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CENTRAL INTELLIGENCE AGENCY

Memorandum

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INDIA'S ECONOMY
AND THE
SINO-INDIAN CONFLICT

14 December 1962

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OCI No. 4061/62

14 December 1962

CENTRAL INTELLIGENCE AGENCY

MEMORANDUM: India's Economy and the Sino-Indian Conflict

1. India's emergency defense effort will place heavy demands on an economy already faltering under an unwieldy economic development program. The economy was lagging when the border crisis broke in October, at least in terms of the economic growth charted by Indian planners under the Third Five-Year Plan (1961-66). Serious lags in production and shortages of domestic resources had developed during the second year of the plan; India's chronic foreign exchange shortage, moreover, seemed to be getting worse rather than better. Indian estimates of the foreign aid needed under the \$23 billion plan were being raised from \$5 billion to more than \$6 billion.

2. Indian planners now must add the costs of an extensive military buildup to the costs of economic development. Neither can be shortchanged, for Indian leaders believe that progress in basic development is not only an economic and political necessity in itself but is as essential to a sound defense as men and guns.

3. The core of the problem, however, does not lie in the foreseeable increases in direct outlays for defense, even though these expenditures are likely by 1966 to total some \$1 billion more than New Delhi had planned to spend before the Chinese attacked. The bulk of this additional direct expense could be met in theory from domestic resources, and if the present upsurge of wartime patriotic fervor is maintained and properly channeled such resources could, in fact, become available.

4. The real problem is the indirect, gradual effects of the reallocation of Indian resources and stepped up defense production on normal economic activity

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including government planning. The Indian economy as a whole is only slowly emerging from an underdeveloped to a more modern industrialized state. The size and the religious, cultural, and linguistic complexities of India's population make it difficult to coordinate the activities necessary to carry out successfully the programs outlined in the government's Five Year Plans. Planning for new factories has tended to overlook the necessity of supplying them with raw materials and of carrying away manufactured goods. Any plan to add further capacity to already underemployed factories would only complicate the problem. The immediate need is to enable existing defense plants to be put to more effective use. Here, however, we believe that India's planners will run into at least two areas where India's resources are inadequate even under present conditions: transportation and industrial power.

5. India depends on rail shipment for the bulk of its commodity distribution, and the rail system--particularly the supply of rolling stock--has never been adequate to absorb an overload on one part of the system without forcing a substantial cutback somewhere else. During the next few years India still will not be able to produce the locomotives and rolling stock necessary to cushion its distribution system from the effect of a prolonged shift in the peacetime patterns of use of railways, and its road system will remain inadequate to permit the use of trucks on the required scale were motor transport to be tried as a substitute. Even the present strain resulting from abnormal shipments over the single-track link to Assam and the fighting front should soon produce significant dislocation in some other part of the system. Such dislocation can spell trouble in one or more of India's food deficit areas.

6. Regarding industrial power, rail transportation again becomes a major factor where coal is concerned. Electricity too is in short supply--so short that even an extension of the work week to utilize fully existing defense production capacity would require rationing of electric power and consequently a dislocation of other industrial production.

7. Indian Government officials have already announced that the government intends to concentrate on heavy industry, transportation, and military

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production and that there will probably be cutbacks in the fields of public health, education, welfare, and non-essential goods. The Congress Party's executive committee, probably concerned over the impact this austerity program will have, recently issued a statement emphasizing the role of "the people" in gearing the whole economy to the needs of the new emergency. It stressed the necessity of intensified programs in rural areas to construct minor irrigation works, improved water supplies, and roads as part of the "war effort."

8. In the present flush of patriotic fervor, the Indian peasant may respond to these exhortations and engage energetically in programs of village uplift. He may also volunteer for various activities in the hope of obtaining employment and two square meals a day. To some extent, as in the case of the already heavily subsidized but still underemployed handloom weaver, he may be provided with the means of increasing his production. For the most part, however, the next year may find many of India's 300,000,000-odd peasants discovering that they are expected to construct their irrigation works without cement, that their anticipated village health unit will not materialize for lack of drugs and medical personnel, that their new school teacher will not arrive, and that the fertilizer and improved tools they had ordered will not reach them because fertilizer factories have been converted to war production, and iron and steel are no longer available for village use.

9. All this does not necessarily spell a decline of Indian living standards. Growth will continue, but probably not as fast as the Indian voter--particularly the awakening peasant--has come to expect. An eventual drop in morale therefore seems likely, especially if there is no new fighting on the border. Behind the danger of declining village morale lies the possibility of losses of food production. The complications that could ensue in India from this danger need no elaboration.

10. The outlook is not good. Whether the actual situation becomes as grim as the possibilities suggest depends in a major way on the amount of foreign exchange the Indian Government has available to buy foreign goods to fill the gaps that reallocation and dislocation

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seem certain to make in the country's economic structure. The prospect in this area is not promising, either.

11. India's foreign exchange holdings have been dropping steadily since 1947. As of October 1962 they stood at only \$195 million, a decline of about \$100 million in the past year. The immediate impact of the fighting has been to depress prospective earnings from tea, and the defense program is likely to reduce exports of cotton textiles and jute, two other major foreign exchange earners, through increased domestic consumption. In the case of tea, the damage may last for the next several years, because supervisory personnel were evacuated from the plantations in northeastern India, and maintenance will not be up to par. Meanwhile some \$59 million worth of tea is spoiling while awaiting shipment because of processing problems and lack of transport.

12. India's chances of obtaining a significant increase in foreign aid beyond needs envisaged for the lagging Third Five Year Plan are uncertain. The United States and other members of the Aid India Club have committed about \$2.5 billion for the first two years of the Third Plan, but previously anticipated foreign exchange requirements for the same period are still greater than this by some \$300 million.

NOTE: Attached are five charts illustrating the recent development of the Indian economy.

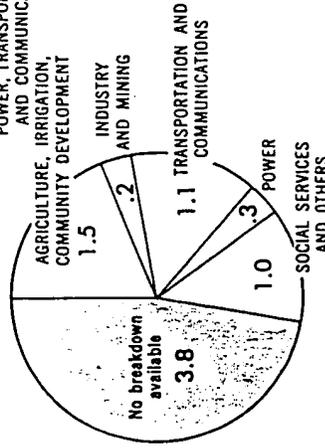
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INDIA'S FIVE-YEAR PLAN EXPENDITURES, 1951-66

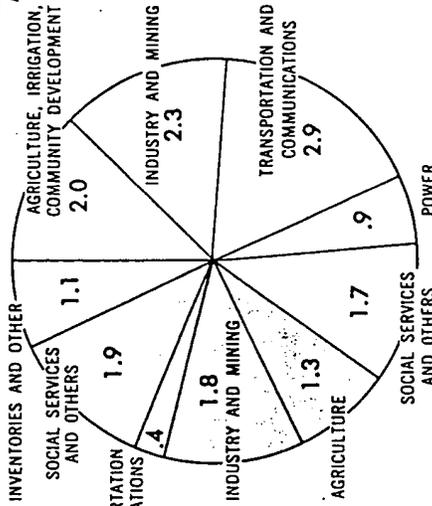
- PUBLIC SECTOR*
- PRIVATE SECTOR

(Billion current US dollars)



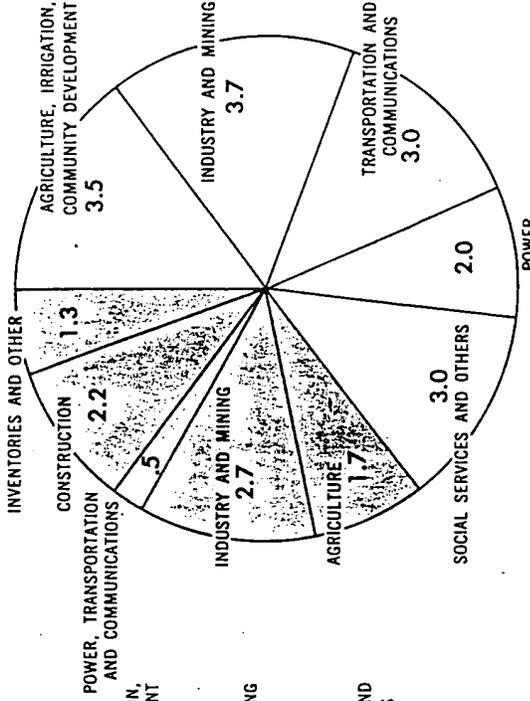
FIRST PLAN—1951-56

TOTAL = 7.9 Billion
 Public Sector = 4.1
 Private Sector = 3.8



SECOND PLAN—1956-61 (Estimated)

TOTAL = 16.3 Billion
 Public Sector = 9.8
 Private Sector = 6.5



THIRD PLAN—1961-66

TOTAL = 23.6 Billion
 Public Sector = 15.2
 Private Sector = 8.4

*Approximately 80 percent of public sector expenditures are investments and 20 percent are current outlays for economic development.

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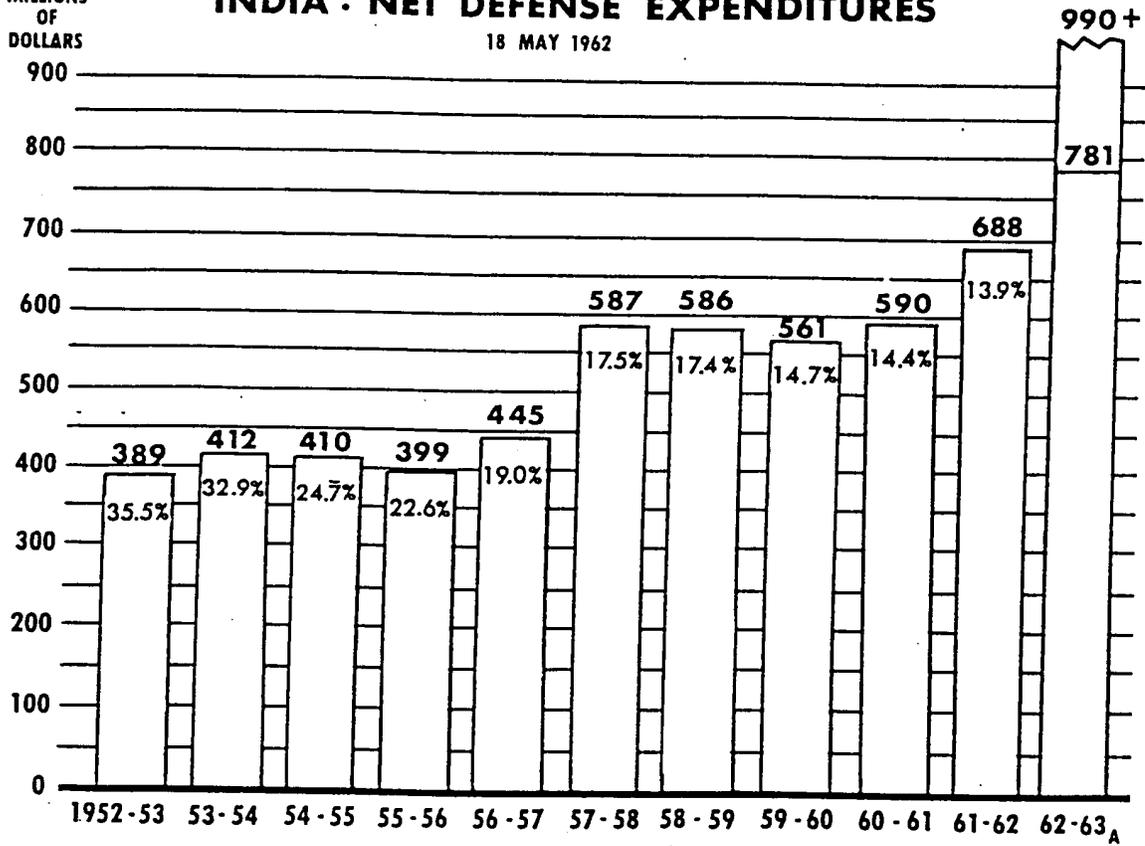
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MILLIONS OF DOLLARS

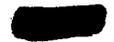
INDIA : NET DEFENSE EXPENDITURES

18 MAY 1962



A - ADDITION BASED ON SUPPLEMENTARY APPROPRIATIONS NOV. 62; WILL PROBABLY RISE STILL FURTHER BEFORE THIS FY HAS RUN ITS COURSE.

00.0% PERCENT OF TOTAL BUDGET

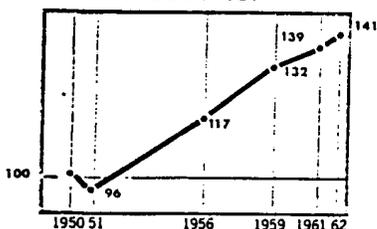


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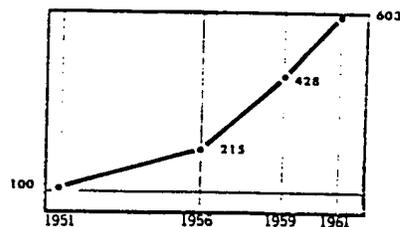
27

INDIA: PRODUCTION INDEXES

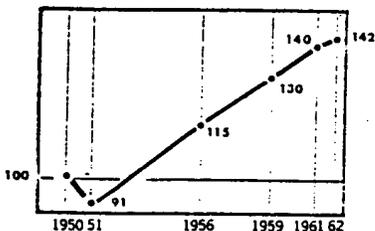
ALL AGRICULTURAL PRODUCTION



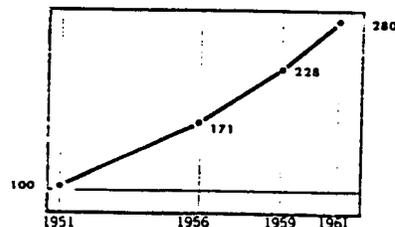
MACHINERY



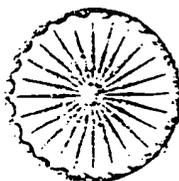
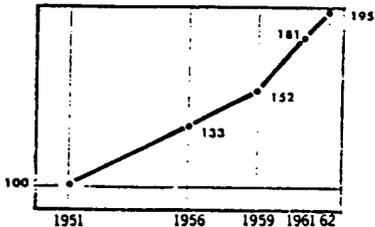
FOOD-GRAIN PRODUCTION ONLY



CHEMICALS

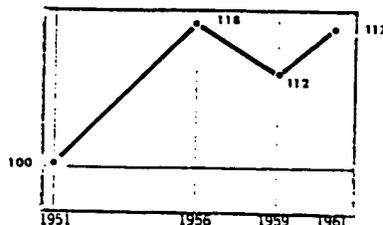


GENERAL INDUSTRIAL

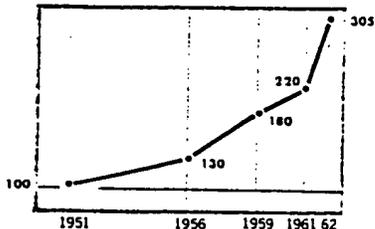


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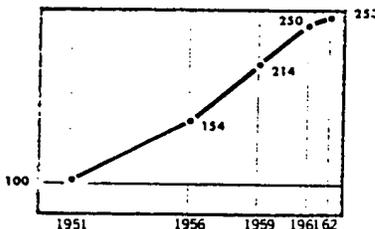
COTTON TEXTILES



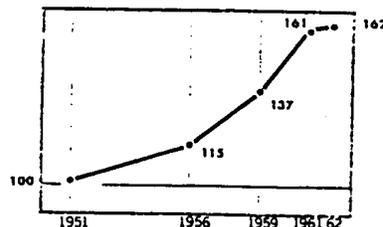
FINISHED STEEL



CEMENT



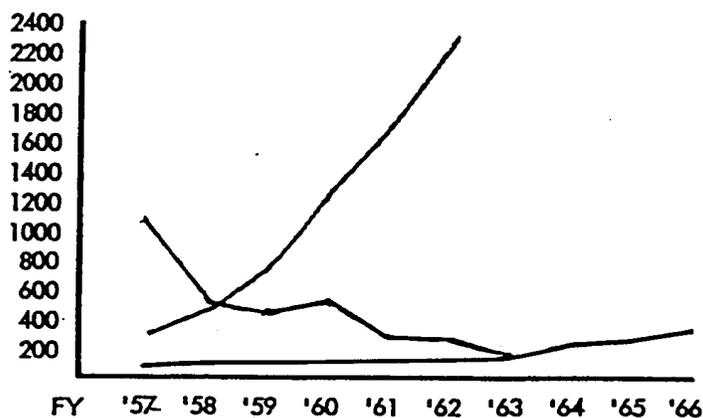
COAL



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INDIA'S FOREIGN DEBT, FOREIGN EXCHANGE POSITION,
AND ANNUAL DEBT SERVICE OBLIGATIONS
(MILLIONS OF US DOLLARS)



FY	Gross foreign debt payable in foreign currencies or exports.	Foreign exchange holdings at year end	Annual debt service obligation payable in foreign currencies or exports (on loans negotiated thru Dec. 1961)
1957	340	1103	53
1958	443	561	66
1959	779	447	73
1960	1281	517	84
1961	1735	286	104
1962	2289	272	124
1963		195 (Estimated as of Oct. 1962)	164
1964			205
1965			236
1966			298

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3.4(b)(1)

INDIA'S UTILIZATION OF EXTERNAL ASSISTANCE ^{a/}

(Government of India, Fiscal Year, 1 April - 31 March)
(Numbers in Millions of Dollars)

	Total Second Five Year Plan (1956/57-1960/61)	Third Five Year Plan Estimate			Total ^{d/} Third Plan
		1961/62	1962/63	1963/64-1965/66	
I LOANS					
Free World					
U.S.A.	339	149	359	960	1,468
United Kingdom	256	48	81	123	252
West Germany	100 ^{b/}	125	125	175	425
Canada	33	-	-	20	20
Japan	35	13	42	65	120
France	-	-	4	26	30
Belgium	-	-	-	10	10
Austria	-	-	-	5	5
Netherlands	-	-	-	11	11
World Bank and I D A	467	78	147	308	533
Switzerland	-	-	-	23	23
Italy	-	-	7	38	45
Yugoslavia	-	-	5	35	40
Bloc					
USSR	157	52	112	485	649
Poland	-	-	3	60	63 ^{e/}
Czechoslovakia	-	-	4	45	49 ^{e/}
Total Loans	1,387	465	889	2,389	3,743
II GRANTS					
U.S.A.					
a. U.S. Government	262	34	16	-	50
b. Ford Foundation	19	3	3	5	11
Canada	127	20	19	26	65
Others	30	4	4	2	10
Total Grants	438	61	42	33	136
III PL 480	1,089	194	255	709	1,158
Grand Total (I, II, III)	2,914	720	1,186	3,131	5,037

^{a/} Includes all aid committed up to March 31, 1962 plus some additional aid pledged at the July 1962 Consortium meeting.

^{b/} Rourkela Steel Plant under suppliers' credit not included.

^{c/} Ranchi foundry - forge suppliers' credit not included.

^{d/} Preliminary figure. Aid for Third Plan is committed by Consortium members on annual basis.

^{e/} Includes \$33 million extended in Nov. 1962.

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3.4(b)(1)