to allow a small quantity of groundnut oil for export by established shippers.¹³

Besides exhortations, the government uses selective credit controls, regulates forward markets and uses direct controls to combat speculative activity. Since 1962,

exporters are required to furnish a 10 percent bank guarantee on the f.o.b. value of contracts, to prevent registration of bogus contracts and cornering of quotas, the guarantee amount is released on the fulfillment of the shipment.¹⁴

But the uncertainty about export quotas and the possibility of making large profits, in case an export license is granted, seem to outweigh all the measures discouraging speculative activity.

Speculation seems to be the link between the internal and external prices of goods whose exports are controlled by quota restrictions. However, there is little quantitative evidence to prove this point. No data are available about stocks
held by the up-country traders and well-to-do farmers. Some data are available concerning stocks held by mills, but these stocks include imported cotton also. However, there are some data concerning bank advances to traders, on the security of raw cotton.

Once the cotton crop is harvested, the stocks have to be held by either the farmers, the traders, the ginning mills or the cotton textile mills. As cotton is imported directly by the users or by the government, imports of cotton do not directly change the stocks of the traders, but the exports of cotton will obviously affect their stocks. Assuming that the traders are just intermediaries, buying from farmers and selling to mills, their total stocks will vary directly with the total production of raw cotton and inversely with the exports of raw cotton. The commercial banks advance credit to traders on the basis of these stocks. Obviously, not all the stocks are so pledged to the banks, but it is assumed here that there is a one-to-one relationship between the stocks known to be held by the traders and the bank advances against raw cotton.

These bank advances should naturally vary directly with the total production and with the domestic prices of raw cotton, that is, with the total value of the stocks. This expected relationship is confirmed by the correlation analysis ($R = 0.78$). As the export prices and domestic prices vary directly ($R = 0.57$), one would expect bank advances also to vary directly with export prices, but such a relationship is not visible in the analysis of the available data. Bank advances against raw cotton seem to be varying inversely with the export prices, although this negative correlation is not very strong. This inverse correlation would be understandable if exports had varied directly with the export price—the increased exports would reduce domestic stocks and consequently the bank advances would be reduced. As a matter of fact, however, exports vary inversely with the export price. In this
case, the stocks of raw cotton in the country would be relatively higher when the export prices were rising than when they were falling. Bank advances against raw cotton, therefore, should vary directly with the export price of raw cotton.

As a matter of fact, the correlation analysis shows that bank advances vary inversely with the export prices and not directly, as should be expected on the basis of cotton exports. This inverse relationship suggests the existence of speculative activity. In India, the speculators try to cover up their operations, and they do not always accumulate stocks under the auspices of the commercial banks and under the gaze of the government and the Reserve Bank. Therefore, when export prices are increasing, the openly held stocks decline and the covertly held stocks increase. In this situation, bank advances against stocks will go up or down in the opposite direction of the export price. Although this evidence does not constitute a sufficient proof of the prevalence of speculative activity, it certainly indicates such a possibility. The influence of selective credit controls, the stocking activity of noncredit-seeking operators, the reaction of farmers to export prices, the effects of export quota announcements, the time lags involved in the economic transactions, and so on, are not considered in this analysis, mainly because of the lack of data. Such other variables may make speculative activity more audible.

LOSS OF FOREIGN EXCHANGE

The perverse export policy arising out of quota restrictions implies a sizable loss of foreign exchange. More skillful administration of quota restrictions would have earned more foreign exchange for India, without increasing the total amount of exports over a given time period. Price stabilization through export restrictions, therefore, has been an expensive policy instrument.
But this is not all. There is also a more direct waste of foreign exchange involved because of the import policy which works to support export restrictions. When internal prices go up, the government not only bans exports but also liberalizes imports of relevant goods. Larger imports, therefore, are made when international prices are high rather than when they are low. The Minister of Commerce and Industry said in 1953 that he had stopped the exports of groundnut oil, and

Meanwhile to relieve the situation I propose to take steps to discourage the use of groundnut oil for industrial purposes in the country. For this purpose, we have already reduced the import duty on palm oil which, I hope, will to some extent replace the use of groundnut oil in soap making industry and we will be prepared to make larger quantities of imported coconut oil and Copra Kernal available to factories which wish to utilize coconut oil in place of groundnut oil.15

India exports short-staple cotton and imports long-staple cotton; these are, of course, not exclusive varieties. Most of the domestic production of raw cotton is used for producing coarse cloth, part of which is exported to the United Kingdom. Cotton textile is the largest industry in India and accounts for almost one third of industrial production. Besides 400 mills, the handloom industry employs over 10 million workers. The government, therefore, watches the prices of cotton more closely than the prices of any other raw material. That is why the impact of the export policy on raw cotton is clearer than on groundnut oil. Moreover, import policy for raw cotton is more consistently used to supplement export policy than in the case of any other commodity. Generally speaking, larger imports of raw cotton are made when international prices are high than when they are low. The highest imports were made in 1951-52 (Rs. 139 crores)
when the prices were the highest, and lowest im-
ports were made in 1958-59 (Rs. 28 crores) when
prices were the lowest in the 1950's. However,
the statistical correlation between these two vari-
ables is not very high, but it is positive, that is,
the demand for imported cotton varies directly with
the import price.

It is not maintained here that foreign ex-
change should not be spent for price stabilization.
It may be necessary to reduce exports and increase
imports for price stabilization, if this is con-
sidered to be of overriding concern. But one must
be aware of the costs involved. One must also be
in constant search for alternative instruments to
reduce the waste of foreign exchange implicit in
the present commercial policy pursued by the
government of India.

INTERESTS OF CONSUMERS

The main declared purpose of quantitative
restrictions on exports is the protection of the
interests of consumers. And this purpose is
achieved by exporting only the surplus in the do-
mestic market. How to determine this surplus is
the really tricky problem. Surplus, indeed, has no
meaning unless it is tied to some recognizable
parameter in the economy. In the interest of con-
sumers, it may be worthwhile to stabilize per head
consumption and to calculate the surplus in rela-
tion to aggregate consumption rather than price
indices.

Demand for a commodity does not depend only on
its own price; apart from changing tastes, it also
depends on the prices of other commodities and,
more importantly, on the income of the people. If,
because of rising income, people happen to demand
and consume more vegetable oil, prices will go up,
and the governmental policy to bring down prices
by reducing exports will raise the consumption still
further. On the other hand, if prices have fallen
because of falling personal income, the export policy will force prices upward and consumption will further decline. In the former case, consumption is unnecessarily stimulated, whereas, in a country like India, it should be discouraged, if possible. In the latter case, the interests of consumers are clearly set aside. In any case, stabilization of prices by manipulating export quotas, irrespective of home production or per capita availability, is likely to lead to unnecessary destabilization of consumption.

In addition, it is very doubtful whether stabilizing prices of one or two goods is worthwhile if the prices of many other goods are left to fluctuate. For example, it is well known that consumption of cloth in India depends to a great extent on the prices of foodstuffs. When food is cheap, people can afford to spend a larger proportion of income on cloth, and when food prices rise, without a corresponding rise in income, expenditure on cloth is reduced. Again, to stabilize the prices of cloth irrespective of food prices is to destabilize the consumption of the former. In the first case, such stabilization unnecessarily boosts consumption, and in the second case, it penalizes the consumer twice over.

Thirdly, one cannot be sure that stabilizing the prices of raw materials will always benefit the final consumer. If the cotton mills are working to their full capacity, a reduction in the price of cotton is not likely to be passed on to the final consumer. Or, alternatively, if profit margins are already high, fluctuations in raw material prices are not likely to lead to fluctuations in the prices of final products. More generally, keeping the prices of raw materials at a lower level in an inflationary situation may only lead to higher profits, and the large profits may in turn create higher wage demands by trade unions. In effect, the policy of stabilizing selective prices may eventually help to create general inflationary conditions.
# TABLE 10

## Imports of Raw Cotton

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports of Cotton in Thousand Tons</th>
<th>Total Value of Cotton Imports, Rs. Crores</th>
<th>Average Import Price, Rs./Ton</th>
</tr>
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<tbody>
<tr>
<td>1950</td>
<td>159</td>
<td>63.3</td>
<td>3,976</td>
</tr>
<tr>
<td>1951</td>
<td>215</td>
<td>100.8</td>
<td>5,119</td>
</tr>
<tr>
<td>1952</td>
<td>217</td>
<td>139.0</td>
<td>6,405</td>
</tr>
<tr>
<td>1953</td>
<td>138</td>
<td>76.7</td>
<td>5,555</td>
</tr>
<tr>
<td>1954</td>
<td>116</td>
<td>52.8</td>
<td>4,545</td>
</tr>
<tr>
<td>1955</td>
<td>123</td>
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</tr>
<tr>
<td>1956</td>
<td>118</td>
<td>57.3</td>
<td>4,858</td>
</tr>
<tr>
<td>1957</td>
<td>107</td>
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</tr>
<tr>
<td>1958</td>
<td>84</td>
<td>40.6</td>
<td>4,808</td>
</tr>
<tr>
<td>1959</td>
<td>68</td>
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<td>4,141</td>
</tr>
<tr>
<td>1960</td>
<td>113</td>
<td>41.2</td>
<td>3,646</td>
</tr>
<tr>
<td>1961</td>
<td>228</td>
<td>81.8</td>
<td>3,572</td>
</tr>
<tr>
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<td>168</td>
<td>62.7</td>
<td>3,732</td>
</tr>
<tr>
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<td>155</td>
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<td>3,671</td>
</tr>
<tr>
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<td>126</td>
<td>49.0</td>
<td>3,888</td>
</tr>
<tr>
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<td>141</td>
<td>58.1</td>
<td>4,120</td>
</tr>
<tr>
<td>1966</td>
<td>88</td>
<td>46.2</td>
<td>4,923</td>
</tr>
</tbody>
</table>

Note: Years are fiscal years ending March 31.

Source: Accounts Relating to Foreign Trade of India (New Delhi: Government of India), monthly publication.

Stabilizing the prices of consumer goods, and especially wage goods such as cloth and cooking oils, may be quite essential in a country like India. But a simple manipulation of export quotas can rarely achieve this aim. Moreover, stabilizing
the prices of consumer goods of minor importance is more likely to do harm than good to a developing economy. Even the Indian economy has now reached a comparatively complicated stage of development, and the economic policies of the government must try to match that complexity if they are to be effective at all.

RATIONAL RESTRICTIONS

The two main wage goods under export restrictions are cotton textiles and groundnut oil. About 10 per cent of wage income is spent on the former, and 2 per cent is spent on the latter. Income spent on spices, onions, chilies and utensils is also insignificant. Whether it is worthwhile to stabilize the prices of these goods, assuming that they benefit the final consumer, is, therefore, doubtful; especially when so much loss of foreign exchange is involved. And to control cloth prices without controlling food prices is likely to create more problems than it solves.

It may also be argued that the present policy, apart from its dubious benefit to the consumers, is not in the best interests of the farmers, who, after all, should be both beneficiaries and instruments of economic development. The Indian farmer is denied the benefit of high international prices, but he has to bear the full burden if international prices happen to fall. India's export policy, like many other development policies, is loaded against agricultural development. The farmer has to suffer for the benefit of the "consumer," which most often means the middle class and the factory workers. In advanced countries such as the United States or the United Kingdom, the farmer's consumption is subsidized; in India, the farmer is expected to subsidize the consumption of the city people. Furthermore, if some farmers are allowed to grow jute primarily for export, why should not others be allowed to grow groundnuts for the same purpose? One can, therefore, make a case for removing all the restrictions on the export trade.
Alternatively, one can think in terms of becoming self-sufficient in wage goods and especially in food. In that case, exports of all cash crops that compete with food production will have to be discouraged. So, instead of encouraging exports of cotton, exports of raw jute can be discouraged. This seems to be the policy that India is following. But the difficulty with India's policy is that exports of agricultural produce are not completely banned; on the contrary, the goal is to stabilize the prices of exportable agricultural goods, and they are almost always higher than the relative prices of foodstuffs. So land is diverted from food crops to cash crops. In a sense, therefore, the perennial food crisis in India can be attributed to a certain extent to India's export policy concerning cash crops. Stopping the export of all agricultural raw materials that use food land and allowing food prices to reach a level where the net advantage of the farmer between a cash crop and a food crop is nullified are likely to be helpful policies for economic development. This point is further explored in Chapter 7.

In practice, perhaps, it is neither possible to ban exports altogether nor to allow unrestricted exports, though the government can choose to move in either of these directions. There will always be occasional surpluses of some commodities, and it may be worthwhile to dispose of them in the international market. But for this purpose a much more sophisticated policy than simply varying export quotas in the direction opposite to internal prices is required. Different policy devices for different commodities may also be necessary. It is not proposed here to develop such detailed policies for different commodities. State trading, export quotas based on the availability of buffer stocks, fixation of per capita consumption to establish the surplus production or other such policies can be devised. Perhaps for a country like India, it may be easier to levy a sliding export duty based on the home price index, rising more than proportionately with the domestic prices
till the duty becomes prohibitive after internal prices have risen to the extent considered a permanent ceiling. Such a policy would at least wipe out the uncertainty concerning export quotas. It is not impossible to construct simple devices by which exports can be managed without creating either uncertainty or excessive intervention in normal trade channels.
CHAPTER 5 IMPORT RESTRICTIONS AND BALANCE OF PAYMENTS

A continuous rise in imports accompanied by a comparative stagnation in exports has created a perennial problem of balance of payments for India. India meets the increasing deficits by reducing foreign-exchange reserves, encouraging an inflow of private foreign capital and seeking more and more foreign aid. Of course, quantitative restrictions constitute the most important instrument for keeping the deficits within limits. India's methods of meeting both ends of the balance of payments are mostly ad hoc, and in the process the government has aggravated and complicated the problems of economic development.

THE RISING IMPORT BILL

In the last fifteen years, India's import bill has been rising continuously by about 6 per cent per year.¹ This rate is much higher than the rate of growth of her national income, which is less than 5 per cent, though it is lower than the rate of growth of industrial production, which is about 8 per cent. More important is the comparison with export earnings. Broadly speaking, India's export earnings have been stagnant in the last fifteen years. A large and rising import bill, therefore, involves a large and rising deficit in the balance of trade. These yearly deficits would have been much larger in the last few years but for the fact that even the imports that are essential for development have had to be curtailed because of the
paucity of foreign exchange. Moreover, the actual import bill is likely to be larger than is shown in the official statistics, because imports due to smuggling seem to be significant. Anything from pencils to elephants is smuggled in or out. A few years ago, the government of India announced, to the delight of cartoonists, stricter penalties for those who smuggled elephants out of India. As for smuggling in pencils, "The low production (of pencils) particularly in 1952 was attributed to alleged smuggling of cheap foreign pencils." It has been estimated that smuggling in of gold alone amounted to Rs. 30 crores per year, that is, about 3 percent of total imports. Since 1958, however, gold smuggling is supposed to have been stopped.

The main goal of import policy is to reduce this rising import bill. Broadly speaking, import controls are meant to divert foreign exchange from "nonessential" consumer goods to essential producer goods such as capital equipment and raw materials.

THE METHOD OF CONTROL

India has chosen to control imports by quantitative restrictions rather than by price adjustments, though the latter have not been completely discarded. In 1947, an almost absolute power was given to the government by the Import and Export (Control) Bill. Up to March, 1962, the import policy was fixed every six months, but since then it has been fixed every year, although, even now, the licensee is asked to use only 50 per cent of his import quota in any six-month period. Each item of import is separately considered, and the commercial policy for each is stated in what is known as a Red Book. Licenses issued are not (legally) negotiable and are valid for only a specific period. Before 1956, there were separate licenses for hard and soft currencies, and United States and Canadian dollars were the main hard currencies in which the sterling reserves were not convertible; but since then no such distinction
has been made, as all foreign exchange has become equally hard and the sterling balances accumulated during wartime have been almost exhausted.

Prior to 1954, some items could be imported by anybody without seeking a specific permit. The list of such goods was called Open General License. The list would vary from 20 to 400 items. Since 1954, no such license has been issued except for a few goods which can only be imported from Pakistan and Afghanistan. The specific licenses for importing consumer goods are generally allotted to "Established Importers," although about 10 per cent of the quota is reserved for newcomers in the import trade. Licenses for the imports of producer goods and for capital equipment are issued to the "Actual Users," although a small percentage is given to the Established Importers, who are supposed to cater to manufacturers too small to seek specific licenses. Licenses for capital equipment and for iron and steel are issued by two special officers, and the over-all administration is entrusted to the Chief Controller of Imports and Exports under the direction of the Ministry for Commerce and Industry.

The procedure of licensing seems to be well established, and each year more than 250,000 applications and a million letters are sifted and about 150,000 licenses issued. Administrative costs are not known, but they are not likely to be large; in any case, they are not borne by the government, as they are supposed to be covered by a small fee charged for making the application. The inevitable delay seems to have been adjusted for by the license-seekers, as the issued licenses are not always immediately used. Complaints, however, are made about the sudden changes in licensing policies. As one industrialist said,

The whole procedure in connection with import licensing has been tedious, so far as the expansion program is concerned. One has to put forward
a scheme, get it approved, then get
the sanction for the capital issue. . . .
Having done all this he has to go to
foreign countries and place order
for his plant and machinery. After
this is done, if he finds one fine
morning a new import policy upsetting
his plans on account of foreign ex-
change difficulties, you can imagine
the extent of frustration that is
caused to him. 5

BALANCE OF PAYMENTS

It is surprising that such complaints are not
frequent, for foreign-exchange difficulties and
consequently import quotas have been changing al-
most every six months. Import restrictions seem
to be mainly concerned with the balance-of-payments
position. The statement of objectives and reasons
for the Import and Export (Control) Bill, re-enacted
in 1955, includes the following:

The need for the central government
to have legislative powers to con-
trol foreign trade of the country
is as great today as it was in 1947.
The balance of payments position though
slightly easier, will need to be
watched closely and continuously to
ensure the availability of foreign
exchange for the purchase of goods
required to sustain the rapid in-
dustrialization envisaged in The
Second Five Year Plan. 6

Import restrictions seem to have closely followed
the balance-of-payments position from year to year.
As the then Minister for Commerce stated in 1950,

It is possible to argue that our
import policy is apt to go to ex-
tremes. In 1946 we had a liberal
import policy including even the dollar areas. In 1947 we tightened it up and went to the other extreme, so much so that we could not utilize our available sterling releases. In 1948 we went back to liberal imports from soft currency countries to an extent which far transgressed the limits of sterling releases and we are now again pursuing a restrictive policy the results of which cannot be foreseen. Such changes are quite inevitable and in keeping with the general economic fluctuations throughout the world. It must be remembered that our policy must be governed strictly by the balance of payment position as revealed by experience from time to time.  

The Second Five-Year Plan (1956–61) was supposed to utilize foreign exchange more systematically, and an annual reduction of Rs. 40 crores in the foreign-exchange reserves was planned. But, 

On January 1, 1956, the total of our sterling balances stood at Rs. 738.6 crores. By May 24, 1957, this figure had fallen to Rs. 469 crores, a fall of almost Rs. 269 crores over a period of seventeen months . . . while considering the import policy for the rest of 1957, we will, therefore, have to take a very careful account of outstanding licenses that are likely to mature in the ensuing months. . . . The shortage of foreign exchange has compelled us to adopt a very strict policy in granting import licenses for the procurement of capital goods from abroad.
Since 1958, the foreign-exchange situation has become very precarious and import quotas have become more uncertain.

In view of the difficult foreign exchange position the government of India, on June 8, 1962, imposed a blanket cut of 50 percent for the licensing period April 1962 to March 1963, in all imports by established importers and consumer cooperative societies. The cut in the import licenses of actual users would be decided on merits in each case, subject to the availability of foreign exchange.\(^9\)

Since 1964, the quota uncertainty has become almost formalized. The 1964-65 import policy announcement says

In view of the need to conserve foreign exchange the import policy continues to be restrictive in various directions as in the previous licensing period. . . . Annual licenses where granted will be subject to the condition that during the first six months of the validity period of the license, the licensees shall be entitled to order shipment of goods to the extent of 50 percent only, of the value of the license. The balance of 50 percent can be utilized only after the commencement of the next half year and after endorsement by the licensing authority and will be subject to such change in value as may be decided upon by the government.\(^{10}\)
PREFERENCE FOR BAD TERMS OF TRADE

Import controls are meant mainly to conserve foreign exchange, but, paradoxically, the administration of controls itself seems to be responsible for wasting foreign exchange. In the first place, there seems to be a built-in wastage in India's import policy to the extent that imports are varied directly with changes in international prices. Availability of foreign exchange depends mainly on exports, and a rise or fall in the export earnings of India is determined mainly by the external demand, which is high in booms and low in recessions. Therefore, more often than not, whenever export earnings are rising, import prices also rise, and it is precisely at this time that the government of India liberalizes imports. At the time when international prices are on the low side, India's export earnings fall and the government restricts imports. In other words, India seems to be deliberately buying more when prices are high and less when prices are low.

This policy of preferring high prices to low ones has not always been due to the immediate needs of the economy, and it was practiced even when foreign-exchange reserves, before 1957, were not insignificant. Nor is the import content of Indian exports so high as to require such a policy. Moreover, this policy has been followed even for building up stocks, as, for example, in the Korean boom, when foreign exchange was available because of increased export earnings.

The primary aim of the import policy in 1950-51 which was continued in 1951-52, was to liberalize imports with a view to enabling industries to acquire adequate supplies of raw materials both for current requirements as well as for rebuilding inventories.\textsuperscript{11} [Emphasis supplied.]

Such a policy is perhaps unavoidable for
noneconomic reasons, or perhaps it is just due to the failure to plan the foreign-exchange budget for a period longer than six months. The continuous shifting in India's imports in the last twenty years has been surprising. Imports have been liberalized or curtailed in anticipation of the changing foreign-exchange situation, so much so that deficits generally rise with rising exports, as can be seen from Table 1 on Page 24.

IMPORTS ENcouraged BY CONTROLS

Quantitative restrictions have not helped to reduce the demand for imports; the pressure of license-seekers has been persistent and strong. The situation, obviously, would have been different if high tariffs had been used to restrict imports to a desired level. Moreover, because both traders and actual users enjoy high profit margins, they are not always careful to buy in the cheapest market or at correct times. Nor do Indian producers make excessive efforts to use substitutes available at home in order to reduce import requirements. For example, Indian textile mills were reluctant to use bleaching powder made in India till imports were discouraged by a protective duty.

The fair ex-works price for indigenous bleaching powder for 1954-55 is lower than the c.i.f. price of imported bleaching powder. Actual production of bleaching powder being, however, very low, the present costs of production are very high. There is also considerable prejudice on the part of the consumers about the quality of the indigenous product. A protective duty of 15 percent ad valorem should, therefore, be imposed on bleaching powder.
One of the hurdles in the path of development is that the peoples in the backward countries themselves have a strong prejudice against the products of the domestic industries. Even the official agencies are not immune to such a bias. For example, the Reserve Bank of India, the nationalized central bank of the country, which is responsible for the administration of exchange controls, did not think much of Indian products.

The government tenders are coming out with a definite condition that only English tiles will be used. The Reserve Bank of India is spending about two crores of rupees for housing its staff, and the conditions provide that only English store shall be used. When this was pointed out to the government of India the import license was refused to The Reserve Bank of India.13

The uncertainty and the heightened atmosphere of scarcity created by quantitative restrictions also lead to the wastage of foreign exchange. Frequently the Indian Government has been faced with a curious problem of importing too much rather than too little, compared with the home demand. "For many items we are pressed to put a restriction on imports merely on the ground that the internal market is saturated and the importers are having to sell below cost."14 In a country where reliable data about the size of the domestic demand are not available, such mistakes are not surprising. Moreover, because of the uncertainty of obtaining a large enough quota each time, importers have tended to ask for a little more than they really wanted; and as the outstanding licenses could be canceled, they have used all the available licenses in a hurry, if a foreign-exchange scarcity has been expected to develop. Such bunching of licenses, for example, occurred in 1957 and 1958, when a foreign-exchange crisis was expected (and therefore brought about) by the importers.
IMPORTING INTERNATIONAL FLUCTUATIONS

India has followed what may be called a programmed balance-of-payments policy; she has incurred a measured deficit on the basis of all available foreign exchange, including grants and loans from foreign countries. The main source of foreign exchange has been exports and, therefore, imports were tied to possible export earnings. Not only nonessential imports but the imports of capital equipment upon which investment depends, and the maintenance imports on which industrial production depends, have also varied with export earnings. Because of such a policy, India seems to have imported international fluctuations into her national economy.

Export fluctuations have been due mainly to international forces and are beyond the control of the Indian Government. On the other hand, fluctuations in imports have been brought about exclusively by India's import policy. The annual data in Table 1 show that imports have almost always fluctuated in the same direction as exports. These figures include imports both on private and on government accounts. The latter part was determined mostly by the aid-giving countries and was not much influenced by the import policy of India. The private imports of machinery, therefore, must have fluctuated by a much wider margin than is seen here.

A more detailed analysis based on the quarterly data was attempted, and the correlation between total exports and the imports of machinery was found to have been significant. Both the R and the level of significance were much improved when the imports of machinery were correlated with total imports. In other words, imports of capital equipment fluctuated more closely with exports than did the rest of the imports. This result was possibly due to the fact that maintenance imports had to be kept more or less at the required level irrespective of fluctuations in export earnings, and,
therefore, the imports of capital equipment was more freely manipulated to adjust the balance of payments.  

It seems, therefore, that India's balance-of-payments policy, instead of warding off foreign economic fluctuations, actually injects them into the national economy, to the extent that the total investment depends on the imported capital goods. In most other countries, the primary purpose of economic policy is to maintain the internal balance of the economy, and the vicissitudes in the balance of payments are managed by quantitative restrictions and, therefore, are not allowed to impinge on the national economy. So, also, some of the partial and temporary disturbances in the national economy are corrected by transferring them to the foreign-trade sector. For such reasons, even surplus countries like West Germany or France keep quantitative restrictions on imports. And deficit countries like the United Kingdom use them mainly for maintaining the internal balance. In the case of India, quantitative restrictions seem to be working the other way around.

It can, however, be argued that a developing country should use whatever resources available at whatever time for the sake of development. But then it is difficult to plan development in a meaningful way, and all other economic policies become subservient to the goal of maintaining an external balance at a fixed rate of exchange. In any case, India has always claimed to have programmed her balance of payments, but the actual state of affairs seems to have been quite different. Moreover, although India had adequate foreign-exchange reserves in her first decade of development (1948-58), imports moved quite closely with the fluctuating exports, and no better planning was visible then than in the 1960's.
THE STERLING RESERVES

In order to meet the deficits, India has been continually reducing her foreign-exchange reserves. Generally, such reductions were planned for years ahead, but the plans were never realized and the reserves were used up in a slipshod way. These reserves were built during World War II, when India was obliged to make huge exports to help the British war effort without getting any imports in return. This export surplus was divided between India and Pakistan in 1947, and India received over Rs. 1,500 crores worth of foreign exchange, that is, about six times the amount of all the foreign capital in India at that time. Fortunately, the British were not in a position to release all the balances at once, and a gradual release was agreed upon. Even then, India exhausted all the foreign exchange within ten years, except, of course, that part which was required as a statutory backing for the Indian rupee. In 1958, the 40 per cent reserve requirement was replaced by a fixed amount of sterling worth Rs. 120 crores. Presently, there are hardly any extra reserves for commercial purposes, and very soon even the token reserve requirement may be nullified to meet deficits. This change is an important development in currency management, but from the point of view of meeting the import bill, it amounts to a once-and-for-all liquidation of foreign investment and not to a source of continuous flow of foreign exchange. The abolition of an unnecessary reserve requirement seems to constitute more rational economic behavior, but this abolition has been forced on the government by the balance-of-payments difficulties. What this indicates mainly is the precarious foreign-exchange situation brought about by maladministration.

FOREIGN AID

Borrowing from foreign governments or international agencies is the most important source of funds for meeting deficits. Such borrowing is
popularly known as foreign aid. In the last fifteen years, India has borrowed about 12 billion dollars from the rest of the world; that is, about Rs. 400 crores per year at the predevaluation rate and about Rs. 600 crores at the present rate. But the repayment and interest charges are steadily mounting, and soon the drain will be larger than the inflow, as more and more loans come to the repayment stage.

As compared with Rs. 50 crores which India had to repay in 1961, during the current financial year she has to repay Rs. 140 crores. . . . In view of this increasing burden, India has been requesting friendly countries to lend her money for development on soft terms--less interest and a repayment spread over longer periods.16

Even if such requests are granted by the lending countries, a heavy drain on the foreign exchange is only likely to be postponed for some time. The main lenders are the International Bank for Reconstruction and Development (IBRD), the International Development Agency (IDA), the United States, the United Kingdom, West Germany, and Japan. Besides these, Canada, France, and Italy are also members of the "Aid-India Consortium." The United States charges only nominal interest on the loans used to buy surplus wheat under P.L. 480. For the rest of the loans, however, most of the countries, excluding Canada and the U.S.S.R., charge about 6 per cent interest; so do the international agencies. Canada prefers giving grants to lending money. The U.S.S.R. charges a low interest rate (2½ per cent) and accepts payments in rupees, which are used to import Indian goods on the basis of bilateral agreements. It is very doubtful whether the World Bank can reduce its interest rate and whether the United States can maintain her aid at the present level, irrespective of the high interest rate.
Moreover, the foreign aid given today is usually tied to different projects, and it is generally not available for meeting a deficit on the balance of payments. It is tied not only to specific projects approved by the aid-giving countries, but also to the specific export capacities of the lenders, such as food production in the United States or the production of heavy machinery in the U.S.S.R. India is trying with some success to get part of the aid in the form of untied loans. In the short run, this will give India more foreign exchange to finance the import surplus, but in later years the difficulties of repayment will mount up.

In this context, it is interesting to note that Russian aid, either by chance or by design, has been properly used by the Indian planners. Russian aid has been invested either in import-saving industries, such as petroleum and heavy machinery, or in the export-creating industries, such as steel or aluminum. In any case the Russians have helped industries that are likely to play a crucial role in India's economic development. India is in need of heavy industries such as iron and steel, aluminum, fertilizers, petroleum refining, chemicals, electricity, and perhaps some machinery. These industries require a large amount of capital and a long gestation period. Rightly or wrongly, India has reserved all such industries for the public sector, although some temporary relaxation in this policy seems to be in the offing. This policy is partly responsible for reducing the role of American aid in India's economic development.

There is nothing very unusual about the Bokaro steel plant. There are five similar plants already working in India and three more are being planned, but Bokaro became well known because American aid was sought for it without success, and eventually Russian aid was offered and accepted. Bokaro, therefore, became a symbol of India's aspiration to build heavy industries and, if possible, to build them in the public sector. These
industries require financial and technical assistance from the advanced countries. It seems very probable that Russian aid for such a purpose is likely to come forth more easily than American aid, for the latter is generally not available for financing projects in the public sector. The Russians, on the other hand, for reasons somewhat unknown, prefer to give aid for heavy industry and large projects. Thus, the need of India and the aid of Russia seem to be well matched. Moreover, Russians charge a low rate of interest and try hard to accept imports from India for repayments. India, therefore, is likely to depend more heavily on the Russians for building up her crucial industries. By the very compulsion of her developing economy, India is likely to move to the left, at least in her economic relations.

PRIVATE FOREIGN CAPITAL

Another way of meeting the deficit is to invite private foreign capital, but India does not seem to be getting much help from this source. In 1948, the total foreign capital in India, including private and official, like that of IBRD, was Rs. 260 crores, and in 1965, it was about Rs. 660 crores. This investment amounts to an average net inflow of Rs. 25 crores per year. Even to keep up this small net inflow is going to be difficult, as the amount of profits repatriated by the foreign investors is inevitably rising. It is not uncommon for investors in India to earn 20 per cent net profits,¹⁷ and even if profits are plowed back for some time, the eventual drain on foreign exchange is inescapable.

In India, private foreign capital is not unwelcome, especially if it enters into partnership with an Indian entrepreneur. However, suspicion of foreign capital dies hard in the developing countries. For example, one articulate spokesman of foreign capital has complained that
The Asian governments are apt to treat the foreign investor as a wild beast whom it is necessary to cage; without permission, he is normally not allowed to invest at all, and even if he is allowed, he is checked by a whole series of leashes. He must take a proportion, perhaps a majority of local capital, he must have a certain percentage of local employees, he must get permission to expand, or to locate his factory or to rationalize his operations. . . . Foreign investment nevertheless continues. There are always some brave pioneers and some firms who have no option. 18

More importantly, private foreign capital is confused with private enterprise, and the governments of the developing countries become, perhaps unintentionally, more "socialistic," because of their suspicion of foreign capital. In a country like India, this suspicious attitude of political leaders and, therefore, of the masses, is one of the hurdles in the path of development. It will be extremely difficult, if not impossible, to create the conditions for sustained and rapid economic growth without fostering private enterprise. Private foreign capital, especially in partnership with Indian enterprises, can help in this direction besides helping to meet the deficits on the balance of payments.

One reason for the suspicious attitude toward private foreign capital is that the repatriation of profits by foreign concerns makes the task of development more difficult than it would be otherwise. If the "profit-reinvestment" theory of development is true, private foreign capital, almost by definition, is not likely to lead to sustained economic growth—sooner or later the foreign capitalist has to take back his profits and snap the chain of sustained development. This result seems to be
inevitable, unless the businessmen are motivated by altruism or migrate to the developing country along with their capital; in the former case they cease to be capitalists, and in the latter case they cease to be foreign.

However, the advanced countries can make private foreign capital more acceptable to the developing countries. It may be worthwhile for the advanced countries to make up the drain caused by the repatriation of profits (not capital) by equivalent grants. Grants are sought and given anyway; there is no reason why they should not be used to ensure the presence of free enterprise in the developing countries and to take the wind out of the "exploitation" thesis. Incidentally, such a tie-up between government grants and private profits would be acceptable to "socialist" governments like that of India, because the larger the profits made by foreign enterprises, the larger the grants the governments would get for enlarging the public sector, if they still happened to disdain private enterprise. Such a step would most probably lead to the liberalization of trade and the elimination of exchange controls and would enlarge the sphere of price mechanism. It would give some "nonpolitical" criterion for distributing at least a part of the aid. Most importantly, it would reduce the total amount of aid required by the developing countries, because of the inflow of private foreign capital. In India today, the total private foreign capital is less than Rs. 600 crores. Even if the repatriated profits happened to be 20 per cent, and even at the present rate of exchange, only 160 million dollars annual grant would be enough to compensate the whole repatriation. As this amount grew, the additional capital inflows could perhaps be secured by less than 100 per cent compensation.

The inflow of private foreign capital would most probably solve India's balance-of-payments problem in two ways: firstly, by increasing the supply of foreign exchange and, secondly, by building up import-saving and export-creating industries. Such a prospect, however, does not seem to be probable in the foreseeable future.
CHAPTER 6 IMPORT-SUBSTITUTE INDUSTRIALIZATION

India's industrialization is neither planned nor left completely to free enterprise. It seems to have suffered from the defects of both systems at the same time. It is proposed here to analyze this problem only to the extent that it sheds light on India's commercial policy.

PROTECTION TO INDUSTRIES

The government of India has never adopted a protectionist policy very enthusiastically. The government has followed the old British policy of giving protection to Indian industries after they have existed for some time and after they have successfully made a case that protection is required for their survival, and upon the recommendation of the Tariff Commission, which carries on a detailed study of the industry before suggesting a minimum protective duty, if any. Paradoxically, this policy seems to constitute an open invitation to start import-substitute industries, because if you really suffer from competition you can always make a case for protection.

However, the government of India made it clear that neither the tariffs meant for collecting revenue nor the quantitative restrictions meant for conserving foreign exchange were to be construed as a reliable protection by the manufacturers.
Speaking next of import control policy in general, the Minister declared that the machinery of import control was not a suitable instrument for the furtherance of indigenous industry which was being looked after by other bodies.¹

Most of the officially protected industries—and there were never more than forty at any time—were not always protected by raising tariffs. Many times the protection consisted of a change in the classification of a tariff from "revenue" to "protective." More importantly, however, the "protection" involved an implicit promise of curtailing imports to annul foreign competition. In exchange for this protection, these industries were expected to follow a fair-price policy and were subjected to special inspection from time to time. Obviously, very few industries sought protection.

As a matter of fact, protective policy based on finely balanced price differentials became obsolete in India long ago because of the perennial shortage of foreign exchange. Indeed, India's need was exactly opposite, that is, to discourage and even to prohibit investment in the import-substitute industries which either were not immediately required or were not justified by a long-term comparative advantage, so that larger investment could be made in more important industries. The government of India does not seem to have made any such effort.

THE INTERESTS OF CONSUMERS

India had a fine opportunity to reduce expensive consumption by controlling the supply of imported goods. But such a goal, though sometimes hinted at (perhaps unintentionally), does not seem to have been seriously set for the import policy in the last twenty years. The government was concerned with keeping up normal consumption; imports
were reduced only if dictated by unavoidable circumstances, and care was taken to protect the consumer from unduly high prices. Import-substitute industries that created a new supply of importables were naturally welcome, especially if the producers did not earn "unfair" profits by exploiting import restrictions. This facet of the policy was quite obvious.

I am perturbed by the fact that some of our industrialists have come to regard the existence of import controls as a condition precedent for industrial progress. In fact, unhealthy dependence on import control saps the internal vitality of industry and jeopardizes the interests of consumers. Freedom from competition has acted as a drag on progress and a temptation so provided for some industries to exploit the situation by charging high prices to the consumer or by persistently maintaining poor quality standards, should not, in the interest of the industrial development of the country become a permanent feature of our economy.  

This statement was made in 1954. Earlier, the Finance Minister had repudiated a charge that import policy was based on short-term considerations.

An analysis of our imports at present will show that the quantity of what may be called non-essential goods which are imported is very small. And in the interest of domestic development we are at present protecting some forty industries and it cannot, therefore, be said that our commercial policy is determined only in terms of immediate cost differences. It must also be borne in mind
that the banning of imports does not by itself lead to an increase in domestic output. It might merely create monopoly profits for the favored producers.\textsuperscript{3}

To keep such profits down and to protect the consumer, imports of consumer goods should be liberalized whenever possible: this principle perhaps explains a curious contradiction between raising import duties and simultaneously liberalizing import quotas.

In the Indian Tariff Act of 1954, import duties were stepped up in the case of 32 items, including woolen fabrics, lead pencils, razor blades, vacuum flasks, boots and shoes, and beer and ale. The increased duties have, besides providing an additional source of revenue to the exchequer enabled us to experiment with some relaxation in our import control regulations. As these duties tend to deter an undue expansion in consumption and provide an umbrella for indigenous products, we have found it possible to do away with a number of inconvenient restrictions and to increase in many cases quota percentages or provide for the issue of additional licenses to be established importers and others.\textsuperscript{4}

The statement of import policy for 1964-65 reiterates this policy.

Cuts have been imposed in imports of items which are of low priority or where indigenous production has expanded. Increases in imports of certain items have been effected to meet the gap between domestic demand and actual indigenous production.\textsuperscript{5}
In other words, the government never tried to restrict consumption by using import controls. But the supply of imported goods always fell short of domestic demand, and those who obtained import licenses continued to earn huge profits at the cost of both the consumers and the domestic industries. The government then resorted to a sort of unofficial rationing system and channeled the imports through the consumer cooperatives, through the State Trading Corporation and through some government-approved private agencies, "with a view to ensuring that the end users obtained these items of household amenities at a reasonable price level."6

INCIDENTAL PROTECTION

Though most of the import-substitute industries were not officially protected, all of them got the benefit of import controls. Such an incidental protection was officially recognized.

I have in recent past received a number of representations from manufacturers in the country saying that they are finding it difficult to maintain their production because internal demand has fallen and competition from imports has become more intense. Now, while opinion may differ as to whether and to what extent the import control should give any protection to indigenous industries there is no doubt that in selecting items where we can make a cut, we must clearly give preference to those where the cut is going to affect the consumer the least because he can get supplies from alternative sources within the country.7

Such a coordination of imports and the domestic production of importables seems to have been an accepted policy.
The primary purpose of the import control is, of course, the conservation of foreign exchange, but in drawing up our foreign exchange allocations, we have naturally taken into account the requirements of the country's economy, and in the process it has been possible to stimulate industrial production by augmenting the supply of goods required by industry and restricting the imports of goods that could be manufactured in the country.  

Some equivocation in such statements was due to the fact that the GATT, of which India is a party, had not allowed before 1956 the use of quantitative restrictions for protective purposes. After 1956, the announcements were shorn of diversionary preambles.

In formulating the import policy for second half of 1956 . . . a closer integration between imports and the development of the country's industrial potential has been sought to be achieved with the result that while in the main, continuity has been maintained, imports of machinery, spare parts and industrial raw materials have been further liberalized and restrictions have been sought to be imposed over the imports of a variety of goods which are or can be produced in adequate quantities in the country.

Incidental protection, therefore, was not quite incidental. Moreover, establishment of import-substitute industries has to be approved by the government and a license has to be granted for importing the necessary capital equipment. Issuance of stocks in the capital market also has to be
approved by the government. Many of these industries were dependent on foreign collaboration that had to be approved by the government. More importantly, most of them required imported components for which import licenses had to be issued annually. It is only fair to conclude, therefore, that import-substitute industries were desired by the government and were granted indirect protection.

WASTE OF INDUSTRIAL INVESTMENT

The difficulty with such indirect protection is that it is uncertain, and a sudden liberalization of imports can be a blow to the domestic industry. Even at a time of general scarcity of foreign exchange, imports of a few items can always be increased, and the industries concerned could face imminent ruin. The following are two sample complaints of Indian industrialists:

In the matter of import policy we should never again repeat the error quite often committed in the past of allowing such large imports of commodities as to discourage indigenous manufacture of them. To quote but one instance, in the case of diesel engines it is well-known how our industry which has touched production figure of 800 per month in December 1951 was very nearly ruined last year by an import of 72,000 engines in 1951-52. Even the Planning Commission do not estimate a requirement of more than 60,000 per annum and that too in 1956-57.¹⁰

Till 1952, large imports were allowed in sanitary ware and glazed tiles a line or business in which I am directly connected. Half a dozen factories installed after
the war with up-to-date machinery were facing keen competition. Some of the factories had closed down for about six months. Facts and figures were placed before the Government of India. They were convinced and a ban was imposed and the quantity was restricted since June 1952.\textsuperscript{11}

Even the Tariff Commission had recommended to the government that import quotas of certain items be reduced so that the domestic industries could flourish.

In order to prevent unnecessary imports it should be verified in consultation with the Central Food Technological Research Institute, whether the higher specification adopted by The Corn Products Company (India) Ltd., (the principal importers of glucose) are essential to meet the genuine requirements of the consumers in this country.\textsuperscript{12}

To make sure that the industries do not exploit the import controls, a policy of importing a wide range of products already being produced in India was evolved in 1953 and followed for some years. This practice was called a policy of token imports. Most probably, it was not appreciated by Indian businessmen.

I am not unaware that the policy of token imports has been received with a certain feeling of uneasiness on the part of some indigenous producers. I must confess that this has come to me as a great surprise. . . . Apart from affording some choice to the consumer, token imports should make a contribution to the advancement of our industry by spurring industrialists to pay increasing attention to the need for improving
quality and lower the costs. . . .
The incidental protection which the import controls must give inevitably to our industries should not make them so complacent and slack that the moment imports are allowed they feel they must die.\textsuperscript{13}

The so-called token imports, of course, did not kill the industries, but they probably made the industries even more inefficient. Such intermittent imports have been especially harmful to those producing such durable goods as typewriters or refrigerators, because of the consumer preference for foreign brands. In the case of such goods, consumers can wait until the next liberalization of the import quota instead of spending a large sum on what they (perhaps rightly) consider to be the shoddy products of undeveloped manufacturers. The second Fiscal Commission pointed out, as far back as 1949, that at least a 20 per cent price difference is required to overcome the preference for imported goods over equivalent products of domestic industries.\textsuperscript{14} The performance of most, if not all, import-substitute industries must have strengthened this consumer preference since then.

One of the reasons for inefficiency in these industries is that they have suffered from excess capacity. Because of the smallness of the market, which was whittled away by continual imports, many of these industries could not use their imported capital equipment to the fullest extent. Some of the excess capacity might have been due to excessive investment; some of it was due to the nonavailability of import components and raw materials and some of it was possibly caused by a technological problem of indivisibilities. But fluctuating import policy was certainly one of the reasons for excess capacity in many industries. A detailed study of each affected industry is required to prove this point. The following remarks are intended to make only a \textit{prima facie} case.
The ten industries listed in Table 11 were not chosen for any special reason except that the relevant data were readily available.

"Import I" refers to a yearly average from 1947-48 to 1951-52 and "Import II" refers to a yearly average from 1952-53 to 1956-57. After 1957, the foreign-exchange position became very precarious, and though the problem of excess capacity remained intact, the reason for it was somewhat reversed; today the excess capacities are due not so much to liberal imports but to the incapacity to import enough raw materials and import components for the established industries.

It should be noted that for the first five industries, imports did not decline much, and the excess capacity has remained very high. The average decline in imports is less than 10 per cent, and the average excess capacity is over 58 per cent. For the other five industries, the decline in imports seems to have helped the increase in production. The average decline in imports is over 47 per cent, and the average excess capacity is less than 23 per cent.

An import-substitute industry can get help from two sources: a reduction in imports and a rise in domestic demand. The rise or fall in total domestic demand is shown in the last column. Assuming no change in inventories, total home production plus imports is taken as a rough indicator of total home demand. It can be seen from the table that the industries with low excess capacities have not been depending only on the reduction of imports; they have equally benefitted by the increase in total demand, with the exception of one industry, namely, wireless sets. Razor blade and pencil manufacture has flourished in spite of import competition; this success has been due to rapidly rising domestic demand. The high excess capacities in these industries could have been reduced by reducing imports, which amounted to about 40 per cent of total home demand.
### TABLE 11

*Excess Capacities in Modern Industries (Figures in Lacs of Rupees)*

<table>
<thead>
<tr>
<th>Item</th>
<th>I</th>
<th>II</th>
<th>III</th>
<th>IV</th>
<th>V</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Refrigerators</td>
<td>43.5</td>
<td>44.7</td>
<td>+2</td>
<td>73</td>
<td>8</td>
</tr>
<tr>
<td>2. Razor Blades</td>
<td>48.1</td>
<td>36.8</td>
<td>-24</td>
<td>64</td>
<td>75</td>
</tr>
<tr>
<td>3. Typewriters</td>
<td>78.0</td>
<td>72.7</td>
<td>-7</td>
<td>60</td>
<td>-10</td>
</tr>
<tr>
<td>4. Pencils</td>
<td>28.0</td>
<td>25.6</td>
<td>-8</td>
<td>63</td>
<td>130</td>
</tr>
<tr>
<td>5. Sanitary-ware</td>
<td>25.4</td>
<td>22.9</td>
<td>-10</td>
<td>32</td>
<td>N.A.</td>
</tr>
<tr>
<td>6. Electric Lamps</td>
<td>156.6</td>
<td>112.9</td>
<td>-28</td>
<td>27</td>
<td>22</td>
</tr>
<tr>
<td>7. Cycles</td>
<td>236.0</td>
<td>141.0</td>
<td>-41</td>
<td>12</td>
<td>74</td>
</tr>
<tr>
<td>8. Sewing Machines</td>
<td>87.2</td>
<td>58.8</td>
<td>-33</td>
<td>3</td>
<td>47</td>
</tr>
<tr>
<td>9. Woolen Fabrics</td>
<td>158.2</td>
<td>74.4</td>
<td>-54</td>
<td>34</td>
<td>455</td>
</tr>
<tr>
<td>10. Wireless Sets</td>
<td>104.2</td>
<td>20.6</td>
<td>-80</td>
<td>36</td>
<td>-4</td>
</tr>
</tbody>
</table>

**Notes:**

I = Annual imports from 1947-48 to 1951-52.

II = Annual imports from 1952-53 to 1956-57.

III = Percentage change from I to II.

IV = Unused capacity as a percentage of total of one shift capacity averaged over ten years.

V = Change in total demand from I to II.

**Sources:** For imports, *Accounts Relating to Foreign Trade of India* (New Delhi: Government of India), monthly publication. For excess capacities, *Monthly Statistics of the Production of Selected Industries of India* (Calcutta: Government of India), monthly publication.

The excess capacities did not seem to have arisen out of technological indivisibilities, as each industry was composed of many units and the establishment of new plants was permitted even in the 1960's.
The problem of excess capacity in Indian industries is much too complex, but certainly it indicates, among other things, the shortcomings of India's import policy. Import restrictions created import-substitute industries, but, at the same time, import policy was most probably responsible for not allowing these industries to flourish. Such industrialization appears to be a culpable waste of resources in a capital-short economy and, more importantly, a waste of foreign exchange involved in maintaining excess capacity in imported capital equipment used by these industries.

MINIATURE INDUSTRIES

As soon as imports were restricted because of foreign-exchange scarcity, the import-substitute industries created an alternative supply to keep up the hampered consumption. The government generally allowed such investment, unconcerned either with the comparative advantage or with the extent of the domestic market. It is difficult to name a product on which imports have been stopped and domestic production not begun. Many of these industries are surprisingly tiny. There are four units that produce passenger cars, but the total annual production is not over 25,000. Domestic refrigerators, washing machines, dryers, vacuum cleaners, cameras, typewriters, air conditioners, telephones, radios, watches, clocks, motorcycles, mopeds, scooters, tape recorders, walkie-talkies and various types of modern electrical and electronic appliances are produced—a few thousand articles annually and by numerous small plants. Even teleprinters are produced—300 per year. The target production of television receivers in 1970 is 1,000 sets.

These tiny industries could not take advantage of large-scale production even though they had to use the most modern machinery imported from advanced countries. The excess capacity so created made them top-heavy and inefficient. The industries were too small to create all the components of their products,
depending heavily on imported components. Many of them required imported raw materials, and all of them had to depend on imports of spare parts for the capital equipment. Any planned industrial structure would have created self-sufficient industries and would have seen that different industries were functionally integrated with each other. In this sense, India's industrialization has never been balanced.

The essential imports required to keep the established industries running are known in India as maintenance imports. The need for these maintenance imports is the index of this imbalance. India's industrial development today is choked off by the inability to maintain these imports at the desired level. It has been estimated by one important observer that if India could import more raw materials and components and could raise her present import bill by 10 per cent, she would be able to increase her industrial production by 20 per cent by utilizing the excess capacities in many of her industries. But to finance these imports, India's export earnings will have to rise by over 15 per cent, or alternatively, the total net foreign aid (excluding that under P.L. 480) she presently receives will have to be almost doubled. The present bill for maintenance imports is slightly larger than the total export earnings, and further industrial investment requiring imported capital equipment has inevitably to be discouraged because of the scarcity of foreign exchange.

Imports of capital goods for new development has necessarily to be given a lower priority than the import of raw materials. It is obviously undesirable to aim at expanding capacity if we are not able to get the utmost out of the existing installed capacity in the country.

The wheel has come full circle; the import controls that were initially meant to encourage industrial investment are now used to stop it.
IMPORTS OF CAPITAL GOODS

In the last twenty years, most industrial development in India has been dependent on imported capital equipment. Without such imports, very little capital formation would have been possible. From turbines in high dams to steel rings in hand-spinning wheels, all investment required crucial import components. In India today, such dependence on imports is regarded as undesirable, and the government has initiated and encouraged domestic capital-goods industries. Because of the rising bill for maintenance imports, the foreign-exchange situation is so precarious that further imports of capital equipment have become difficult.

Recently the applications for import licenses for capital goods have been considered only when the applicant himself can make satisfactory arrangements for raising external finance. . . . The government was willing to consider investment only in the equity capital of the company or long term loans. Short term deferred payments facilities were not acceptable owing to anticipated pressure on the payment position arising from repayment liabilities.17

For this reason, some Indian economists, influential in the government, are advocating that a developing country, from a long-run point of view, must make an effort to build its own capital-goods industry. Recently, S. J. Patel has pointed out that

The adequate flow of capital goods for investments in India cannot be assumed without much faster development of the heavy industries than any other sector of the economy for some years to come. The import policy will, therefore, have to be strictly selective, not just encouraging all capital
goods imports as against consumer goods, but even within capital goods imports, give the highest priority to the imports of capital goods that produce capital goods.\textsuperscript{18}

The same thesis was formalized by Raj and Sen. They pointed out that if the fixed amount of foreign exchange can be spent to import machines that can produce more machines rather than either intermediate products or final goods, the rate of growth of consumption can be kept continuously rising in the long run, although consumption would have to be curtailed in the short run.\textsuperscript{19} As far back as 1949, the Fiscal Commission's minority report had urged the government of India to encourage the production of capital goods in the country.\textsuperscript{20} In the last few years, the government's commercial policy seems to be veering in this direction.

Apart from the problem of time preference, this view attaches some special significance to the production of capital goods, comparable with self-sufficiency in food or defense equipment for the sake of national security in the long run. Otherwise, it is difficult to see why capital goods industries should be preferred to other industries, unless there is a clear comparative advantage in the production of capital goods.

Capital goods certainly form a crucial part of industrial investment, but this fact need not be confused with their quantitative importance in terms of foreign exchange. It is possible that Indian planners are making exactly this mistake. As a matter of fact, the bill for capital goods imports in India does not seem to be excessively large.

It has been pointed out,\textsuperscript{21} for instance, that during 1956-62 the cotton textile industry required imported machinery to the extent of Rs. 17 crores per year, whereas raw cotton, yarn, dyes, chemicals, fuel oils and lubricants required
## TABLE 12

Maintenance Imports
(Annual Figures in Crores of Rupees)

<table>
<thead>
<tr>
<th>Item</th>
<th>1950-54</th>
<th>1955-59</th>
<th>1960-64</th>
<th>1964</th>
<th>1965</th>
<th>1966</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Period I</td>
<td>Period II</td>
<td>Period III</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Total Imports</td>
<td>690</td>
<td>860</td>
<td>1,092</td>
<td>1,222</td>
<td>1,350</td>
<td>1,392</td>
</tr>
<tr>
<td>2. Total Exports</td>
<td>596</td>
<td>609</td>
<td>684</td>
<td>794</td>
<td>816</td>
<td>806</td>
</tr>
<tr>
<td>3. Machinery</td>
<td>84</td>
<td>120</td>
<td>225</td>
<td>268</td>
<td>313</td>
<td>302</td>
</tr>
<tr>
<td>4. Transport Equipment</td>
<td>34</td>
<td>62</td>
<td>68</td>
<td>71</td>
<td>73</td>
<td>70</td>
</tr>
<tr>
<td>5. Electrical Goods</td>
<td>31</td>
<td>43</td>
<td>65</td>
<td>85</td>
<td>91</td>
<td>87</td>
</tr>
<tr>
<td>6. Iron and Steel</td>
<td>20</td>
<td>92</td>
<td>99</td>
<td>93</td>
<td>105</td>
<td>98</td>
</tr>
<tr>
<td>7. Mineral Oils</td>
<td>77</td>
<td>78</td>
<td>89</td>
<td>105</td>
<td>69</td>
<td>68</td>
</tr>
<tr>
<td>8. Chemicals</td>
<td></td>
<td></td>
<td>92</td>
<td>89</td>
<td>95</td>
<td>104</td>
</tr>
<tr>
<td>9. 3 + 4 + 5</td>
<td>149</td>
<td>225</td>
<td>358</td>
<td>424</td>
<td>477</td>
<td>459</td>
</tr>
<tr>
<td>10. 4 + 5 + 6 + 7 + 8</td>
<td></td>
<td></td>
<td></td>
<td>413</td>
<td>443</td>
<td>433</td>
</tr>
<tr>
<td>11. Food Imports</td>
<td>116</td>
<td>76</td>
<td>177</td>
<td>214</td>
<td>323</td>
<td>341</td>
</tr>
<tr>
<td>12. Cotton Imports</td>
<td>87</td>
<td>44</td>
<td>60</td>
<td>49</td>
<td>58</td>
<td>46</td>
</tr>
<tr>
<td>13. 11 + 12</td>
<td>203</td>
<td>120</td>
<td>237</td>
<td>263</td>
<td>381</td>
<td>387</td>
</tr>
<tr>
<td>14. 13 as a % of 2</td>
<td>34</td>
<td>20</td>
<td>34</td>
<td>33</td>
<td>47</td>
<td>48</td>
</tr>
</tbody>
</table>

Note: Years are fiscal years ending March 31.

Source: Statistical Abstract (New Delhi: Government of India), monthly publication.
for this industry made up an import bill of Rs. 70 crores per year. Moreover, the latter bill can continuously increase with textile production, but only Rs. 8 crores per year will be sufficient for the replacement of capital equipment.

In the three five-year periods from 1950 to 1964, imports of machines constituted, respectively, only 20, 26 and 33 per cent of total imports. This includes not only the machinery required to establish new industries and spare parts, but all the transport and electrical equipment and electrical appliances of all sorts. The need for electrical and transport equipment is so large and continuous, even for the established industries, that, from the point of view of the productive capacity of the economy over a few years, it may be useful to include these items in intermediate goods rather than in capital goods. In any case, India has already started producing these goods, and unless the available investment is diverted to the production of heavy machinery, self-sufficiency in transport equipment and electrical goods is likely to be soon attained. In the three five-year periods, imports of machinery excluding electrical and transport equipment constituted, respectively, only 10, 13 and 20 per cent of the total imports. Even in terms of stagnant export earnings these percentages were 10, 20 and 33. They have never been larger than 38 per cent of the total exports and 24 per cent of the total imports in any year. India, therefore, does not seem to be in great need of machines producing more machines, and importing machines for investment is not likely to be an insuperable hurdle in the way of development.

This does not mean, however, that India should not invest in any capital-goods industry. It is very possible that India has a comparative advantage in certain types of capital goods where there is a large home market for replacement, as in textile machinery, or where a new type of equipment suitable to Indian conditions has to be designed because it cannot be imported from the
technologically very advanced countries, for example, a simple sugar-cane-crusher. But, by and large, it seems quite unnecessary to lock up huge investment in capital-goods industries.

Commercial policy encouraging investment in capital goods is likely to waste valuable resources and keep down investment in the production of goods that are immediately required for continued economic growth. Moreover, foreign aid for financing a continuous deficit in the balance of payments is generally not available, and most often the aid is given for financing the imports of capital goods required for large investment projects. Apart from the waste of resources, therefore, domestic production of machinery can, to a certain extent, hamper the flow of foreign exchange that is presently available.

Recently, the Finance Minister declared in the Parliament that, for a country "like India . . . there is no escape from the production of metals and machinery." But a clear distinction between intermediate goods, such as metals, and fixed equipment, such as machinery, has to be made, and the former must be preferred over the latter. Most of these industries are "heavy industries," and all of them can be classified as "producer goods industries." It is not improbable that the semantics problem of this classification is besetting the Indian planners. In the last twenty years, India wasted part of her investment on nonessential import-substitute industries. Now, it is possible to go to the other extreme and consider all producer goods industries equally essential. According to one official of the government of India, plans are being made to raise the production of machinery to Rs. 2,000 crores per annum from the present level of Rs. 300 crores. It is difficult to verify these figures; but if they are true, an incredible waste of resources seems likely, unless India happens either to invest per year at least one third of her national income or to become a major exporter of capital equipment.
More possibly, India will end up with more industries with huge excess capacities. Import-substitute industrialization, both in the fields of consumer and capital goods, seems to be thwarting India's development potential.
In India, agricultural development is the precondition of sustained growth. Unless the peasant is helped to produce more food and encouraged to sell a larger part of his production in exchange for industrial goods, a rising number of people cannot be given gainful employment in the nonagricultural sector. Though industry and agriculture are interdependent, the lever lies in the latter, because increasing industrial employment requires an increasing agricultural surplus. India's commercial policy seems to have ignored this fact.

**THE PEASANT IS IGNORED**

What India requires is reduction in expensive consumption and diversion of the resources to agricultural development. But as soon as imports of "nonessential" goods were cut down, imports of capital equipment to produce "nonessential" goods were freely granted. Indeed, expensive consumption in India has increased since the beginning of the five-year plans. This increase is quite natural, because imported goods with high tariffs and quota restrictions were generally very expensive. But when these goods are produced domestically, not only has the government lost the tariff duty but also the consumers are left with more money to indulge in expensive consumption. If a person could purchase only an imported refrigerator, now it was possible for him to buy both a refrigerator and an air conditioner. The Taxation Enquiry Commission suggested
in 1955 that "Indigenous industries which have developed under a protective tariff wall should be called upon to replace the loss of customs revenue on imports." But understandably this policy was not followed. Because it was no use protecting the industry and then imposing excise duties that would certainly stultify the industry because of the reduced demand. Import-substitute industries, therefore, expanded and extended the avenues of expensive consumption.

In the latter half of the 1950's the government of India had almost decided on the production of a "people's car" in the public sector. It was not found possible to produce a car that would be within the reach of the lower middle classes, and that inability was the only reason for shelving the scheme. However, the effort has never been given up, and in the next few years this objective may be realized.

The production of passenger cars in India during 1964 went up by 48 percent from 15,711 in 1963 to 23,226 in 1964. . . . Despite increase in production there is a great demand for cars and the government are considering the manufacture of a small car. A few proposals for production of small cars have been received and these are being examined by the government.\textsuperscript{2}

So also, a television service has been started, and now the production of television sets has begun.

The T.V. receiver designed and developed by the Central Electronics Engineering Research Institute is expected to have more than 85 percent indigenous components. It is estimated to cost about Rs. 800. An annual target of 1,000 receivers is expected to be reached within a year.\textsuperscript{3}
Now a new effort is being made to increase the investment in "consumer goods" industries by inviting foreign capital. The Finance Minister, T. T. Krishnamachari, recently made an explicit statement.

India needed a variety of consumer goods which it could not afford to import for want of foreign exchange. He therefore, called on them (foreign investors) to provide most sophisticated equipment with which Indian entrepreneurs could produce consumer goods in India itself. The Finance Minister said that a foreign investor had good prospects in India for at least twenty-five years.  

It is hard to believe, but it is possible, that Indian planners confuse "consumer goods" with "wage goods." India's greatest need was to conserve and expand the supply of wage goods, but the government mistook the production of "consumer goods" and mainly import-substitutes for economic progress. Had India channeled the investment into goods needed, wanted and demanded by the peasantry, the story of Indian development would have been different.

But the peasant is not at the center of industrial planning in India. Industrial investment was mainly for the benefit of the middle and upper classes. The city-based planning has all but ignored the potential market in rural India, which, incidentally, constitutes more than 80 per cent of the total population. One wonders whether the planned industrialization is helping at all to bridge the dual society inherited from the British. It is true that there is no ready demand for varied industrial goods in rural India, but the potential demand is certainly worth tapping, and the government of India does not seem to have left all the development effort to private enterprise; the government could have taken the initiative in stimulating and satisfying potential rural demand.
Moreover, where demand is abundant, the government does not seem to be acting more favorably to the peasant. When sugar is rationed, he is given only half the allowance that the city-dweller gets. India exports oilcakes (animal feed and fertilizer) and imports liqueurs, exports edible oils and imports petroleum for cars, exports sugar and imports household electrical appliances. Fertilizers are in such high demand that black marketing and adulteration are not infrequent; but in 1961 and 1962, imports of fertilizers were reduced because of an increase in the imports of long-staple cotton for superfine cloth. Cement exports are subsidized, while rural housing projects are held up for years because of the lack of cement and steel. Copra is an item of food in many parts of India. In the 1964-65 budget, the import duty on copra was raised while that on automobiles was reduced. The budget speech, of course, mentioned in passing, the "inadequate rate of growth of agriculture" and an instant cure "a new organization was established for the purpose of solving the disturbing problem of rising food prices."  

FREE FOOD IMPORTS

India's food production has not kept pace with the demand for food that is constantly rising because of the rapid increase in population and also some increase in per capita income. In the last twenty years, therefore, India has always been a net food importer. However, most of these imports have come from the United States under P.L. 480. For all practical purposes, these imports are free of charge; India pays for them nominally in rupees that are held in special account in the State Bank of India and are not supposed to be spent by the United States. India, therefore, got food from the United States not only without spending any foreign exchange but also without using any other resources.

There are only 3.5 million people working in factories that employ ten or more persons each.
Assuming that an average family consists of five persons, about 4 per cent of the total population earns its living from Indian industries. In the last sixteen years, India has imported food, on an average, to the extent of 4 per cent of her total needs. As a matter of fact, these imports were larger than the total food requirement of the industrial population, because often more than one person in a family works in an industrial establishment. A population of 35 million people, or a little over 7 per cent of the total, live in 110 cities with a population of 100,000 or more, and in the last four years about 7 per cent of the total food supply has been acquired from foreign countries. Most of it, of course, comes from the United States under P.L. 480. One can say without exaggeration, therefore, that the whole industrial and administrative superstructure in India is literally sustained by the costless food imports from the United States.

This method of supporting industrialization seems to be the main cause of distorted economic planning in India. The fact that industrial development in India must be subservient to the needs of agriculture and the agriculturist could not have been ignored for such a long time if the limited foreign exchange had to be spent on ever-increasing food imports. But the availability of food from the United States for a nominal price had somewhat obscured this point, pushed agricultural development in the background and smothered the population-control policies that would otherwise have been developed. It does not seem to be an accident that the government of India has taken its family-planning program seriously only since 1964, after reaching the possible limit of food imports under P.L. 480. The United States Government had almost underwritten the expanding Indian population by supplying food grains much in advance of actual need and not only for saving lives at the time of famine. Food exports were very satisfactory to the United States Government, because the huge costs of warehousing the stocks were saved and starving millions were retrieved to vote for the Indian democracy. This miserly philanthropy, however, did not do India
much good. American grants would have been less
damaging had they been untied dollar grants, to be
spent in any country and on any goods. Spending
these huge sums of money on food imports would have
at least made clear the opportunity cost of imported
food and would have helped Indian planners to devise
a better agrarian policy.

AGRICULTURAL PRODUCTIVITY

Since 1963, the government of India has had
to pay hard-earned foreign exchange for importing
extra food from Canada, Australia, Thailand and
Burma, and since then the industrial programs have
been, at least partly reoriented toward agricultural
development. A "crash program" of building ferti-
лизer factories is already under way, and some ef-
fort to encourage the use of agricultural machinery
is being made. Some dissemination of scientific
information has begun, and some useful agricultural
research has been made. But, by far, this effort
to change the face of rural India has hardly begun.
To be effective, this effort would have to be on
such a large scale that India would not be able to
invest in anything else (except, perhaps, defense)
for a long time to come. It is doubtful whether
the planners realize this point, and one bumper
crop, thanks to good monsoons, is enough to send
them back to their routine.

Very recently, the Finance Minister declared
in the Parliament:

The question is not so much of relative
emphasis on heavy industry and agricul-
ture, the resources that go into each
of these are by and large non-competi-
tive. . . . The fact that over 70 per-
cent of the population depends on
agriculture is an argument as much for
giving all facilities to agriculture
as for creating conditions in which
a rapid increase in non-agricultural
employment can be generated to relieve
the pressure on land. ... Industry has been growing at a rate somewhat in excess of 8 percent while agriculture has grown at a rate somewhat less than half as much and in the last three years, hardly at all. ... The lesson of the last three years is not that we reverse our strategy of the plan and slow down development, it is that we should continually strive to improve the returns from investment in every field so that the rate of growth of the economy is speeded up.6

But nothing short of a complete reversal of the present investment priorities is going to help Indian agriculture. It is not proposed here to present an estimate of essential agricultural investment, but it would certainly run into thousands of crores of rupees.

The Indo-German agricultural development project in Mandi district of Himachal Pradesh has resulted in a significant increase in agricultural production. In the demonstration plots the highest yield of maize was 95 maunds an acre as against an average of 12 maunds in the district; and the yield of paddy went up to 30 maunds an acre compared to the average of 12 maunds in the district. Besides providing the team of project experts, the West German Government has supplied equipment worth about $567,000 which includes agricultural implements, soil testing laboratory, small and medium tractors, and bulldozers for soil conservation work.7

Besides this equipment, the visiting German President had donated $105,000 for building a community center. The entire arable land in the district is 200,000 acres, and only 65 per cent of it
is to be covered by this project over a period of five years. On this basis, it will not cost more than 1,500 crores of rupees to look after all the arable land in India. But to make it possible to absorb this on-the-farm investment, the overhead investment in irrigation, electricity, roads, education and training, and in the production of fertilizers, tractors, insecticides, implements, steel, cement, petroleum and so on, would obviously be very large. Besides, investment in consumer goods desired by the peasants has to go hand in hand with increasing agricultural productivity. It is doubtful whether investment on this scale for the benefit of the agriculturist will be tried in the near future. What is lacking is the will to see the problem at all.

Perhaps, seeing and analyzing the problem is considered tantamount to solving it. Otherwise, it is difficult to explain the overanalysis of many agrarian problems by the officials. Here is an interesting example:

Dr. K. L. Rao, Union Minister of Irrigation and Power, drew pointed attention to the poor irrigation facilities which existed in south Bihar and urged speedy action to make up the deficiency. Bihar could be divided into three regions each of 14 million acres—the northern region, the southern region up to the range of the hills and the area lower than the hills; irrigation facilities had to be developed in all the areas.8

Mechanization of agriculture is not considered desirable in India. The use of modern machinery such as tractors, electrical pumps, or oil engines is insignificant, and a wooden plow and sickle are the only instruments used by 97 per cent of the farmers. The only source of power for 99 per cent of the farmers is a pair of starving bullocks. Apart from the problem of efficiency, mechanization
of agriculture is essential in India so that the draft animals on farms can be removed, releasing the arable land now used to support these animals. The Indian Council of Agricultural Research has suggested a need for raising the feed supply.

Notably an expansion of the acreage in special fodder crops by about five-fold (to 63 million acres, or about 15 percent of the total crop acreage as against 3 to 4 percent now) and nearly a tripling of the output of edible oilseeds. In addition, there is presupposed an effective campaign to make more efficient use of natural grasses. . . . (This program is) designed to meet more adequately the needs of a population of the present size.  

The social costs of mechanization, therefore, are bound to be much lower than the immediate and private cost-benefit calculations show. Agricultural productivity in India is about one third of that in other countries. If per acre production is increased from three to four times the present level, the animal draft power will become that much more expensive and mechanization will turn out to be much more economical even than in the advanced countries. Scarcity of land is at least as good a reason for mechanization of agriculture in India as the scarcity of labor in some other countries.

FOOD SELF-SUFFICIENCY

The government of India had announced that the first goal of the development effort would be to make the country self-sufficient in food production. This goal was to be reached in 1951. The government's intention was taken too seriously by some puzzled foreign observers.

The original goal was complete independence of food imports by 1951,
1950-51 might seem implied, but already in 1950 it was clear that 1951-52 was perforce meant and by 1951, "no imports" was interpreted as meaning no imports except to build reserves, to allow of diversion of land to other needed crops and to meet natural calamities.\(^\text{10}\)

Now a new target year for self-sufficiency in food has been set at 1971, by the end of the Fourth Five-Year Plan. One minor advantage of five-year plans is that target years for different attainments can be set and reset in multiples of five years.

Everybody knows that such a self-sufficiency by 1971 is extremely improbable, barring, of course, a few occasional years of bumper crops. None is more aware of this fact than the government itself; it is most probably evolving a new goal of earning sufficient foreign exchange to be able to pay for food imports.

It should be easy for us to understand the desire of some of the food-grain exporting countries to continue their exports to us and to buy from us number of manufactured goods in return. Therefore, in the long term, in the context of modern international trade, it may not be altogether feasible for us to think in terms of a total elimination of the imports of food and other agricultural products.\(^\text{11}\)

This generous statement was written by Saradar Swarn Singh, Minister for Food and Agriculture. The article ends, however, by promising self-sufficiency in the near future.

Our deficit in food-grains is only a small percentage of our total production which is now of the order of 80 million tons. Through efforts on the part of all concerned, this small gap
in our requirements can certainly be bridged in the next few years.\textsuperscript{12}

Such confusion of thought at the ministerial level is not necessarily discouraging; it only shows the blending of realism and optimism so often essential in political affairs.

More realism and much less optimism was exhibited by the Food Minister in an earlier statement.

Turning to the F.A.O. World Food Program, he said that this multi-national effort to use food to assist economic development should be put on a permanent footing as early as possible and should work hand in hand with bilateral and other multilateral programs. "There can be no real peace or happiness in the surplus countries as long as there is food deficit leading to hunger and malnutrition in any country" he said.\textsuperscript{13} [Emphasis supplied.]

To acquire free food from abroad on a permanent basis sounds very pessimistic, and one hopes that such a policy is really not intended. Most of this food has to come from the United States. It should be noted, however, that the American food surplus is huge only in relation to her own demand and genuine exports. Even if the 15 million acres of land that are kept fallow today are put under cultivation and the extra 10 million tons of wheat are shipped only to India each year, India's food problem can be "solved" for only ten more years, if, in the process, the population and agricultural problems are not further aggravated. This is obviously not a long-term, or even a medium-term, solution, even if all the complicated political problems involved in such a solution are dismissed as irrelevant.\textsuperscript{14}

Nor will India be able to pay for food imports by any conceivable export promotion. The
target production of cereals in 1971, that is, by the end of the Fourth Five-Year Plan, is 100 million tons. Even to make up a 10 per cent fall in production would take Rs. 750 crores, assuming the present food prices in the international markets and the present exchange rate for the rupee. This amount is little larger than the annual average export earnings of India in the last five years. To take another example, if every person in India were to get one imported egg per day, almost all the present export earnings would be required to finance such imports, assuming again constant exchange rate and the present international prices. Since 1963, India actually has been importing food worth over 45 per cent of her export earnings. These imports have been marginal and have not saved the millions of people from near-starvation and malnutrition. The population of 520 million is rising by 2½ per cent per year; and if agriculture remains stagnant, India will have to spend all her export earnings on food imports. Even if one assumes sufficient foreign exchange, there may not be enough food in the world to be purchased. India's development problem, therefore, is not so much to maintain a balance between agriculture and industry as to gear the whole industrial structure to the development of agriculture and to concentrate on population control.

Besides food, India imports many basic materials such as crude oil, sulfuric acid, nonferrous metals, timber, pulp, tanning materials and many other agricultural raw materials. These imports are difficult to replace by domestic production, at least on the basis of the present information and the presently available technology. The search for oil, gas, copper ores, sulfur and other minerals is in full swing, but no sensational discoveries have been made as yet. India may possibly have great oil fields, and occasionally it is announced by the officials that one city or another is sitting on an oil keg. Self-sufficiency in all petroleum products by 1971 is already predicted by the Minister of Oil and Natural Gas. This optimistic prediction, though useful for bargaining with
the monopolistic exporters in the oil world, is not likely to come true even in 1981. India's long-term import-dependence seems to stem from the scarcity of natural resources, including arable land.

Besides minerals, India has to import long-staple cotton, raw jute, raw rubber, vegetable oils, copra, some kinds of tobacco, spices, timber, dried fruits, fish, silk, raw wool and so on. In the last five years, imports of raw cotton alone amounted to Rs. 60 crores per year; domestic production of raw cotton is rising, but it is rising at the cost of short-staple, exportable cotton and food grains. The same is true of raw jute, most of which was imported from Pakistan before 1950. The goals of attaining self-sufficiency in agricultural raw materials and also in food production seem to be almost incompatible, unless one assumes an unprecedented rise in agricultural productivity.

In the face of all these unavoidable imports, the goal of food self-sufficiency seems to be quite desirable. It may be worthwhile to discourage or even to ban exports using any resources that can be alternatively used for food production. Besides transferring land from cash crops to food crops, such elimination of exports will raise the relative price of food. This indirect subsidy to food farmers may help to raise India's food production. If an absolute increase in food prices leads to inflation, some device to give a better deal to the food farmer has to be sought. The government of India's present policy of holding down the prices obtained by the farmers is not ideal.

In India, the middle classes—the factory-employed labor, businessmen and, of course, the Indian planners—are quick to denounce any rise in food prices, and exhortation is considered a sufficient incentive for the farmer to grow more and eat less food. Low food prices are so firmly assumed by industrialists that they are on record as advocating a change-over to cash crops for increasing the farmer's income. Planners are busy denouncing speculators, speeding up transport,
opening fair price shops, controlling interstate trade in food grains and using other administrative devices to hold down food prices. One wonders whether they see the problem from the point of view of the peasant at all. For example, a member of the Planning Commission in the middle of a technical paper says, "An increase in the price of cereals bears very heavily on the poorer people in India; and it is of great importance to prevent this."17 But poorest of all is the food farmer, who is essentially a forgotten person in India.

Indeed, food-growing is not an economic proposition in India. Any other cash crop such as jute, tobacco, cotton, sugar, rubber, tea or oilseeds and sometimes even grass can bring in more money than the food crop, acre for acre. Much food production, if not all, is due to the fact that the farmer has to grow food for his own consumption, that he is too traditional and ignorant to change the age-old routine, that some land is specific for food crops such as rice land and, perhaps most importantly, that he lacks the necessary capital to effect the change-over. A better farmer generally turns to cash crops and looks down upon food farming. He gets credit more easily; he gets more stable prices for his produce; the market for his product is better organized; he absorbs most of the agricultural investment and finally, being comparatively affluent, he influences the political process that shapes agricultural policies. In the land of perennial food crisis, the social status of the food farmer is much lower than that of the cash crop farmer. The food farmer is not only ignored by the Indian planners, he is humiliated. This situation must be changed if the goal of food self-sufficiency is ever to be attained.
CHAPTER 8

PLANNING AND PRICE MECHANISM

Generally speaking, the defects in India's commercial policy are due to a defective strategy of development. There seem to be two main shortcomings in the development effort. First, agricultural development has not been given sufficient emphasis and, second, not enough use has been made of the price mechanism.

CONTROLS AND PRICE MECHANISM

India is officially a socialist country. But its socialist policies have backfired. There is neither more socialism nor any sign of sustained economic growth after twenty years of developmental effort. Asok Mehta, the Minister for Planning and Development, has himself made this point:

India's planned edifice is democratic, it is socialistic, it tries to husband human resources, it seeks to enmesh agriculture and industry together, it boosts the public sector, it endeavors to energise all economic activities with evolving technological skill and finally it restricts population growth. These basic principles are easy to inscribe, they are difficult to implement. In spite of a number of visible indicators of progress, we have not found it easy to make our administration either responsive to democratic pressures
or development-oriented. Our agriculture, in spite of much attention, remains as freakish as our monsoon. Economic disparities continue to defy attempts at containing them.¹

One of the main reasons for this failure is the so-called socialism that did not respond to the needs of the peasants, who form 80 per cent of India's population. India's industries are concerned, directly or indirectly, with the production of import-substitutes which were desired mainly by the middle and upper classes.

India seems to be more interested in who is to produce than in what is to be produced. Anything produced in a public sector is hailed as essential production. Bharat Electronics, a government enterprise, produces telephones, watches, radios, walkie-talkies and other electrical and electronic appliances. The Third Five-Year Plan target of 300,000 telephones per year has already been overshot and is now reset at 400,000. Hindustan Machine Tools, another public-sector enterprise, will be producing "unique, sophisticated machinery, mainly wanted for the automobile industry."² Another government enterprise produces television sets at Rs. 800 per set. India's per capita income is Rs. 400 per year.

Many import-substitute industries that helped to maintain and expand expensive consumption were private enterprises. They were obviously profitable because of the faulty import policy that restricted "nonessential" imports but encouraged the imports of machinery to produce the same goods. Besides the mistaken belief in costless labor and the political pressure of the middle classes, the "socialistic" industrial policy seems to have been responsible for distorted investment priorities. In April, 1948, the Indian Parliament gave an important directive to the government of India: the well-known Industrial Policy Resolution. This resolution limited the sphere of private enterprise to "consumer goods" industries, and all the "heavy
and key" industries were reserved for governmental investment. Since then, the resolution has twice been modified, in 1956 and in 1964. But still, industries such as iron and steel, petroleum refining, fertilizers, aluminum, electricity, transport and many other technologically large industries are not open to private enterprise. The industrial policy, in effect, has diverted private investment to "consumer goods" from the industries required for development. In other words, the industrial policy of the government loads the dice in favor of high consumption rather than high saving and investment. The advantage of having an automobile industry in the private sector and steel industry in the public sector is never made clear. If it is a question of controlling the private sector, an exactly reversed arrangement can, perhaps, be equally justified.

The fact is, to be able to control and regulate the economy, a government need not own any property, not even the buildings where its offices are housed. It is high time that the Indian Government slough off the nineteenth-century confusion between ownership and control and divert all its energies to the regulatory functions of government. Governmental activity in India expands because the government cannot govern. To curb profiteering and to ensure equitable distribution of some scarce goods like cement, the government has expanded state trading; to stop fraud in the insurance business, it has nationalized insurance companies; fed up with excessive competition in aviation, it has nationalized all air transport. Railways were already nationalized by the British; but annoyed by the poor bus service, it has nationalized almost all bus transport. The largest bank in India is already nationalized, and the nationalization of the rest of the banks is in the offing. None of the already-existing industrial enterprises are yet nationalized, but almost all the large enterprises are being built and managed by the state. These new economic activities of the government have led it to ignore its primary tasks.
It may be true that government enterprises today are more efficient than those which were displaced, perhaps because in India, government service attracts better people than private employment. To the extent, therefore, that the government expands its activities, the private sector could become more inefficient, creating a further justification for enlarged governmental activity. This vicious circle, however, could not last long, because sooner or later the average level of official personnel must come to the national level. To be able to perform their regulatory functions and to be able to educate and direct the majority of the people, the governments in backward countries have more reason not to overextend themselves than in the advanced countries.

Government officials enjoy controls because they bring in arbitrary power, an expanding staff and, above all, a pleasant sensation of being a prime mover of national development. Otherwise, it is not clear why the government of India so overwhelmingly preferred quantitative controls to tariffs for restricting imports. This procedure led to inexplicable variations in imports, the loss of possible revenue, ever-increasing controls to stop profiteering in import business, justification of state trading, distortion of the domestic price structure and encouragement of speculative activity. Quantitative restrictions may be more suitable than price adjustments through tariffs for swift and temporary changes in imports, and for avoiding uncertainty regarding the possible expenditure of foreign exchange or for precise coordination of imports and domestic production of import-substitutes. But restrictions in India were not always for such justifiable reasons.

Even when tariffs were used, along with quantitative controls, they were so devised as to increase an arbitrary interference in the economy. One can understand "essential" and "nonessential" classification of imports, though these terms were nowhere clearly defined. But after such a
classification, one would expect uniform tariff rates in each class of items. But, in India, liquors are taxed at 112 per cent ad valorem, whereas wines are taxed at 33 per cent. Cigarettes are taxed at 76 per cent and betel nuts at 154 per cent; perfumes at 37 per cent and glassware at 54 per cent; watches and clocks at 72 per cent and motor cars at 55 per cent; gasoline at 89 per cent and electrical goods at 25 per cent.Obviously, some official must be evaluating different goods on some scale; but this explanation is not available to the public except in a few cases where taxes were recommended by the Tariff Commission for the protection of domestic industries.

In a certain sense, the government is over-responsive to democratic pressures; controls are popular in India and governmental intervention is invited by the people, not only in economic affairs but also in social, artistic and religious affairs. One can meet any articulate person at random and find him complaining against the government for not intervening in this or that. More controls are urged to overcome speculation, to bring down prices, to stop population growth, to ban cow slaughter, to eradicate flies, to punish vagrant wives or to help marriageable girls get husbands. Indian statute books are full of laws against all social evils, including the caste system, acceptance of dowry, begging, betting, drinking, usury and so on. The government is expected to encourage literature, drama, music, cinema, dancing, painting and sculpture. The annual awards in different fields stamp national recognition on artistic creations. Great artists receive pensions from government, and folk singing and dancing functions are subsidized by the government, changing, perhaps, the very meaning of folk art.

The government in India has a prestige no other nonofficial organization can claim. Educated classes, absorbed mostly in government service, give the government a strong hold over public opinion. Perhaps, a call for governmental action
is due to the impatience of the people, who want to rapidly advance to catch up with the rest of the world--essentially a hangover from stultifying foreign rule. It is also possible that opposition to "progressive" legislation is considered imprudent, as one can always get around laws and regulations if they happen to be inconvenient.

Most of the time, the feeling behind governmental intervention is laudable; but, apart from encouraging private action, official involvement in all aspects of social life does not seem to be either desirable or necessary. Most of the pious laws are dead letters, and government-sponsored activities are often rackets. Being ubiquitous, the government makes itself available to be blamed for all the real and imaginary troubles of the people. Riots that generally destroy government-owned property perhaps indicate that the government in India promises too much, does too little and succeeds in destroying the self-reliance of a great many people.

That the people expect the government to use its power for creating a better society is indeed a healthy sign. This desire demonstrates that Indians are not as fatalistic as they are said to be and that they are aware of the effectiveness of human action in improving material welfare. The real difficulty lies with the official and unofficial experts who think that everything can be straightened out by more and more controls. People can give the government only a broad mandate; they themselves cannot suggest correct social action. Thus the government and the experts have to bear the major blame for using power indiscriminately.

FLOATING EXCHANGE RATE

In the field of commercial policy, the most important source of frustrating restrictions is the artificial rate of exchange. This high rate is maintained by strict exchange controls and
multifarious interventions, not only in foreign trade but also in other economic transactions. All this effort seems to have harmed rather than helped Indian economic development.

In June, 1966, the Indian rupee was devalued by 33 per cent, from 21 cents to 14 cents to the rupee. In other words, before 1966 the rupee was overvalued, according to the government, by 50 per cent. This fact was known to everybody concerned since 1954, and the government's decision to remedy the situation came rather late. Moreover, it did not go far enough, because the rupee is still overvalued by about 20 per cent, if black-market rates are any guide to its real value.

The value of the rupee was fixed at 18 pence by the British in 1929 when Britain went off the gold standard. Since then, until June, 1966, for thirty-six years, the exchange rate between the rupee and sterling was maintained intact. In September, 1949, sterling was devalued; the Indian rupee too was devalued vis-à-vis the dollar, but, again, the sterling-rupee rate was kept constant. The Great Depression, booms, recessions, World War II, the Korean conflict, the independence and partition of India, the population explosion, Chinese aggression and the three five-year plans have all gone by without leaving any scar on the pegged rate of exchange. It would be a miracle if the rate of exchange was anything but artificial.

The 1966 devaluation was not popular in India, and it was considered a bold move on the part of the new prime minister. One of the reasons why the low exchange rate is not liked in India, and in many other developing countries, is that the traditional exports to advanced countries become unnecessarily cheap. But this result is not inevitable. All traditional exports can be taxed, and foreign prices of such exports can be maintained at the desired level even after devaluation. This policy is exactly what the government of India followed in 1966. These new taxes have improved
the government's fiscal position, but the exact measure of this improvement is not yet available. A good part of this money was lost in the last twelve years to those who imported foreign goods, because importers are the beneficiaries of the high exchange rate, unless an equivalent amount was collected by taxing the imports. Furthermore, a high exchange rate is an implicit tax on all export items; it seems uneconomic to tax exports of modern manufactures and also of many other items that can be considered as luxuries in India, because India's capacity to maintain agricultural exports is bound to decline in coming years. India has much scope to use fiscal measures for reducing domestic consumption of exportables and for promoting exports without increasing production. The high exchange rate, indeed, amounts to a subsidization of domestic consumption of luxury goods which India can ill afford.

There is a widely held popular belief in India that a low exchange rate makes the country pay more for its imports, and, therefore, when imported capital goods cost more, economic development is in jeopardy. It is true that the individual importer in terms of his domestic currency would pay more, but the country as a whole would be paying more only if exports also were comparatively cheaper in a foreign currency. If exports are taxed, the extra money that the importer has to pay comes back by way of the export tax and the country as a whole does not lose. Whether or not the country would pay more could only be ascertained by examining the change in the terms of trade, which are certainly not determined by exchange rate alone.

That capital goods will cost more to individual producers is not necessarily a disadvantage. To keep the currency overvalued is to give a continuous and indiscriminate subsidy to imports of capital goods. This policy is surprising in India, where the government favors labor-intensive methods of production, because labor is supposed to be in unlimited supply. One of the reasons for the
foreign-exchange barrier is indeed the indiscriminate importing of all sorts of capital goods, and better screening of imports may help the development effort. When abundant investment projects that do not require imported machinery are held up because of a real fear of inflation, none need fear slackening investment caused by the high prices of imported capital goods. If imported equipment costs more, the foreign-exchange bottleneck will be widened, investment priorities can be more clearly determined, replacement will be more cautious and maintenance more careful. The use of complex automatic machinery to produce soft drinks or cosmetics creates a foreign-exchange barrier for the investment in steel plants or fertilizer factories. In India, the old manual method of making carbonated water is already obsolete, and one can see expensive imported machinery producing soft drinks even in small towns. Indian textile mills have been able to find only one way to maintain competitive prices in the international market, that is, by using up-to-date automatic machinery imported from the United States. With a lower exchange rate, such use of capital-intensive methods may turn out to be uneconomic and more capital can be used for a better purpose.

It could be argued that, in spite of overpopulation, India needed capital-intensive methods of production, and the government encouraged, albeit unwittingly, a desirable choice of techniques by maintaining a high rate of exchange. But an indiscriminate subsidy on all the imports of capital goods means a confusion between the choice of techniques and investment priorities; explicit subsidies for specific projects would certainly be more helpful to development.

Cheap imports of capital goods are likely to discourage the domestic production of capital goods, and this possibility also seems to have gone unnoticed. It is unnecessary to give preference to capital-goods industries, but it is not necessary to discourage them either, by subsidizing the prices of imported equipment. A correct rate of
exchange may assist the capital-goods industries in determining their comparative advantage.

A pegged exchange rate has rendered the price mechanism ineffective, has distorted economic priorities and has kept the government preoccupied with ever-growing controls. If India maintained a floating exchange rate, with a temporary support for smoothing out erratic fluctuations and, perhaps, with some exchange controls for regulating any outflow of capital, it would be possible to use commercial policy more effectively for economic development. Indeed, no other single measure would be more helpful in combating India's multifarious economic ills than a freely floating exchange rate. It should be noted, however, that the case for a floating exchange rate for a developing country like India does not rest on the grounds of laissez faire; it is sufficient to consider the administrative inefficiency and ineffective controls that go with the artificial exchange rate. If India restricted her imports by replacing quota restrictions with increased tariffs and imposed export duties on her few traditional export items, a floating exchange rate would be easier to maintain and more helpful to developmental planning than the intricate trade and exchange controls used in the last twenty years. The artificial exchange rate is the single greatest source of sterile governmental intervention in the economy.

NEED FOR GOVERNMENTAL INITIATIVE

Governmental initiative and regulation is certainly necessary in a country like India if she is ever to rise out of the quagmire of poverty. But at the same time, controls that collide head on with basic economic forces are not likely to be effective. The trick is to integrate the controls with the market mechanism. The difficulty in India is not that there are controls but that they throw the price mechanism askew.
The government in India has enough work to do even if it sticks to the theory of minimum government. It is a great job in India to see that the generally accepted rules of the game in a complex economy are observed by all the economic units. Because of the all-pervading poverty, ignorance and official regulations, even ordinary honesty and decency become rare in economic dealings in India. When food prices cannot be raised because of price controls, traders and farmers make up the loss by adulteration, false weights and black-marketing.

Government sampling indicates that more than 20 percent of all food sold here is adulterated. Any rice merchant who fills a bag all the way up with rice is considered a silly goose. . . . Some of the practices can be dangerous. Mustard seeds used for flavoring are often adulterated with argamone seeds which look the same but are highly toxic. Inspectors find 39 percent of all milk sold is mixed with some other liquid, usually unfiltered water, filled with disease producing bacteria.5

India has had a law against adulteration since 1955 but the gap between legislating laws and enforcing them is very wide. Taxes in India are as commonly evaded as they are paid. The Indian laws prohibiting liquor have given birth to a vast private enterprise, and most probably a larger number of people drink today than before the days of prohibition. Unless the government's basic work of enforcing the laws is fully and properly done, the development effort is not likely to succeed.

Besides creating the legal atmosphere and proper conditions for private initiative, the government in India has to get involved in direct developmental effort. In a backward country, it is not enough to devise an incentive tax system or to give liberal grants or to manipulate monetary policy to bring forth a desired response from the
people. Direct governmental initiative to supplement and encourage private effort is needed. It is impossible, for example, to solve India's population problem without intensive governmental effort, and agricultural development is not likely to occur in India without official help. These problems cannot be solved by passing laws or by relying on exclusively private effort.

Generally speaking, government initiative is required to develop and bolster the lagging sectors in the economy. In a growing economy, all the sectors do not grow at the same rate; all the factors that constitute growth do not respond to the desired extent. The lagging sectors and the slowly responding factors in the economy hold back the whole development process. Development planning has to begin, therefore, in the lagging sectors of the economy. In overpopulated countries, when the level of income rises, the death rate falls rapidly, but the birth rate continues to remain high. The consequent rapid increase in population swamps the development effort, and very little improvement in the standard of living can become possible before the birth rate is reduced. No private organization can invest in this effort, because the benefits of the reduced birth rate cannot be reaped to a significant extent by any single private agency. But when the government invests in this project, its contribution to economic progress is obviously very high. Supplying clean water, cheap electricity and feeder roads, training the labor force and disseminating useful information are some other sectors that may not attract sufficient private effort, but these lagging sectors hold down the general development. In India, the most lagging sector is agriculture in general and food production in particular. Governmental effort must concentrate on this sector. By and large, industrial development can be left to private incentive; the main hurdle is the stagnation in agriculture that has to be removed by a planned effort. The government of India has concentrated on the leading sectors in the economy such as steel
production and has left the peasant alone. Given demand and the facilities to raise capital at home and abroad, the private sector would certainly produce enough steel, because steel production, especially in India, is profitable. Government initiative is required to influence the behavior of millions of farmers and to channel investment in rural India. Planning, of course, cannot be confined to agriculture, and the planners will need to define priorities in industrial development also. Industrial planning is mainly required to sustain agricultural development. To be able to invest enough in fertilizer and tractor factories, it may be necessary to reduce investment in automobiles or refrigerators. But nothing more than licensing, subsidies and excise taxes is required to elicit industrial response to the demands of agriculture.

Notwithstanding all the talk of planning in India, it is doubtful whether the lagging sectors of the Indian economy received any sustained attention from the planners. Rapid growth cannot be achieved unless the government of India evolves and implements proper policies with respect to population growth and agricultural productivity. Exhortations, controls, rationing, state trading, nationalization of industries, high taxes or even building of a few spectacular factories does not constitute planning. Developmental planning consists of evolving policies that will create high material incentive for the majority of people to make decisions they would otherwise not make and to use governmental power and finance to underwrite growth in the lagging sectors that would otherwise grind down the engine of growth. The shortcomings in India's commercial policies are, generally speaking, attributable to the lack of economic planning.
NOTES

NOTES TO CHAPTER 1


5. Beef is the most expensive food, in terms of agricultural inputs. Due to a religious taboo, Indians do not eat beef; eventually, this may turn out to be an important factor for furthering industrial development in India by keeping down the income elasticity of demand for food.

6. This point does not seem to be widely appreciated; Professor Bhagwati, for example, would like to rule out consumption of luxury goods.

7. "If there is no hope of prices falling as fast as productivity increases, the capitalists' next best move is to prevent the farmer from getting all his extra production. . . . A state which is ruled by peasants may be happy and prosperous, but it is not likely to show a rapid accumulation of capital." W. Arthur Lewis, "Economic Development with Unlimited Supplies of Labour," *Economics of Under-development*, ed. A. N. Agarwal and S. P. Singh (London: Oxford University Press, 1958), pp. 433-34.

8. This, it seems, is the main basis for the espousal of the doctrine of unbalanced growth. "Countries fail to take advantage of their development potential because they find it difficult to take the decisions needed for development in the required number and at the required speed." Albert O. Hirschman, *The Strategy of Economic Development* (New Haven and London: Yale University Press, 1961), p. 25.

9. "Indian exports can only be expected to drift along, as they have done in the past, a downward curve, despite the increasing number of expert bodies and export promotion councils that may be appointed to reverse it. It is better part of wisdom to accept this unwelcome and brutal fact and to prepare to live with it." S. J. Patel, "Export Prospects and Economic Growth: India," *The Economic Journal*, LXIX (1959), 502.

10. Professors Gustav Ranis and John C. H. Fei assume landlordism, and hence their analysis of subsistence wage, commercialization of agriculture and turning points does not seem to be applicable to most of the developing countries today.
11. "In the process of economic development the distribution of incomes is altered in favor of the saving class. The major source of savings is profits and if we find that savings are increasing as a proportion of national income, we may take it for granted that this is because the share of profits in the national income is increasing." Lewis, op. cit., p. 416.

12. The problems created by wilfully changing the employment levels are ignored for the sake of simplicity.

13. Indeed, in Professor Sen's model, the capitalist uses machines to produce "corn" by which he means wage goods. But the main wage good, food, is produced by the peasants. So the capitalist, unlike in Sen's model, can only produce this indirectly, by renting out the machines and supplying the peasants with manufactured wage goods in exchange for food. The capitalists, if not a capitalist, in a subsistence economy, should be more interested in increasing the marketable surplus of the farmers than in increasing their own reinvestable surplus; because the latter is useful only if the former is forthcoming. Cf. A. K. Sen, Choice of Techniques (Oxford: Basil Blackwell, 1962).

14. An historian has noted unmechanized horrors on the plains of India and China where men and women are "living lives little better, to outward appearances, than those of the cattle that toil with them by day and share their places of sleep by night." T. S. Ashton, The Industrial Revolution: 1760-1830 (London: Oxford University Press, 1960), p. 161.

15. "Rising prices and lagging wages provided capital and gave strong incentives to use it capitalistically. . . . It will be interesting to see whether economic planners for underdeveloped areas can hit upon a more effective device for either restraining consumption or inducing investment than rising prices and lagging wages." Earl J. Hamilton, "Prices as a Factor in Business Growth," The Journal of Economic History, 1952, pp. 338, 348.
NOTES TO CHAPTER 2


7. "Black tea, i.e. fully fermented tea, which contains less tannin than green tea, is generally recognized as suitable in the diets of most people, even when other beverages are barred for reasons of health." V. D. Wickizer, *Coffee, Tea and Cocoa* (Stanford, California: Food Research Institute, Stanford University, 1951), p. 7.


NOTES TO CHAPTER 3

2. India News, March 6, 1964, p. 3.


5. India News, March 27, 1964, p. 3.


8. Quoted in ibid., p. 128.


NOTES TO CHAPTER 4

2. Ibid. (July, 1950), p. 66.


4. Ibid. (December, 1953), p. 1783.


10. Ibid. (December, 1956), p. 1829.


NOTES TO CHAPTER 5

1. See Table 1, p. 24.


10. India News, April 10, 1964, p. 3.


15. No emphasis is placed on the conclusions based on the quarterly data because the data were collected from different sources and were not properly collated.


NOTES TO CHAPTER 6


10. Comments by Lala Sri Ram, reported in *Proceedings* (Calcutta: Federation of Indian Chamber of Commerce and Industry, 1953).

11. Comments by Chandulal P. Parekh, reported in *Proceedings* (Calcutta: Federation of Indian Chamber of Commerce and Industry, 1953).


21. S. Kumarsundaram, "The Balance of Payments Implications of Industrial Production: The

22. India News, March 6, 1964, p. 3.


NOTES TO CHAPTER 7


3. Ibid., March 26, 1965, p. 3.

4. Ibid., January 22, 1965, p. 3.

5. Ibid., March 6, 1964, p. 3.


12. Ibid., February 7, 1964, p. 5.

13. Ibid., December 6, 1963, p. 5.

15. See Table 12, p. 114.


NOTES TO CHAPTER 8


2. *India News*, March 26, 1965, p. 3.

3. These effective rates were computed by the Taxation Enquiry Committee for the year 1953-54. Similar rate differentials exist even to this day, but computation of precise effective tax rates, as opposed to nominal rates, is a laborious task. See *The Report of The Taxation Enquiry Committee* (New Delhi: Government of India, 1955).

4. For example, see G. B. Jathar and K. A. Jathar, *Indian Economics* (London: Oxford University Press, 1957), p. 311. This work is a popular textbook in Indian universities.


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