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978-0-521-15307-2 - India's Economic Relations with the USSR and Eastern Europe  
1953 to 1969

Asha L. Datar

Excerpt

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## I

## INTRODUCTION

The purpose of this study is to evaluate the contribution to India's development made by economic and technical co-operation with the USSR and other East European countries (henceforth referred to as the East European countries only). While the subject of this study is an assessment of the costs and benefits to *India* of this debtor/creditor relationship, it is to be expected that the case study will throw light on some issues which are of common interest and concern to other developing countries also. The issues are (i) the role of external finance in a country's development effort (i.e. the difficulties in matching availabilities with requirements), (ii) the terms and conditions of aid and (iii) the special advantages or disadvantages associated with establishing trade and credit relations with the centrally planned economies.

If the volume of aid offered was the chief determinant of its impact on development, the aid received from the centrally planned economies<sup>1</sup> would not be all that important. Together they gave only about 8 per cent of the total external official finance utilised during the period 1951/2 to 1968/9. Even looking at 'economic cooperation' rather than aid, while the share of East European countries in India's external trade has increased, it still constitutes only 20 per cent of the total external trade. It is worthwhile examining the impact of this aid on the Indian economy for two reasons. First, the continued economic cooperation between a mixed economy and centrally planned economies is a rather unusual phenomenon. Second, because of the cold war situation in the 1950s, the Soviet aid programme precipitated a re-examination of aid policies by other donors. This indirect benefit was equally, if not more, important to the developing countries than actual aid offered by the East European countries.

<sup>1</sup> In this study 'centrally planned economies' and 'the East European countries' mean Bulgaria, Czechoslovakia, East Germany (GDR), Hungary, Poland, Rumania, USSR and Yugoslavia (where, however, planning operates within a market); 'socialist countries' includes all these and China.

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This study deals with India's trade and credit relationship with East European countries rather than just 'aid'. While trade and aid have different meanings and are to be distinguished in common usage, they are used interchangeably in East European literature. Indeed trade is considered as a special kind of aid.

The definition of aid is a controversial question. It is used to cover a multitude of transactions involving the transfer of resources – funds, commodities and skills – to the developing countries.<sup>1</sup> It is not proposed to review the growing literature on aid or to choose one definition: 'aid' means different things to different people. To donors the important factor is the sacrifice involved in giving aid, i.e. the opportunity cost of real or financial resources released.<sup>2</sup> To recipients what matters is the net benefits from a so-called unilateral transfer – not just the so-called grant 'element'.<sup>3</sup> Since one of the purposes of this study is to find out how much of what is called aid is really beneficial, defining aid flows is equivalent to prejudging the issue.

The East European countries consider trade as aid, which is hence also treated in this study; but there are, further, two good economic reasons why East European aid cannot be treated in isolation from trade. First, the East European countries commit themselves to accepting repayment in goods. Second, since 1958/9 all the commercial and non-commercial transactions between India and East European countries are covered by comprehensive non-convertible currency payment arrangements. Any currency balances accumulated can only be used to buy goods and services from the partner country. Net benefits from this arrangement depend upon the quality, prices and volume of goods that India buys and sells. If she cannot

<sup>1</sup> In its annual reports on aid to the developing countries (61) the OECD includes grants, loans and government suppliers' credits in the official flow of funds. On the defined terms of OECD official development assistance of OECD and the USSR, see Kaser (38, pp. 476–8).

<sup>2</sup> Pincus (67, p. 308) makes the point that a donor does not view a foreign loan as aid if its terms and conditions approximate those on the domestic capital market. However, it is still 'aid' for the recipient if his alternative borrowing rates are higher. See Carter (14) for an assessment from the aspect of the benefits accruing to the USSR from aid.

<sup>3</sup> Ohlin (60) developed a formula for measuring the grant equivalent in various loans, based on interest rate, grace period and maturity.

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purchase the goods she wants, the benefits from this arrangement may be lessened. In other words, if exporting to a country does not involve a commitment to buy an equivalent amount from that country and vice versa, the two questions of trade and aid can be treated separately. But, given the payment arrangement India has, the answer to the question whether and how India benefits from the availability of credit from the East European countries really depends upon an examination of India's trade and balance of payments with them. However, trade is only one dimension of Indo-East European economic cooperation. Two other dimensions are equally important, if less tangible. First, since foreign exchange is a scarce resource, by tying credits to specific projects or sectors, donors may have influenced sectoral priorities and policies. Second, as mentioned before, Soviet aid has influenced the availability of finance from other donors. Western countries, especially the United States, certainly interpreted it as a challenge and another move in the cold war and reacted to it as such. This reaction is best summarised in the words of Dwight Eisenhower, then President of the United States, 'If the purpose of Soviet aid to any country were simply to help it overcome economic difficulties without infringing its freedom, such aid would be welcomed as forwarding the free world purpose of economic growth. But there is nothing in the history of international communism to indicate this can be the case. Until such evidence is forthcoming, we and other free nations must assume that Soviet Bloc aid is a new subtle, long range instrument, i.e. directed towards the same purpose of drawing its recipient away from the community of free nations, and ultimately into the Communist orbit.'<sup>1</sup>

To study this three-dimensional relationship, the main questions discussed in the subsequent chapters are:

(i) How much credit, in the sense of unilateral transfer of goods instead of exchange, has India received? In a comprehensive trade agreement the deficit on current account should equal net capital receipts. However, India might have been accumulating idle currency balances and such balances would represent a waste of credit finance. It is worth asking whether such 'waste' was a serious problem because other developing countries have also faced this problem in their economic

<sup>1</sup> U.S. Department of State (89, p. 1).

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relations with the USSR. In fact, one of the charges levelled against the Soviet Union's trade and credit programme has been its supposed inability to deliver the goods.<sup>1</sup> If the criticism is justified, the utility of non-convertible payment arrangements is questionable.

(ii) What is the true worth of this aid? Since all the past credits have been tied to imports for particular projects from the creditor country, the nominal value of aid will have to be discounted for any costs associated with bilateral trade and the tying of aid.

(iii) Were India's exports to these markets in repayment of aid additional to her exports elsewhere? If India's exports to the East European countries increased at the expense of her other markets, there would be no net gain in foreign exchange earnings apart from the temporary addition to India's resources during the period between receipt of aid and repayment, and possibly higher unit prices for exports in these and/or other markets. But if the aid agreements enable exports greater than could otherwise be realised, the benefit to India is clearly increased. These bilateral trade agreements may be self-defeating if they result in trade diversion. Conceivably, they might even reduce India's total foreign exchange earnings. The question how far they actually did so is to be examined.

(iv) To what extent were the prices of India's exports and imports comparable to those she got from the rest of the world? If India paid a higher price for her imports than would have been paid to alternative suppliers, this might have been neutralised by a higher price for her exports. What really matters is the import purchasing power of her exports.

(v) The prices of exports, however, may be important in themselves, if the prices received in bilateral trade affect India's exports elsewhere.

(vi) Did the project financed from such credits have a high priority in the development plan and did it deserve the priority it received? Since the East European countries offered a 'package deal' (i.e. including technical know-how and personnel with machinery and equipment), better planning and speedier,

<sup>1</sup> The studies on Soviet aid and trade in the 1950s emphasised the USSR's inability to export goods on time. See Allen (3), and various contemporary U.S. Department of State booklets.

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more efficient implementation of the projects receiving credits from the East European countries might be expected. In practice, it is found that there was inadequate project planning, resulting in an escalation of project costs. Whenever these can be attributed to the collaborators, they are treated as reducing the real value of aid.

(vii) The impact of the availability of credits from East European countries on sectoral priorities and the distribution of investment between public and private sectors is worth examining.

(viii) The impact of the availability of finance from East European countries on the aid efforts of other countries will also be investigated.

Before getting down to discussing these questions it will be useful to review the main trends in the international aid effort. This will clearly bring out the interplay between various forces, such as the attitude of India and the donors towards aid. Towards the beginning of the 1960s there was a greater willingness among donors to treat external funds as an integral part of resources available for investment. India's attitude towards dependence on foreign funds and aid changed in the late 1950s. To understand fully India's economic relations with the East European countries, it is necessary to view them within the context of the changing international scene and the economic and political developments in India.

On the international scene, the main actors are the United States and the Soviet Union, the principal protagonists in the cold war. There are four landmarks in U.S. aid policies. The first phase ended in 1948, when communist forces entered Greece in the arena of civil war. During this time, Europe was struggling to restore its economy with scant American support. While the USSR was also busy recovering from the war, it was also consolidating its gains in Europe. The cold war tensions came to a head with the invasion of Greece and President Truman initiated his famous Point-4 programme in Congress: the Marshall Plan for Europe was launched in 1950. The primary motive behind extending money and technical assistance at this time was to enable countries to stand up to the threat of communism and the main effort was directed towards Europe. Promoting economic development was only an incidental

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by-product of the scheme aimed at protecting the United States and others; it is significant that the aid authorising act was entitled the Mutual Security Act. And even from the discussions in hearings on the annual authorisation and appropriations, it is quite clear that defence support and economic aid were indistinguishable.<sup>1</sup>

The second landmark was the Korean War. The industrialised countries did not properly appreciate the importance of the developing countries until the outbreak of hostilities in Korea. In his message to Congress in 1952, President Truman underlined the importance of developing countries as markets and as suppliers of raw materials. In fact, he went to the extent of saying that to ensure production at full capacity in American factories, foreign aid was essential.<sup>2</sup>

In the literature on U.S. aid, various reasons are mentioned to support the case for providing capital to developing countries. Thus Brown and Opie, in a book published in 1953, said, 'The interest of the U.S. in extending assistance to the underdeveloped countries is compounded of a humanitarian impulse to aid the less fortunate, a desire to promote sound and expanding world trade, the necessity of increasing supplies of raw materials and the firm determination to forestall the spread of communism. But the role of the U.S. in assisting underdeveloped countries is conditioned by its belief in the value of the democratic form of political organisation and in certain basic principles of economic philosophy that are embedded in the American system.'<sup>3</sup> Even Brown and Opie do not emphasise the role of aid in promoting development as such.

Since the primary motive behind the U.S. aid programme was to strengthen the countries anxious to fight communism, it was natural that those who refused to align themselves in this crusade should suffer. While India did receive substantial amounts of grants and surplus commodities from the United States before 1954, the U.S. Government and Congress made no secret of their displeasure with Indian neutrality, and on

<sup>1</sup> See the Annual Discussions on Mutual Defence Security Act 1951-5.

<sup>2</sup> These views were expressed by President Truman in his speech to the Newspaper Guild, 28 June 1950, and by Henry Bennet speaking for the Technical Co-operation Administration and are quoted in an article by J. Rippie, 'Historical Perspective' (97, p. 13).

<sup>3</sup> Brown and Opie (13, p. 83).

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occasions Congress reduced the aid appropriations requested. The American reaction is understandable, for the Indian Government was challenging the very core of the proposed defence mechanism – the military alliances. It is interesting though, that in the pre-1954 period, American policy makers did not feel embarrassed to let it be known that economic aid was dependent on good behaviour, i.e. commitment and concrete action to oppose communism.<sup>1</sup>

In his book on foreign aid, Andrew Westwood describes how the United States faced awkward situations in countries like Indonesia and Iran because of the supposed requirement imposed by the American Congress that all recipients of American aid, except under the Point-4 programme, should in effect declare their alignment with the 'Free World'. In practice the recipients of economic aid were required only to declare their adherence to the principles of the United Nations,<sup>2</sup> but even this was treated as a string and became a source of irritation to the neutral developing countries.

During the 1950s, it was the U.S.A. who gave most bilateral assistance to independent governments. Great Britain and France concentrated mainly on meeting the needs of their colonies and former colonies.<sup>3</sup> Until the USSR entered the picture, the United States was virtually the only donor making capital available to developing countries. She therefore had a strong bargaining position.

The third landmark was the Soviet Union's entry into the aid-giving business. The USSR's emergence as a competitor and its success among the developing countries led to some soul-searching in the United States. The prevalent opinion was that the theatre of war had changed, while the Russian desire for domination had not, and that the United States must devise weapons to cope with this type of economic warfare.<sup>4</sup> It is fair

<sup>1</sup> The objectives and methods of the aid programme were closely scrutinised in Congress and the anti-communist bias of the aid programme is clear from the hearings before the Senate Foreign Relations Sub-Committee.

<sup>2</sup> Westwood (95, p. 33).

<sup>3</sup> For a history of international aid in the 1950s see Little and Clifford (44); Friedman, Kalmanoff, (27, ch. 2); and Pincus (80, 81).

<sup>4</sup> The economic activities of the Sino-Soviet bloc became a very fashionable subject for discussion among political scientists. The bias of American authors is evident even in the various titles of works on the subject, *Soviet Economic Warfare*, *Sino-Soviet Offensive in the Less Developed Countries*, *The Challenge of Co-existence*.

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to point out that individuals – economists, political scientists, Congressmen, Administration officials – might have been interested in offering aid even before the USSR took the ‘offensive’, but their views were not translated into policies. The re-orientation of the American aid programme which was manifested in many ways – establishment of the Development Loan Fund (DLF), support for concessionary terms of loans and for international coordination of aid, including IDA – might not have received Congressional backing but for the argument advanced that development aid would be a new and more suitable weapon to cope with the new type of warfare. The biggest bonus of the Russian presence was that ‘disinterested aid’ became very popular and neutrality became acceptable as a political stance. Since 1957, the United States has taken a continuous interest in providing aid to India and has co-operated with the World Bank to coordinate international aid efforts.

The fourth landmark was a new American policy, offering long-term development loans on a continuing basis and integrating external funds into the planning process. It was not crystallised and formalised until President Kennedy moved into the White House. In his aid message to Congress in 1961, he tacitly recognised that a reason why the American aid programmes had not been more successful in the past was the lack of emphasis on a long-term programme and he urged a commitment by the United States to this. He said, ‘Uneven and un dependable short-term finance has weakened the incentive for long-term planning and self-help by the recipient nations which are essential to serious economic development. The lack of stability and continuity in the programme – the necessity to accommodate all planning to a yearly deadline – when combined with a confusing multiplicity of American aid agencies within a single nation abroad – have reduced the effectiveness of our own assistance and made more difficult the task of setting realistic targets and sound standards. Piecemeal projects, hastily designed to match the rhythm of the fiscal year, are no substitute for orderly long-term planning. The ability to make long-range commitments has enabled the Soviet Union to use its aid programme to make developing countries economically dependent on Russian support – thus advancing the aims of



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world communism.<sup>1</sup> The American aid programme has not lived up to the standards set by President Kennedy, and the hope for a 'decisive' turnaround in the fate of the less developed countries in the development decade has not been realised.<sup>2</sup>

This study does not review foreign aid policies of other donors, because while they have made substantial contributions, aid from other sources (apart from the United Kingdom) really started in the 1960s, within the framework of the Indian Consortium. Although these countries are treated as a group, it is not implied that they had identical views on aid policies or foreign aid objectives. However, the purpose of reviewing American aid policies is to show how the international climate changed in favour of long-term development aid in the 1950s. In this context, the two most important entities are the U.S.A. and the World Bank. The World Bank assumed importance, first, because it was the most important agency giving development loans in the early 1950s, and second, because it took the leading role in organising the Indian Consortium in 1958, and itself gave loans on concessional terms.

There was also an interesting reversal in the World Bank's position. In the early 1950s, several developing countries sought to establish a special U.N. fund (SUNFED) to give loans on concessionary terms, but the Bank did not favour that proposal. In the late 1950s, however, the Bank established its own affiliate to provide such funds – the International Development Agency (IDA).

The USSR's rediscovery of the road to Paris via Peking and Calcutta<sup>3</sup> became evident after Stalin's death. Whatever her specific motives and objectives in cultivating the friendship of the developing countries, there was a fairly standard pattern for winning friends and influencing people. The USSR concentrated its efforts on a few developing countries, opening trade with them and offering them credits. The occasion chosen was usually when a country was in serious economic difficulties, i.e. when it could not find markets for its major exports – Egyptian cotton, Burmese rice, Icelandic fish. The USSR then

<sup>1</sup> The Message of the President to Congress, quoted in Goldwin (29).

<sup>2</sup> This hope was expressed in the same 1961 aid message to Congress.

<sup>3</sup> Lenin had observed soon after the Revolution that the road to Paris lies through Calcutta and Peking.

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offered to buy the goods, sometimes at a premium.<sup>1</sup> The opening of trade relations was accompanied by an exchange of cultural and goodwill missions and visits of political dignitaries and offers of economic missions. The USSR was using economic relations as a part of its wider objective of establishing close relations with the developing countries, but the international situation was such that, while promoting its cause, it could in fact claim truthfully that it was only helping the developing countries to achieve their own aspirations of economic and political independence of the West. Whether this independence would bring about changes favourable to the USSR – in social systems and political institutions – is another question.

In dealing with the developing countries the USSR had certain advantages, such as its ability to move quickly to respond to changed situations and its lack of a colonial past. In fact, the Soviet spokesmen could sympathise with the developing countries, pointing to the fact that the USSR had also suffered at the hands of Western countries in the 1920s. Khrushchev, in a speech made at the Aswan Dam, referred to the lack of support and the consequent hardships the USSR had to suffer at the hands of Western powers. In fact, he listed this as one of the motives for the Soviet Union's economic cooperation with the developing countries.<sup>2</sup>

Just as the United States learnt from the USSR's experience later, the latter had learnt from the initial reactions of developing countries and its programme was tailored accordingly.

The chief characteristics of Soviet economic cooperation are:

1. Emphasis on 'equality' between partners. The newly liberated countries were very sensitive about inferior status. The Soviet spokesmen therefore emphasised that it was an equal partnership. One consequence of this was that they offered not 'humiliating charity', i.e. grants, but businesslike loans.
2. Coordination between trade and aid policies. They looked upon this cooperation as a means of finding markets for machinery and equipment and obtaining raw materials from developing countries. The reasons for this are partly economic

<sup>1</sup> The Sino-Soviet bloc's economic activities in the underdeveloped countries have been described in the pamphlets and booklets produced by the U.S. Department of State and various Congressional Committees (see e.g. 87, 88, 89 and 90).

<sup>2</sup> Khrushchev's speech (49).