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# **Foreign Trade Regimes and Economic Development:**

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on Foreign Trade Regimes  
and Economic Development*

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New York 1975

**Foreign Trade Regimes  
and Economic Development:  
INDIA**

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# INDIA

by **Jagdish N. Bhagwati**

MASSACHUSETTS INSTITUTE OF TECHNOLOGY

**T. N. Srinivasan**

INDIAN STATISTICAL INSTITUTE

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*Relation of the Directors of the National Bureau to  
Publication of the Country Studies in the Series on  
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The individual country studies have not passed through the National Bureau's normal procedures for review and approval of research reports by the Board of Directors. In view of the way in which these studies were planned and reviewed at successive working parties of authors and Co-Directors, the National Bureau's Executive Committee has approved their publication in a manner analogous to conference proceedings, which are exempted from the rules governing submission of manuscripts to, and critical review by, the Board of Directors. *It should therefore be understood that the views expressed herein are those of the authors only and do not necessarily reflect those of the National Bureau or its Board of Directors.*

The synthesis volumes in the series, prepared by the Co-Directors of the project, are subject to the normal procedures for review and approval by the Directors of the National Bureau.

To  
H. G. Johnson  
and  
C. R. Rao





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## **Co-Directors' Foreword**

This volume is one of a series resulting from the research project on Exchange Control, Liberalization, and Economic Development sponsored by the National Bureau of Economic Research, the name of the project having been subsequently broadened to Foreign Trade Regimes and Economic Development. Underlying the project was the belief by all participants that the phenomena of exchange control and liberalization in less developed countries require careful and detailed analysis within a sound theoretical framework, and that the effects of individual policies and restrictions cannot be analyzed without consideration of both the nature of their administration and the economic environment within which they are adopted as determined by the domestic economic policy and structure of the particular country.

The research has thus had three aspects: (1) development of an analytical framework for handling exchange control and liberalization; (2) within that framework, research on individual countries, undertaken independently by senior scholars; and (3) analysis of the results of these independent efforts with a view to identifying those empirical generalizations that appear to emerge from the experience of the countries studied.

The analytical framework developed in the first stage was extensively commented upon by those responsible for the research on individual countries, and was then revised to the satisfaction of all participants. That framework, serving as the common basis upon which the country studies were undertaken, is further reflected in the syntheses reporting on the third aspect of the research.

The analytical framework pinpointed these three principal areas of research which all participants undertook to analyze for their own countries.

Subject to a common focus on these three areas, each participant enjoyed maximum latitude to develop the analysis of his country's experience in the way he deemed appropriate. Comparison of the country volumes will indicate that this freedom was indeed utilized, and we believe that it has paid handsome dividends. The three areas singled out for in-depth analysis in the country studies are:

1. *The anatomy of exchange control*: The economic efficiency and distributional implications of alternative methods of exchange control in each country were to be examined and analyzed. Every method of exchange control differs analytically in its effects from every other. In each country study care has been taken to bring out the implications of the particular methods of control used. We consider it to be one of the major results of the project that these effects have been brought out systematically and clearly in analysis of the individual countries' experience.

2. *The liberalization episode*: Another major area for research was to be a detailed analysis of attempts to liberalize the payments regime. In the analytical framework, devaluation and liberalization were carefully distinguished, and concepts for quantifying the extent of devaluation and of liberalization were developed. It was hoped that careful analysis of individual devaluation and liberalization attempts, both successful and unsuccessful, would permit identification of the political and economic ingredients of an effective effort in that direction.

3. *Growth relationships*: Finally, the relationship of the exchange control regime to growth via static-efficiency and other factors was to be investigated. In this regard, the possible effects on savings, investment allocation, research and development, and entrepreneurship were to be highlighted.

In addition to identifying the three principal areas to be investigated, the analytical framework provided a common set of concepts to be used in the studies and distinguished various phases regarded as useful in tracing the experience of the individual countries and in assuring comparability of the analyses. The concepts are defined and the phases delineated in Appendix A.

The country studies undertaken within this project and their authors are as follows:

Brazil	Albert Fishlow, University of California, Berkeley
Chile	Jere R. Behrman, University of Pennsylvania
Colombia	Carlos F. Díaz-Alejandro, Yale University
Egypt	Bent Hansen, University of California, Berkeley, and Karim Nashashibi, International Monetary Fund
Ghana	J. Clark Leith, University of Western Ontario

India	Jagdish N. Bhagwati, Massachusetts Institute of Technology, and T. N. Srinivasan, Indian Statistical Institute
Israel	Michael Michaely, The Hebrew University of Jerusalem
Philippines	Robert E. Baldwin, University of Wisconsin
South Korea	Charles R. Frank, Jr., Princeton University and The Brookings Institution; Kwang Suk Kim, Korea Development Institute, Republic of Korea; and Larry E. Westphal, Northwestern University
Turkey	Anne O. Krueger, University of Minnesota

The principal results of the different country studies are brought together in our overall syntheses. Each of the country studies, however, has been made self-contained, so that readers interested in only certain of these studies will not be handicapped.

In undertaking this project and bringing it to successful completion, the authors of the individual country studies have contributed substantially to the progress of the whole endeavor, over and above their individual research. Each has commented upon the research findings of other participants, and has made numerous suggestions which have improved the overall design and execution of the project. The country authors who have collaborated with us constitute an exceptionally able group of development economists, and we wish to thank all of them for their cooperation and participation in the project.

We must also thank the National Bureau of Economic Research for its sponsorship of the project and its assistance with many of the arrangements necessary in an undertaking of this magnitude. Hal B. Lary, Vice President-Research, has most energetically and efficiently provided both intellectual and administrative input into the project over a three-year period. We would also like to express our gratitude to the Agency for International Development for having financed the National Bureau in undertaking this project. Michael Roemer and Constantine Michalopoulos particularly deserve our sincere thanks.

JAGDISH N. BHAGWATI  
Massachusetts Institute of Technology

ANNE O. KRUEGER  
University of Minnesota

## Preface

This study of India's trade and exchange rate policies is part of the NBER project described in the Co-Directors' Foreword. At the same time, as explained there, the organization and emphases in analysis have reflected our own views about what is important to examine and evaluate in the Indian economy.

In some ways, this work may be regarded as a sequel to *India: Planning for Industrialization*, by Bhagwati and Desai (see Chapter 1, note 1, below), which was finished some five years ago, just as the first effects of the June 1966 devaluation were being worked out. Our present work has managed to build on this earlier study, indeed freely drawing on it where useful; it is, however, self-contained and can be read on its own.

We have been helped in our analysis by a number of officials and economists in India. In particular, we should mention A. Vaidyanathan, Arun Ghosh, Manmohan Singh, K. G. Vaidya, and R. M. Honavar. Our thanks must go particularly to K. Sundaram for the material on the political effects of the 1966 devaluation (Chapter 10), V. R. Panchamukhi for working out the premium data and the ERP estimates (Chapter 13), Kirit Parikh for assistance in running the Eckaus-Parikh model program (Chapter 14), and Ashok Desai for surveying several firms on their research and development activities (Chapter 15).

As with other authors in the NBER project, we have benefited from the comments of other participants at the several conferences at which working drafts of our study were discussed. In addition, we should like to thank Mark Frankena, Jean Baneth, Neville Beharie, Solomon Fabricant, and Peter

K. Clark for helpful suggestions. The helpful comments of Anne Krueger have also led to many improvements in this study. Our greatest thanks go to Hal Lary of the National Bureau, who has read through successive drafts with the utmost care and thoroughness, far beyond the call of duty. His searching queries and patient prodding have resulted in a vastly improved manuscript.

For excellent and efficient research assistance, we thank B. M. Juyal, Asim Dasgupta, and, in particular, Chellamma Ramaswami and H. C. Sharma who put in sustained work. Parts of the manuscript were typed by Mehar Lal. The full draft has been typed by Katherine Eisenhaure, but for whose efficiency and cheerful cooperation we would have been totally lost between different drafts through the three-year period over which we were working on this book, and by Kris Beard, who worked on the final draft with equal efficiency. During the past year, while Bhagwati was Visiting Ford Research Professor at the University of California at Berkeley, the manuscript went through substantial revisions. The input provided by the university's secretarial facilities is gratefully acknowledged.

We should like to thank the *Economic and Political Weekly*, Bombay, for permission to reprint Chapter 10, which appeared there as the first of three installments during September 2, 9, and 16, 1972; the Oxford University Press for permission to quote and to use material from the Bhagwati and Desai volume mentioned above; and the M.I.T. Press for permission to reproduce tables 1.1, 3.1, and 3.2 from R. S. Eckaus and K. S. Parikh, *Planning for Growth* (1968).

Finally, we should record the caveat that our analysis was basically completed by October 1973. Most of the empirical results reported in this study were obtained, using published and unpublished (provisional) data which were available as of that date. At the time the page proofs were corrected (May 1975), revised data became available. The revisions, especially with respect to data on savings and investment, have been drastic and, in some instances, even the methodology of estimation has been changed. We have not been able to work with the new data at this late stage. However, we do not anticipate that our conclusions, particularly with respect to economic policy, will be changed in any major way. Needless to say, the events of 1971, leading to the dismemberment of Pakistan and the creation of Bangladesh, with all their economic consequences for 1972 and thereafter (e.g., India's refugee relief burden and her continuing aid to Bangladesh after the latter's creation), and the Declaration of Emergency in June 1975 have been major disturbances on the scene, whose long-term effects will not be clear for some time to come.

JAGDISH N. BHAGWATI  
T. N. SRINIVASAN

# Principal Dates and Historical Events in India

## Political.

### I. *Constitutional events*

Independence Day, August 15, 1947

Republic Day, January 26, 1950

### II. *India's prime ministers*

Jawaharlal Nehru, August 15, 1947–May 27, 1964

Interim (Gulzarilal Nanda), May 27, 1964–June 9, 1964

Lal Bahadur Shastri, June 9, 1964–January 11, 1966

Interim (Nanda), January 11, 1966–January 24, 1966

Mrs. Indira Gandhi, January 24, 1966–

### III. *Wars*

Indo-Chinese Conflict, October 20, 1962–November 21, 1962

Indo-Pakistan Conflict, August 5, 1965–September 23, 1965

Indo-Pakistan War, December 3, 1971–December 17, 1971

### IV. *General elections* (opening dates; first election ended February 1952)

First general election, October 1951

Second general election, February 24, 1957

Third general election, February 16, 1962

Fourth general election, February 15, 1967

Fifth general election, March 1, 1971

**Economic.**V. *Plans* (dates of formal adoption)

First Five-Year Plan (April 1, 1951–March 31, 1956), December 1952

Second Five-Year Plan (April 1, 1956–March 31, 1961), May 1956

Third Five-Year Plan (April 1, 1961–March 21, 1966), August 1961

Interim Annual Plans (April 1, 1966–March 31, 1969)

Fourth Five-Year Plan (April 1, 1969–March 31, 1974)

VI. *Industrial policy*

First Industrial Policy Resolution, April 6, 1948

Second Industrial Policy Resolution, April 30, 1956

VII. *Devaluations* (changes in rupees per U.S. dollar as a percentage of the older rates)

1949 devaluation (approximately 43.9 percent), September 20, 1949

1966 devaluation (approximately 57.5 percent), June 6, 1966

VIII. *Aid*

Formation of the Aid-India Consortium, 1958

IX. *Planning: Miscellaneous*

Formation of the Planning Commission, March 1950

Publication of

Professor Prasanta Mahalanobis's Second Plan Frame, March 1955

Draft Outline of Second Five-Year Plan, February 1956

Draft Outline of Third Five-Year Plan, June 1960

First Draft Outline of Fourth Plan (abortive), August 1966

Final Draft Outline of Fourth Plan, May 1970 (presented to Parliament May 18, 1970)

Approach to Fifth Plan, May 1972 (approved by National Development Council May 31, 1972)

**Foreign Trade Regimes  
and Economic Development:  
INDIA**



