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Intelligence Memorandum

Indira Gandhi's Economic Policies

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CENTRAL INTELLIGENCE AGENCY
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INTELLIGENCE MEMORANDUM

INDIRA GANDHI'S ECONOMIC POLICIES

SUMMARY

1. Indira Gandhi in her seven years as Prime Minister of India has pushed for detailed government control over large-scale industry, for greatly increased production of foodgrains, and for diminution of private foreign investment. Her economic policies are essentially modifications and extensions of earlier Indian policies and do not represent bold new departures in the direction of the economy. Because Mrs. Gandhi is primarily a politician, her economic policies tend to be piecemeal and lacking in consistency and depth.

2. Control over industry takes the form of a growing web of licensing requirements designed to regulate the direction, scope, and ownership of new plant facilities above a certain size. For example, investment proposals by firms with more than 200 million rupees (Rs)[1] of assets (or Rs 10 million if the firm controls more than one-third of the market for a particular product) must be cleared by government committees. The system is complicated by exclusions for technologically advanced goods and export goods and by discrimination against foreign-owned businesses.

3. From the beginning of her term as Prime Minister, Mrs. Gandhi has given more weight to agriculture in the allocation of resources than did her predecessors, who emphasized industrial expansion. In an effort to make India self-sufficient in grains and to build up emergency stocks, Mrs. Gandhi has embraced the "Green Revolution." Under her general direction, the strategy has included (a) concentrating the new technology

1. The Indian rupee was valued at approximately US $0.13 at the foreign exchange rate that prevailed prior to 13 February 1973, which greatly overstated the real value of the rupee.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

on areas of assured water supply; (b) giving priority to the increased supply of chemical fertilizer, pesticides, and up-to-date equipment; and (c) fixing grain prices at levels that encourage increased output. Until the disastrous 1972 monsoon, this policy was crowned with success – wheat output alone had doubled in four years.

4. A long-time partisan of socialism through democratic means, Mrs. Gandhi has not concealed her antipathy toward private foreign investment and her wish to be free of foreign aid. In addition to the stringent screening of new investment proposals sponsored by foreign firms, the Indian government harasses existing foreign firms, throwing in occasional threats of nationalization. The US oil companies Exxon and Caltex and US pharmaceutical companies are favorite targets. Net foreign aid has declined from an annual rate of $1 billion when Mrs. Gandhi took office in 1966 to perhaps $130 million in fiscal year (FY) 1972.[2] Even if Mrs. Gandhi had not wished to reduce India's dependence on foreign assistance, the rising level of debt repayments and the weariness of foreign donors would have caused a substantial decline in net aid.

5. Important political and economic constraints reduce Mrs. Gandhi's freedom of movement. Three of these are:

- The burgeoning defense budget now takes 4% of India's gross national product (GNP) and absorbs much of its dearly bought technological skills.

- The desperately poor Indian masses are reproducing at a rate that eats up much of the gain in agricultural output.

- The political issues stemming from poverty, unemployment, and regionalism limit the extent to which modern methods and incentives can be introduced into agriculture and industry.

6. At the beginning of 1973, Mrs. Gandhi surveys an economy that is in disarray. Industry is stagnating because of overcontrol by government bureaus, shortages of agricultural raw materials and imported industrial materials, and inadequate foreign technical support. The agricultural crisis stemming from the erratic 1972 monsoon is leading to a drain on foreign exchange reserves, serious shortages of grain, and renewed dependence on imports of grain from foreign nations, including the United States. The population growth rate remains high, and increased hunger and disease are the grim prospect for at least the next few months. In this bleak and deteriorating economic situation, Mrs. Gandhi is making adjustments to the necessities of the moment without abandoning her basic economic goals.

2. Beginning 1 April of the stated year.

DISCUSSION

Introduction

7. The political entity known as India is an amalgam of hundreds of small societies with widely different social, religious, and linguistic traditions, but bound by a widely felt spirit of nationalism. Similarly, economic activity exhibits extreme variations -- from the most primitive agricultural and handicraft operations to the modern practices of the Green Revolution and the manufacture of jet military aircraft. Among the noteworthy characteristics of economic life in India are:

- The prevalence of traditional isolated village life in vast rural areas;
- The Malthusian pressures of a huge population of more than one-half billion operating with inadequate land, equipment, and technology;
- The enormous disparities in income caused by the caste system, the unequal ownership of land, and the restriction of major entrepreneurial opportunities to a privileged elite;
- The bureaucratization of economic activity, particularly in urban areas, with the resultant tangle of red-tape and foot-dragging; and
- The key role in economic development of the small class of Western-influenced English-speaking scientists, engineers, politicians, and planners.

8. The dominant political and economic characteristics of India make economic development an extremely difficult process. The development strategist must face not only the problems of how to mobilize a portion of India's scant resources for investment and modernization but also the problems of introducing change into a lassitudinous and tradition-bound society. Mrs. Indira Gandhi, who began her eighth year as India's Prime Minister in January 1973, came to power dedicated to the concept of a centrally planned economy. She committed herself during the 1971 election campaign to the slogan **garibi hatao** (banish poverty) and, in addition to the goals of economic development, is pledged to such social measures as land reform, income redistribution, and fuller employment. Mrs. Gandhi has faced serious political and economic constraints in moving toward these goals, such as the defense requirements stemming from continuing hostility

between India and Pakistan and an uneasiness about relations with the People's Republic of China (PRC) since the 1962 border war. This memorandum assesses Mrs. Gandhi's economic policies and the direction in which India's economy is moving under her leadership. An Appendix presents major economic indicators for 1964-72.

Situation Prior to Mrs. Gandhi

9. In the 1950s, India's planned economic development was considered by many to be a model for other developing nations. India was rapidly acquiring an impressive layer of modern industry and technology which was being superimposed on the largely agrarian economy. In the 15 years following India's constitutional formation as an independent republic in 1950, a national Planning Commission was pre-eminent in articulating and leading this national economic advance. Prime Minister Nehru was the first chairman of the Commission, which contained some of the country's most promising executive talent. The Commission also tapped the talents of top economists. For example, Professor P.C. Mahalanobis, a noted Indian statistician and economist and one-time head of the Indian Statistical Institute, played a decisive role in formulating the Second Plan (1956-60). In addition, many foreign economists such as Oskar Lange and Paul Rosentein-Rodan made important contributions to the planning process. Failures under the Third Plan (1961-65), however, permanently reduced the Commission's prestige and power.

10. From the beginning, India's industrialization has been constrained by concurrent social welfare goals, such as the alleviation of poverty, the reduction of unemployment, and the achievement of a more equitable distribution of income. In the early years, a maze of industrial controls was initiated to forward these goals, including measures to promote small-scale and cottage industries, to develop backward regions, to stabilize prices of consumer goods, and to maximize industrial employment. The Industrial Development and Regulation Act of 1951 called for government licenses for practically any new industrial project. The 1956 Industrial Policy Resolution went much further in providing for increased public participation in the country's development. The Resolution authorized the government to undertake any industrial activity and reserved basic heavy industries such as coal, petroleum, and iron and steel exclusively for the public sector. The private sector could continue to participate in any other industry, under government licensing procedures.

11. The industrialization drive that began in the mid-1950s concentrated on increasing the capacity and output of industries that produced goods then being imported – i.e., it stressed a policy of "import substitution." Imports were tightly controlled. The result was high costs

for a protected home market. At the same time, India's import needs were badly underestimated because the industrial expansion continued to raise requirements for imported machinery and industrial materials. The trade deficit increased steadily. Private foreign investment was prohibited in this period except in industries, such as petroleum and chemicals, that required huge chunks of investment and/or large doses of foreign technology.

12. The principal export industries, such as cotton textiles and jute manufactures, remained predominantly in private hands and received practically no government policy support. On the contrary, they were taxed heavily to help pay for investment in heavy industry. In addition to the tax burden, India's exports were adversely affected by an overvalued exchange rate. Third, when a large domestic market existed for an export product, the government frequently imposed export quotas. Finally, industrial profits were squeezed by liberal labor legislation and by union pressures against the installation of modern labor-saving equipment.

13. During 1956-64, national income gains averaged about 4% per year -- industry moving ahead at 8% and agriculture at 3%, or roughly abreast of population. This period of reasonable progress came to an end, however, in 1965:

- Drought caused agricultural output to fall so sharply that widespread famine was threatened.

- Industrial operations dropped to 60% of capacity because of a combination of reduced demand, shortages of agricultural inputs, difficulties in obtaining imported machinery and materials, and growing governmental red tape.

- Exports continued to falter, and the cumulative effects of balance-of-payments deficits became serious.

- War with Pakistan brought higher prices and new problems in government finance and allocation of resources.

When Mrs. Gandhi came on the scene in 1966, the earlier emphasis on building up the heavy industrial sector was already being abandoned and new emphasis was being placed on agricultural production, particularly foodgrains.

Mrs. Gandhi Takes Over

14. When Indira Gandhi assumed the post of Prime Minister of India in January 1966, she thus faced a sticky economic situation with no easy solutions in sight. Because her main interests -- by temperament and training -- are political rather than economic, she is reluctant to concentrate on economic problems. Even if she were so inclined, she has neither the expertise nor the determination to push forward with bold new economic approaches such as radical land reforms, which conflict with the vested interests of important blocs of political support. The following discussion of her economic policies deals principally with her policies toward the control of industry, the stimulation of agriculture, and the achievement of independence from foreign investment and technology.

Policies Toward Industry

15. In 1966, Mrs. Gandhi's first year in office, a number of industrial regulations were relaxed in an effort to stimulate production. The government exempted 42 industries -- including several industries of importance to agriculture and exports -- from the licensing provisions of the 1951 Industrial Development and Regulation Act. Regulations regarding the diversification of industrial production were further liberalized in October 1966. In order to permit quick adjustment to technological developments and to the changing requirements of foreign and domestic consumers, new articles could be manufactured for the first time without a license. In typical fashion, however, there were detailed qualifications on the new freedom: no new foreign exchange expenditure could be used; no additional plant and machinery could be installed; and output of the new article could not exceed 25% of total production. Mrs. Gandhi also announced in 1966 that industrial firms could increase output up to 25% beyond licensed capacity without a new license. This privilege was denied to the so-called "larger firms,"[3] foreign firms, and others with assets of more than Rs 50 million.

16. In spite of these more liberal industrial policies, industrial production was lower in 1966 and 1967 than in 1965. Inadequate supplies of inputs, especially raw cotton, steel, nonferrous metals, and oil seeds, hobbled several important branches of industry. Supply shortages arose in part from New Delhi's inability to arrange for adequate imports and in part from agricultural policies that downplayed industrial crops. Related factors in the industrial decline were spot shortages in capacity and sluggish demand for certain projects. All these difficulties were compounded by the

3. A total of 1,005 firms, which are interconnected with 20 industrial groups, had assets of more than Rs 350 million in 1964.

ponderous bureaucratic controls over industry. In 1968-70, however, industry pulled out of the recession and production increased about 6% annually. The recovery is attributable to increased supplies of agricultural raw materials, higher agricultural incomes, and, with the fall in food prices, increased demand for such products as cotton textiles.

17. Mrs. Gandhi's industrial policies, under increasing attack from leftists even within her party as being "soft" on big business, hardened in 1970. A new industrial licensing policy reduced controls over smaller investments, while further tightening controls over the direction and scope of investment by the larger industrial firms. For example, new undertakings for the expansion of existing units requiring an investment of less than Rs 10 million were generally exempted from the licensing requirements. New investments in 128 new product lines also were reserved for the small-scale sector. Investments from Rs 10 million to Rs 50 million in certain industries were assigned licenses liberally, except if proposed by the larger industrial enterprises or by foreign-owned firms.[4] The policy ostensibly allows larger firms to expand only into strategic industries where large-scale investment and advanced technology are essential. Nevertheless, the policy is not rigidly enforced against export-oriented industries and industries established in backward areas. Investments in these latter sectors of more than Rs 50 million have been open to the larger industrial houses and foreign firms, subject to the reservation made in favor of the public sector in the 1956 Industrial Policy Resolution.

18. Also in 1970, the Monopolies and Restrictive Trade Practices Act became law, supplementing the controls administered through the industrial licensing system. Under this law, most investments by firms with more than Rs 200 million of assets, or by firms with assets of more than Rs 10 million that control more than one-third of the market for a particular project, must be approved by the government. Proposals by the larger firms have to be sanctioned by a newly created cabinet-level Committee on Economic Coordination headed by Mrs. Gandhi.

19. In a further turnabout, the 1970 Industrial Licensing Policy was relaxed in January 1972 in an effort to ensure fuller use of installed capacity. The relaxation did not apply automatically to companies in which foreigners own a majority of the equity or to companies belonging to the larger industrial houses. Certain industries, including agricultural tractors and machinery, fertilizer, basic metals, and iron and steel, are allowed to increase

4. In 1970, private foreign investors held about one-fifth of India's industrial capital assets. The United States alone accounted for about 15% of total private foreign investment in India. US investment is concentrated in the petroleum refining, pharmaceutical, and other manufacturing industries.

their output up to 100% above the production levels specified under their licenses provided they do not require additional investment to do so.

20. In addition to licenses and other direct controls, Mrs. Gandhi's policies have included a number of financial measures which provide even further government control of private industry. An equity conversion clause is normally included in loans of more than Rs 5 million from public financial institutions; this clause can be used as an arbitrary way of increasing control over the borrowing firm. In addition, shares pledged to secure bank loans of more than Rs 50,000 must be transferred to the lending bank along with voting rights.

21. Prime Minister Gandhi has continued in her efforts to maximize employment by promoting small-scale endeavors. This objective is partly in conflict with the objective of modernizing large-scale industry. The protection of inefficient, labor-intensive techniques in village industries retards the development of the organized industrial sector, reduces the volume of savings available for investment elsewhere, and thereby slows the overall pace of development. Similar consequences have emerged from Mrs. Gandhi's continuation of policies that freeze levels of employment in organized industry and discourage the introduction of modern equipment. Restrictions on the dismissal of workers contribute to managerial rigidity and inefficiency. Mrs. Gandhi's restrictive policies were largely responsible for a slowdown in the growth of industrial output -- from an average of 6% in 1968-70 to 3% in 1971 and about 4% in 1972.

Agricultural Policies

22. Until 1972's disappointing monsoon, Mrs. Gandhi could point with pride to the performance of the agricultural sector, especially in foodgrains. After her accession to power, agricultural production rebounded sharply from the drought and continued to progress under her policies. The average annual rate of growth in output was 6% between crop years 1966/67 and 1971/72[5]; foodgrains alone rose 7%. This track record probably was a critical factor in Mrs. Gandhi's resounding election victory in March 1971.

23. Preceding administrations had emphasized growth in industrial production, particularly for "import substitution." Mrs. Gandhi's policy was to shift resources toward agriculture, not only to boost current production and consumption of food but also to build up stocks so that periods of bad weather could be suffered without recourse to foreign supplies of food.

5. The crop year runs from 1 July to 30 June.

To this end, agriculture and related activities received 43% of government development funds in 1966-71, compared with 35% in the previous five-year period.

24. The Green Revolution provided the technology needed for rapid progress. Mrs. Gandhi's strategy consisted of (a) directing this new technology to areas of assured water supply; (b) providing increasing quantities of chemical fertilizer, pesticides, and other modern inputs; and (c) guaranteeing grain prices at levels that encouraged additional production. Mrs. Gandhi's policies did not change the private ownership of agricultural production. Also, wholesale trading of agricultural production was left essentially in private hands. Mrs. Gandhi, however, greatly expanded the government's grain procurement programs in order to build stocks for emergencies and to provide for distribution, at subsidized prices, through a nationwide network of government-controlled fair-price shops.

25. These agricultural policies, while stimulating foodgrain production, helped create shortages of oilseeds, cotton, and jute mainly because acreages of these crops stagnated or declined while the area and yields of foodgrains increased. The resulting shortages of raw materials contributed to the slow growth in industrial production, to the decline in exports of traditional commodities, and to the short supplies of consumer goods that brought rising prices.

Policy Toward Private Foreign Investment

26. A third theme in Mrs. Gandhi's economic policies has been the attempt to diminish -- and ultimately eliminate -- the role of private foreign investment and foreign aid. The government has moved to reduce the volume of private foreign investment and to limit the autonomy of the remaining investment. As to volume, New Delhi encourages only private foreign investment that provides essential new technology or is devoted to increasing exports. New foreign investors normally must accept a minority interest, giving up the ultimate control and management of their invested funds. Even old-line foreign-controlled firms have been under constant pressure to reduce their equity to a minority position. Applications for direct investment are rigidly screened by the government in a long drawn out bureaucratic process that may take years. Furthermore, Mrs. Gandhi's policies curb profits and capital repatriation. For example, in 1972 a policy was adopted that restricted the repatriation of reserves by wholly owned foreign companies. In addition, a 1972 policy that prohibits foreign oil companies from marketing non-petroleum products under their brand name reduced profits. Finally, the policy of progressive Indianization of foreign firms requires the steady replacement of foreign with Indian managers.

27. Mrs. Gandhi's policies originally did not discriminate against US firms in comparison with other foreign firms -- they were all subject to new regulations and pressures. Following the halt in US economic aid in 1971, however, the United States was given short shrift as a source of new technology and equipment if they could be found in other countries. Two US oil firms, Exxon and Caltex, which account for nearly 50% of all US private foreign investment in India, have been special targets of the domestic political pressure on Mrs. Gandhi's government to take over the operation of private foreign oil companies. The large US pharmaceutical interests have also come under close scrutiny. By early 1973, the flow of private US capital into India had shrunk to practically nothing. Many US firms in India have been trying to accelerate the repatriation of profits, reserves, and other capital before the situation deteriorates further. The warming trend in Indo-US relations in early 1973 could improve the situation, or at least slow the pace of deterioration of US business's position in India.

Economic Aid: Going But Not Gone

28. With respect to foreign aid, Mrs. Gandhi has stated that the reduction of dependence on foreign aid is inescapable. Even if the Indian leaders wished to -- or had to -- continue acceptance of large-scale foreign aid, there is a climate of aid weariness in donor countries. Foreign aid was crucial during the 1960s for maintaining a higher rate of investment than domestic resources could provide and for meeting chronic balance-of-payment deficits. Under Prime Minister Gandhi, net foreign aid has declined steadily from more than $1 billion per year in the mid-1960s to about $130 million in FY 1972 (see Table 1). Net aid receipts have been declining because of both sharply rising debt payments and a falling off in gross aid receipts. "Food aid" amounted to one-half billion dollars annually in the mid-1960s before dwindling almost to zero in 1972.

29. The USSR and Eastern Europe have provided little more than 10% of India's foreign economic aid, and their contribution to the country's overall economic development has been slender. Their aid has been earmarked almost entirely for large heavy industrial projects, which in recent years included the Bokaro Steel Mill, the Heavy Electrical Machinery Plant at Hardwar, and the expansion of the Bhilai Steel Mill with almost nothing for agriculture or for industrial raw materials to keep industry operating. In contrast, the Western aid Consortium[6] has been supplying hundreds of millions of dollars in commodity aid each year.

6. Formed in 1958 to provide India with economic assistance when foreign exchange reserves fell to $700 million from a record $1.9 billion in 1956. The Consortium is made up of the United States, the United Kingdom, Austria, Belgium, Canada, Denmark, France, West Germany, Italy, Japan, the Netherlands, Norway, Sweden, the World Bank, and the International Development Association.

Table 1

India: Foreign Economic Aid Receipts and Debt Repayments

Million US $

Fiscal Year[a]	*Total Aid Receipts*	*Debt Repayment*[b]	*Net Aid*	*Food Aid*	*Net Non-Food Aid*
1961	718	224	494	181	313
1962	947	235	712	255	457
1963	1,191	261	930	352	578
1964	1,473	322	1,151	482	669
1965	1,567	368	1,199	526	673
1966	1,507	387	1,120	480	640
1967	1,499	473	1,026	391	635
1968	1,135	491	644	210	434
1969	1,301	549	752	200	552
1970	1,037	599	438	50	388
1971	1,090	624	466	12	454
1972 est.	800	670	130	N.A.	N.A.

a. Beginning 1 April of the stated year.
b. Including interest payments and repayments of principal.

30. Both political and economic relations between India and the United States cooled after the United States suspended $86.7 million of its aid to India in December 1971. Because of rising debt service payments, however, New Delhi's net aid receipts from the United States had already been declining for several years. Net economic aid from the United States (excluding PL 480) was about $350 million annually in the early 1960s but little more than $150 million in 1971. In 1972, New Delhi proceeded to seek alternative sources of supply for commodities previously financed by US aid. Businessmen have been pressured to reduce dollar requirements for raw materials, parts, and capital equipment, and some importers have been informed by Indian officials that import licenses were less likely to be approved if the United States was the source of supply. Mrs. Gandhi herself halted the shipment of US concessionary foodgrain in late 1971, proclaiming that India was now self-sufficient.

31. In early 1973, as New Delhi grapples with a severe drought and threatening famine in large parts of India, the government has indicated it is importing 2 million to 3 million tons of foodgrains on a commercial basis and presumably will dip into its holdings of foreign exchange to make payment. New Delhi probably will try to survive the present time of troubles without asking for new large-scale food aid. Another poor monsoon, however, would probably force a reappraisal of this policy.

Resources for Defense

32. Mrs. Gandhi has been frustrated in her program for economic growth and self-sufficiency by the necessity to provide additional resources for defense. A large portion of India's dearly bought industrial assets are tied up in the armaments industry. The consequence has been a leveling off of economic development expenditures in spite of a 90% rise in total government spending since 1964 (see Table 2). The rise in total expenditures resulted principally from increased military expenditures and, in the fiscal year (FY) 1971 budget, from economic aid to Bangladesh and the unplanned expense of caring for 10 million refugees. In addition, states often have not complied with Mrs. Gandhi's policy of monetary restraint and have continued to accumulate excessive overdrafts with the Reserve Bank. Furthermore, the government has failed to raise the operational efficiency of public sector industry,[7] which has been a steady drain on the country's resources.

Table 2

India: Financing the Budget

Billion Rupees

					Financed By	
Fiscal Year[a]	*Budget Expenditures*[b]	*Public Development Expenditures*	*Domestic Revenue*	*Deficit*	*Foreign Aid*	*Domestic Measures*[c]
1964	39.55	19.82	32.30	7.25	5.68	1.57
1965	42.23	22.93	33.31	8.92	6.95	1.97
1966	53.04	21.42	40.83	12.21	8.63	3.58
1967	50.75	22.30	39.23	11.52	8.82	2.70
1968	50.23	23.76	42.55	7.68	5.83	1.85
1969	55.81	21.82	49.49	6.32	7.18[d]	0
1970	61.02	26.42	53.05	7.97	5.38	2.59
1971	75.23	22.40	67.04	8.19	4.48	3.71

a. Beginning 1 April of the stated year.
b. The figures for budget expenditures refer to all budgetary outlays of the central government, including food subsidies, industry subsidies, and assistance to the individual states. In FY 1971, the consolidated state budgetary expenditures amounted to about three-fourths of central government expenditures. The central government subsidizes about 90% of the individual states' development expenditures.
c. Drawdown of cash balances or government borrowing from the Reserve Bank.
d. Resulted in a budget surplus.

7. The main elements of public sector industry are steel, heavy machine building, and petroleum.

33. Prime Minister Gandhi has continued to divert a large share of the country's resources to defense. India has fought Pakistan twice and the PRC once in the past 10 years, and Mrs. Gandhi is determined to keep India strong militarily. In FY 1971, defense spending increased 16%, reaching Rs 15 billion, or $2 billion converted at the official exchange rate. In FY 1972 it remained at this level. Defense spending is now the equivalent of almost 4% of GNP and about 20% of the central government budget. The effect on economic development is more severe than the dry figures indicate because of the pre-emption of the choicest resources in the economy and the further diversion of the leadership's energies away from short-term and long-term economic problems. Among the "choicest resources" are: (a) foreign exchange (India devotes about 17% of its hard currency earnings to defense), (b) industrial equipment (the most modern machine tools go to the aircraft and other military branches), and (c) skilled manpower (no doubt a disproportionate share of India's engineers and skilled technicians work in the defense sector of the economy).

The Prime Minister as Economic Policymaker

34. Mrs. Gandhi's promises of expanded social welfare measures, her commitments to increased public control over industry and trade, and her political dependence on large land barons -- who are the backbone of the ruling Congress Party in rural areas -- all figured in the economic policies described above. In many respects, Mrs. Gandhi has neither the expertise nor the temperament to deal effectively with India's massive economic problems. She employs a number of economic advisers and has picked up some of the jargon, but she leans more heavily on her political advisers. She is inclined to simplistic **ad hoc** economic decisions that agree with her political instincts. For this reason, her economic policies tend to be piecemeal and lacking in consistency and depth.

Prospects

35. As the Prime Minister begins her eighth year in power, the economy is again in serious trouble. A decline in national income is expected in the current fiscal year (ending 31 March 1973), the first such decline in six years. Because of erratic rainfall, the 1972/73 grain crop is likely to decline to about 96 million metric tons, or about nine million tons less than the previous year. Prices are rising sharply after several years of relative stability. Industrial production continues in the doldrums, investment is lagging, and unemployment is increasing.

36. Mrs. Gandhi's response has been to announce a reorientation of the forthcoming Fifth Five-Year Plan (FY 1974-78) in order to emphasize economic growth, "self-reliance," and expanded state control of the

economy. The preliminary draft had emphasized redistribution of income and an increase in social services. In reality, the reorientation of the earlier draft is a change in tone more than a change in substance. Instead of accenting a "frontal attack" on poverty, the new draft emphasizes that a faster growth rate will itself generate fuller employment and a higher standard of living. It envisages an average annual rate of growth of 5.5%, with agriculture and industry contributing 4.5% and 8% to 9%, respectively. The export target is again placed at 7% per year. The earlier plan placed a greater reliance on foreign assistance. The new plan still requires $4 billion in foreign aid to finance the foreign exchange deficit but adds a proposal to end net foreign assistance by 1978. The size of the plan remains unchanged -- Rs 510 billion for the five-year period, including both public and private development expenditures. Nor is there any material change in the sectoral allocations.

37. Two resolutions adopted in October 1972 at a policy-level Congress Party meeting may show the drift of future economic policy. One resolution, drafted by the Minister of Industrial Development, calls for the states to take over wholesale trade in rice and wheat and to exercise stricter controls over the distribution of essential commodities -- sugar, edible oils, kerosene, and cloth. The central government is continuing to push for early action on these measures. The states, however, are moving slowly, and very little has been accomplished. The second resolution, drafted by the new Planning Minister, calls for speedy self-reliance by the rapid development of basic industries. The latter emphasizes that the country must become self-reliant in all essential production by the fastest possible means, and a detailed industry-by-industry program of import substitution was given priority.

38. Mrs. Gandhi appears to be in for some tough sledding on the economic front. Her economic policies are by political necessity directed toward conflicting goals. First, the goal of stricter government control over industrial investment is not consistent with a rapid self-generating modernization of the industrial sector. Second, the goal of income equalization is not consistent with many economic incentives needed for growth, let alone consistent with the political necessities of retaining support of propertied groups. Third, the goal of a strong national military establishment is not consistent with the allocation of additional resources to industrial modernization, agricultural development, and welfare services. And, finally, the goal of financial independence from the United States and other leading industrial nations is not consistent with rapid modernization of the economy and with the acquisition of development resources at the lowest possible cost.

Appendix

India: Selected Economic Indicators[a]

	1964	*1965*	*1966*	*1967*	*1968*	*1969*	*1970*	*1971*	*1972 (est)*
					1960=100				
National income (1960 prices)	119.7	113.0	114.7	125.3	128.3	135.1	141.1	142.5	137
Industrial production[b]	140.9	153.8	152.6	151.4	161.1	172.5	180.8	186.1	194
Agricultural production[c]	112.1	93.6	92.6	113.0	112.1	120.9	128.1	125.8	115
					Million persons, mid-year				
Population[d]	468	480	491	502	513	524	536	547	559
					Million linear meters				
Cotton textiles[b]	7,720	7,642	7,336	7,276	7,896	7,702	7,550	7,400	7,700
					Million metric tons				
Foodgrain production[c]	89.36	72.03	74.23	95.05	94.01	99.50	108.4	104.7	96
					Million US $				
Exports (F.O.B.)	1,714	1,692	1,537	1,598	1,813	1,880	2,047	2,138	2,250[e]
Imports (C.I.F.)	2,833	2,958	2,771	2,677	2,479	2,104	2,173	2,464	2,750
Net foreign aid	1,151	1,199	1,120	1,026	644	752	438	466	130
Foreign exchange reserves[f]	498	600	608	662	682	926	1,066	1,206	800

a. Unless otherwise noted, these data are for the Indian fiscal year, which begins on 1 April of the stated year.
b. Calendar year.
c. Crop year, beginning 1 July of the stated year.
d. A tentative series based on the latest official census count (547 million at mid-year 1971).
e. Excluding an estimated $150 million worth of concessionary shipments to Bangladesh.
f. End of fiscal year.

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