'1'   PN-ABG-996
ISN 62012

John P. Lewis
July 1989

Policy Based Assistance: An Historical Perspective on AID's Experience and Operations in India/Asia in a Bilateral and Multilateral Context

1. Introduction

The essence of policy-based assistance is kibitzing by a donor government or agency with respect to a recipient government's policies. In a way, it is odd this is regarded as being somewhat unusual -- for donors are forever sending substantive how-to-do-it messages to recipients. Indeed, such is the case even when, as in the case of U.S. economic assistance to Israel, the donor simply writes checks: the latter has the option of withholding the aid, and therefore, by giving development assistance, can be interpreted as endorsing the recipient's development strategy. (The same can be said of any discretionary aid donor.)

Capital assistance in the project mode, of course, is replete with didactic content; typically, the donor makes elaborate efforts to encourage and require the recipient to do the kind of project the donor favors in a way the donor approves. And technical assistance, obviously, is an enterprise consisting of little else than the exchange of constructive messages.

It is true, however, that policy guidance was not something aid donors were heavily into early on. Policy, on a general-specific spectrum, lies between the generality of the rhetoric and arithmetic of a country's development strategy or plan and, on the other hand, the specificity of sitespecific projects. This middle level of policy is critically important, of course; it translates plans into actionable sectoral and other implementation agendas; and it frames and provides coherence to development projects.

There were two reasons, however, why, in the 1950s, and early 60s, when aid donors were endorsing development plans and engaging in detailed, on-going project negotiation, they were slow to intrude into the realm of policy guidance. In the first place, there was the matter of the suitability of the vehicle. Policy advices from external parties, if they have much chance of being attended to, have to be conveyed by -- coupled to -- some kind of concessional transfer instrument. The instruments overwhelmingly in use in these earlier years of the aid business were project agreements -- for both capital and technical-assistance projects. And practitioners quickly and almost intuitively recognized that project grants and loans were ill-designed for carrying general or sectoral policy recommendations. Usually -- typically -- the carrying capacity of these instruments was consumed in conveying the donor's input to the design and implementation of the particular project itself. There was no spare room, so to speak, for adding on broader policy advice.

This point, about the match or not between the broadness of an aid instrument and the width of the swath of recipient behavior the donor seeks to influence, is almost common-sensical. It will be corroborated by the South Asian experience I review. Yet it has not been widely remarked, and therefore I would like, here at the outset, to posit as almost axiomatic the desirability of using sector-wide instruments for sector-wide targets, and economy-wide instruments for economy-wide targets. If I am not mistaken, the point helps explain, for example, the vehemence with which World Bank policy-based lending burst on the world at the start of the 80s. Through the 70s the Bank assembled the world's biggest array of development-policy-analysis talent -- and was progressively frustrated because, being locked overwhelmingly into a project mode of business, its effective outlets for its policy-advising ability were so limited. By establishing an unmistakable need for more nonproject funding, the adjustment crisis that overtook us in 1979 created the opportunity for the surge of multilateral-led policy-based lending that is still underway.

So (to return to the comparative lack of a policy emphasis in AID's early years) one reason, then, was the paucity of nonproject vehicles. The other reason was more obvious: host governments, especially perhaps in newly emerging nations with newly minted sovereignties, detested this kind of intrusion. Projects, which were discrete and bounded, they could handle; most projects could be psychologically and politically quarantined. Similarly, support of and advice concerning general development strategy were too diffuse to be very threatening. But <u>policy</u> advice, concerning fiscal and monetary management, trade and exchange rates, market regulation, agricultural promotion and incentives, the interface between agriculture and industry, the development of the human resource sectors -- pointed external intrusions into such matters struck nerve tissue. Perhaps such interventions were particularly objectionable when they came bilaterally -- from another government, a juridicial peer. (We shall return to the question of whether a multilateral agency has inherently better standing as a policy kibitzer.) But, in any event, policy advising was a prickly, contentious business that donors, especially those with kinder, gentler manners or under the influence of foreign ministries allergic to diplomatic boat rocking, did not enter casually.

I already have alluded to the surge of interest in and practice of policy-based assistance that began at the start of the 1980s. The terms of reference for this paper do not call for an examination of this recent experience. But the latter obviously motivates the request for the paper: the present salience of the subject excites curiosity about earlier instances of such assistance, and one such case or set of cases involved South Asia in the 1960s. The countries were India and Pakistan, with Pakistan slightly in the lead chronologically but with the longer, more complex story being played out in India. The players on the donor side were the United States and the World Bank, the two being distinct but close and cooperative, with the stronger lead coming from the U.S., especially in Pakistan. The "U.S." meant mainly the then newly reconstituted aid agency, of course, but it also meant, to a separate extent, the ambassadors in Delhi and Karachi/Pindi as well as the State Department in Washington; it very much meant also the Department of Agriculture in the Indian case; it quite actively meant much of the Executive Office structure, including the Budget Bureau and the Office of the National Security Adviser; and, too a quite extraordinary degree in the case of President Johnson, it meant the President himself.

I can testify personally that the speed with which a policy focus moved center-stage on the donors' South Asian agenda in the early 60s was striking. In 1959-60 I spent 12 months in India gathering material for a book on Indian development and in that capacity fraternized a lot with Indian, U.S., and World

Bank officials and with other interested observers. At that time the focus was still heavily on the arithmetic of plan architecture -- on the totals of investment and other plan outlays, intersectoral allocations, growth rates, gaps, internal consistency, and requirements and resources balances. One heard little talk from the donors about policies as distinct from projects and the financial aggregates. When, four years later, I was being briefed in Washington for a return to India as director of the AID mission, the air was full of policy talk; the touchstone issue in the agency (and, with the launching of the Bernard Bell Mission to India, it was becoming so at the World Bank) was how to use transfers to promote certain key sets of economic reforms in the recipient country. The new enthusiasm for policy-based lending, moreover, was not callow. It recognized that such lending would need to be coupled with greater use of program loans, or other nonproject vehicles; and it was prepared to go against the grain of preferred (pro-project) aid practice in this regard. Second, the new policy enthusiasts knew perfectly well that they were about to stir up a measure of turmoil on the side of their clients -- and they were prepared to pay that cost. What had brought such a change of heart?

The shift had two interlocking components. First, matters of substance. At the end of the 50s in India donors' acceptance of the cogency of Indian development planning and strategy was still comparatively uncritical. In 1960 three distinguished outsiders, headed by Sir Oliver Frank, whom President Eugene Black of the World Bank asked to assess India's Third Five Year Plan (for 1961-65) gave the design a quite resounding vote of confidence. But at about the same time staff appraisals in the Bank and also in AID began to express growing concern about the way the regimes of external and internal controls of (among other variables) imports, investments, new starts, materials allocations and prices that the GOI had adopted to implement its inward-oriented import-substitution industrial strategy were pyramiding on one another and progressively inhibiting market transactions and obstructing growth.

Similarly, as to agriculture, while in 1960 there already was great concern on the side of the Americans that the GOI was under-investing in agriculture, by 1964 there was much greater clarity among the donors (as we shall see, their views were shared by many Indians) about what the nature, the content, of agricultural reform should be. A focus on prices and incentives had come center stage and -- even more important -- a powerful new technology was becoming available. These two strands of reform -- in agriculture and in trade and industrial policy -- were the interlocking reform agendas for both India and Pakistan during the 60s.

The second factor that brought policy issues to the fore for the donors in South Asia in the early 60s was personnel. In Pakistan there was less of a backlash against official planning than in India because the official planning of the 50s was not as ambitious, or taken as seriously as the Indian, nor was the government as forceful an economic manager until General Ayub took charge at the end of the decade. But Pakistan, with heavy inputs from Harvard, Yale, Williams, and Stanford, all Ford Foundation funded, became in the 50s a veritable bootcamp for the training of progressive development economists who nevertheless had a lively appreciation of the usefulness of markets. The elder statesman of this group was Edward Mason. The apostle who captured the minds of some senior Pakistanis, including Ayub himself, to liberalization doctrines during the early 60s was Richard Gilbert. And one of the most influential was the first field chief of the Harvard Group, David Bell, who, of course, turned up as AID's Administrator in 1962. In the realm of liberalization, therefore (much less, of agriculture) ideas by 1964 had spilled from people in Pakistan, and in and out of Pakistan, to both major donors and all of South Asia.

This sketch of the policy-based assistance experience in South Asia in the 60s will concentrate on the Indian case. That is where my own experience was, and it is on India that most of my current research has been concentrating. At the same time, the Pakistan record also is important, of course, and fortunately I had occasion to review some of it for the World Bank four years ago. Hence subsequent sections will be ordered as follows: (2) India; the pre-1964 background; (3) Indian agricultural reform (1964-72); (4) Indian trade and industrial liberalization (1964-68); (5) summary of the Pakistan experience; (6) conclusions.

2. India: the pre-1964 background

Certainly one question to be asked in assessing the effectiveness of external policy intervention is whether the intervention was needed. Or were the ideas already there and the locals in the process of acting on them?

The conventional wisdom -- at least academic wisdom -- on the subject of this paper is that U.S. and World Bank policy kibitzing in India in the 60s was pretty badly botched. But the conventional North-Western[1] opinion also is that the intervention was badly needed -- the Indians required an outside input to straighten out their policies.

As to the latter, the facts are quite mixed. The Indians had chosen their capital-intensive, import-substitution, controls-intensive model of industrialization, not mainly because of Marxist infection but because they thought it fitted their giant-economy circumstances. It suited their passion

---

[1] North as in North-South, West as in East-West.

for swadeshi -- self reliance. As a re-emerging sovereign state they tried, as quickly as possible, to make for themselves as much as possible of all the products they needed; their natural commercial policy was protectionist. They took their lessons less from the Russians than from the British and American economies of the 30s and 40s. The British and American governments, first, during the Depression, then in the war, lost much of their respect for imperfectly competitive markets and substituted an abundance of market regulations, controlled resource allocations, and activist fiscal and monetary policies. India's bureaucratic elites proceeded along the same lines.

However, a fair grounding in neoclassical economics was part of the intellectual baggage of most of these same officials, and, once the resources situation tightened up as the more ambitious Second Five Year Plan (1956-60) took hold and the country's wartime accumulation of reserves was run down, many of the officials began to have second thoughts. For then the clutter of controls started to bind and self-proliferate, placing increasing drags on industrial expansion. Many bureaucrats and ministers, to be sure, enjoyed wielding the power created by the controls system; but more and more of them, impressed by the system's costs, became -- on practical, not ideological, grounds -- nascent converts to liberalization.

The background as to agricultural policy was both more complex and more intriguing. One thematic view of agriculture throughout the 50s can be identified with the Planning Commission. It was against excessive allocations to agriculture, so that more resources could be provided to industrialization. The planners invoked the dominant development economics of the time, which argued that newly developing economies, in order to speed industrialization, needed to extract surpluses of one kind or another from agriculture. Moreover, the planners, anxious to keep down the cost of wage goods, were against mobilizing the surpluses via market incentives; it was better, they thought, to use such artifacts of the command economy as levies, government monopoly procurement, and food zones.

Another leading strain of agricultural opinion was that of the institutionalists. This was the preferred view of many social scientists, only some of whom were politically radical. Among expatriates a distinguished exemplar was Gunnar Myrdal.[2] According to the institutionalists, the Indian countryside, including its principal industry, agriculture, was so ridden with gross, discriminatory and counterproductive inequalities that it required a structural transformation -- most particularly, a radical recasting of land distributions and tenurial arrangements -- before any program of productive expansion could take hold effectively.

In a sense the community development movement, which dated from the beginning of the 50s and promoted organized rural grassrootsism of a rounded institutionally articulated, kind, was intellectually allied with the institutionalists -- even though the latter tended to regard community development as a rather tame palliative. The institutionalists, however, reserved their real scorn for those they did not call, but might well have called, the agricultural mechanics.

The latter were the technocratic precursors of the 1960s reforms. Their collective contention was that, without any monumental institutional changes, you could fix up the agricultural production function by a series of interconnecting adjustments in pricing, technology, agricultural research, extension services, input supplies, marketing, credit and stock management.

---

2 The Asian Drama, New York, Twentieth Century Fund, 1968.

Most of the agriculture-related external actors who appeared on the Indian scene in the 1950s -- notably the U.S. Technical Corporation Mission (which would become AID in 1961), the Ford Foundation and the Rockefeller Foundation -- propagated one or another of the components of the mechanical approach. But for a time no one of them advocated as comprehensive a form of what became the reform program as the one that began emerging from the GOI's Ministry of Food and Agriculture in the early 50s.

One should not suggest that the Ministry of Food and Agriculture had its act completely together either. Within the Ministry, for example, there were still two schools over whether such activities as irrigation and research should be aimed at maximizing output or, in a drought-prone monsoon climate, be defensively oriented (as they were under the British) toward drought protection. Moreover, at the end of the 50s there was a Minister of Food and Agriculture who became so enamored of doing large PL480 deals that his commitment to domestic production promotion sagged.

Nevertheless, there was a dominant Ministry position that was articulated by successive ministers in the 1952-54 period and elaborated by a Foodgrains Inquiry Committee in 1957. The chairman of the latter was a Praja Socialist politician, Asoka Mehta, who would be the Planning Minister during the reform years in the 60s. But the connecting link through all these exercises -- as senior economist, member-secretary, and/or adviser -- was the distinguished government economist, Dr. S.R. Sen. The S.R. Sen program, as it was developed from 1952 onward, would have raised the agricultural investment priority, established incentive price supports for cultivators, dismantled food controls, established a buffer stock to cushion food price fluctuations, established a public-sector food corporation to handle food procurement, inventories, and releases nationwide, and instituted a standing agricultural prices commission to set support and stock-release prices from season to season.

The Sen program was light on one pivotal component of the 1960s "new agricultural strategy," namely heavy reliance on the new seed-fertilizer-controlled water technology for growing high yielding varieties (HYVs) of foodgrains -- because, while its foreshadows had begun to reach India, that technology was not yet quite available for adaptation in the 50s. Because the role of fertilizers would be greatly magnified by the new technology, the Sen program also gave less emphasis to the modalities for expanding fertilizer production than would the new strategy that Minister C. Subramaniam would announce to India's Parliament in December 1965. But otherwise the 1950s scheme encompassed nearly all facets of the 1960s agricultural reform agenda.

By the turn of the decade, moreover, the main American actors in Delhi all were making reinforcing moves. Rockefeller was introducing the beginnings of HYV breeding. TCM, by beginning to assist the launching of state agriculture universities, was helping broaden the research and training infrastructure. Ford, having sponsored a "food crisis team" that shouted the need for greater agricultural effort, was promoting so-called "package programs" for particularly promising districts. Indeed, with this much reinforcement, the line of the food-ministry technocrats for raising the production function might have overcome the Planning Commission's and the Finance Ministry's allocative reservations, had it not been for one thing: the Prime Minister.

Jawaralal Nehru, an elitist, self-made constitutionally stalwart, non-Marxist socialist, enthusiastically shared and led the country's industrialization strategy. In agriculture he was an early supporter of community development but, more fundamentally, was what I have called an institutionalist. Early on he was much too sanguine about the political feasibility of thorough-going land reform -- and about the achievability of agricultural output expansion without great government effort. When, by the mid-50s, he had sobered on both counts, he led the left-leaning wing of the Congress Party into a no-win "solution": agricultural expansion was to be achieved cooperatively -- not just via credit and service co-ops (they were old hat in India) but via cooper tive production; single-family farms were to give way to joint cooperative farming. By now in the 1980s nearly everyone -- in the socialist countries as well as the rest of the world -- would agree this was a wrong call. Indeed, it was immediately resisted in India; there was minimal implementation of joint cooperative farming in the early 60s. But this, after all, was the Prime Minister's aberration -- it delayed alternative decisions.

It is not clear how long that delay would have continued had Nehru not died at the end of May, 1964. But with this greatest of India's prime ministers still in place, and continuing to lead and place great reliance on the Planning Commission, it is quite clear the reforms of the 60s would have had tougher sledding.

As to the reforms' Indian background in the 50s, then, my conclusion in a longer, yet unpublished, examination of the period is the following:

> ...[F]or a variety of reasons, only one of which was the Prime Minister, what became the policy agendas for the 60s, in the areas both of agriculture and of trade and industrial policy, had not yet snapped into actionable focus when the decade started, or even by the time Nehru died. Intellectually, the makings of a reform largely existed within the country, but they needed some catalyzing.[3]

---

[3] John P. Lewis, "Donors and Policy Reform -- India in the 60s -- I. The Case of Agriculture," unpublished draft, February 1989. Rights remain with the author.

3a. India: the agricultural reform transaction 1964-65)

The first phase of the use in India of nonproject and food aid in support of agricultural policy reform lasted only a year and a half -- the same year and a half of Lal Bahadur Shastri's prime ministership and the first 1 1/2 years of C. Subramanian's tenure as food minister. Shastri was a lesser person than Nehru but his own man. In establishing the office of Secretary to the Prime Minister for the first time (the senior, pragmatic, market-oriented civil servant, L.K. Jha, was the initial incumbent) Shastri signalled his wish to stay somewhat distant from the Planning Commission and Finance. That his priority for agriculture exceeded Nehru's was indicated by his selection of the new reform-minded Minister of Steel from Madras, C. Subramanian, as Minister of Food and Agriculture.

Subramanian, a versatile lawyer, himself from a farm family, quickly staked out his style and directions. He was for incentive prices and wanted to institutionalize their availability. He was for a food corporation that would contribute to this end, begin to reduce the balkanization of the national food market, and start building the buffer stocks that market stabilization and a public distribution program would require. He was emphatically for science, for building the indigenous agricultural research establishment, and for early and bold resort to the new varieties of food grains. He restaffed his ministry with more scientists and new, nontraditional risk-taking senior bureaucrats.

Subramanian's initiatives were mainly, if not reliably, backed by Shastri. Many Planning Commission people as well as his fellow Tamil, T.T. Krishnamachari, the Finance Minister, lined up in opposition. However, he found close allies in L.K. Jha and Asoka Mehta, now the head of central planning. I have noted how enthusiasm for levering Indian policy reforms was building in Washington in the summer of 1964. Quite clearly, the way Subramaniam burst onto the agricultural scene helped translate these intentions into action. We were anxious to strengthen him in his pursuit of an agenda we so largely favored. Thus in September 1964 Willard Cochrane, lead economist of the U.S. Department of Agriculture, visited Delhi and lent analytic support to the food pricing and food management policies and institutions that the Minister and L.K. Jha favored. And at the beginning of October the AID Mission did a bit of an end run on the Finance Ministry (which had been planning to use the foreign exchange for other purposes) by writing a letter to Finance but with a copy to the Food Minister noting that the balance of India's nonproject entitlement for the year could be used for more imported fertilizer. Thus alerted, Subramaniam faced down Finance and seized the prize. The era of activist U.S. policy intervention can be dated from those two modest beginnings.

In the case of agriculture, donor activism was mostly a U.S. affair. Up to 1964 the World Bank had given much less time and attention to agriculture than had the official and non-official American actors -- TCM/AID, Ford, and Rockefeller. When a major Bank review of Indian development strategy -- the (Bernard) Bell mission, which will be discussed in a later section -- was launched in the summer of 1964, the Bank made a point of going outside itself to augment the mission with a strong agricultural component headed by the senior Australian government economist, Sir John Crawford, and including Louis Goreux, Wolf Ladejinski, and W. David Hopper. The Crawford et al subreport (based, like the rest of the Bell Mission Report, on several months of in-country analysis) that emerged in the summer of 1965, was a thorough, authoritative, and sensible assessment of India's agricultural needs. But it very largely agreed with the strategy discussions in which USAID, together with the two foundations, already was immersed with the Food Minister and his staff.

This USG-GOI discussion (the word today is dialogue) continued straight through the fall of 1964 and the whole of 1965. It culminated in Minister Subramanian's announcement of a "New Agricultural Strategy" in Parliament, and the U.S. responded with a fresh (nonproject) loan, both in December 1965. This was the basic agricultural reform transaction. Given what I have sketched of S.R. Sen's 1950s thinking, together with the supplemental matters of HYV technology, and of the fertilizer issues related thereto, the content of the "New Strategy" will come as no surprise. In due course I will summarize what jelled by the end of 1965. But an examination of what intervened procedurally is rather more interesting, for the year had anything but a tranquil story line: it included a drought, a war, and the beginnings of some quite extraordinary Presidential behavior. Yet the cause of reform made marked and fairly steady progress.

To a striking extent a two-team pattern emerged on the USG side. All of the U.S. actors thought Indian policies needed changing and that it was appropriate to use transfers, especially of the nonproject kind, to encourage such changes. But the one school was more upbeat and positive in its assessment of Indian potentials, behavior, and needs. In the eyes of the other school, the first was too soft on the Indians. The first school had a cleavage of its own to begin with. Those of us in Delhi, led by Ambassador Chester Bowles, tended to be more upbeat than our AID colleagues in the NESA Bureau. But then, at the start of 1965, we wrote a confidential memo called "Betting on

India" that (to quote my still-to-be-published material)

> argued that India's development performance lately had been better than its reputation, suggested that a faster pace of liberalization reform could not be expected until the country had more foreign exchange cushioning, and proposed that the Agency ponder seriously whether India might not be ready for the kind of "big push" therapy that AID's chief economist and Assistant Administrator for Program, Hollis Chenery, had been hypothesizing. Why not, said the memorandum, consider raising per capita aid to India closer to what Pakistan already was getting (about twice as much per capita)? Such a thought, the Mission noted, could, among other things, powerfully enhance agriculture's inputs as well as incentives.[4]

The AID Administrator, David Bell, ruled immediately that NESA and the Mission should undertake a joint analysis to test out the Big Push hypothesis. This was done energetically but amiably in the early summer of 1965. The two units met each other half-way. The Bureau raised its sights, while the Mission agreed that the incremental bill could be covered in large part by shifting project aid into nonproject uses. From this point through the balance of the 60s, not only was there substantial agreement between the Bureau and the Mission; the converged, positive view of India's prospects and reform potentials was shared by AID's top command, i.e., by David Bell, and by his then deputy, later successor, William Gaud; and the same perspectives resonated well in the Executive Office -- with the Budget Bureau, with those members of the National Security Council staff who worked on India, and with the latter's successive chiefs, McGeorge Bundy and Walt Rostow.

Indeed this majority upbeat school might have prevailed at will had it not been for one thing: the President of the United States was a member of the

---

[4] Same source and retention of rights in footnote 3. The memorandum was dated January 14, 1965. A declassified version is now available at the LBJ Library, Austin.

minority. President Johnson started skeptical not only of the size of aid to South Asia but of the seriousness and cogency of the Indian development effort. His memoirs indicate that he came to this view himself, but he was reinforced in it by his Agriculture Secretary, Orville Freeman, and the latter's staff. At the behest of Chester Bowles (another ex-Democratic governor) Freeman had paid a strenuous and thoughtful visit to India in April 1964, just before Nehru's death. He was troubled by what he saw not happening in agriculture and wrote the President about it. Their joint, interacting, skepticism escalated. Freeman sent a couple of staff economists to India in the early months of 1965 who came back with a more bearish view of the country's agricultural prospects than AID's; in particular, their estimate, which quickly found its way to LBJ's pocket, placed little reliance on the "new strategy" moves that we on the ground thought the GOI was making. The President, for his part, in April refused to let the U.S. delegates to the annual pledging session of the aid-India consortium do their usual pledging; he refused to let us proceed with a nonproject loan for which appropriations already were in hand; and, to the particular dismay of the Indians, from the end of March onward, the President began what was to be a chronic feature of his whole remaining term. He delayed approving what previously had been a matter of routine -- the signing of a new PL480 agreement.

Having sorted out the multifaceted new agricultural strategy that he would succeed in having adopted by the end of the year, Subramaniam in August spread it before the Planning Commission, which rejected it as excessively ambitious. But, at least ambiguously supported by Shastri, the Minister pressed ahead, laying the same program before the National Development Council[5] the following month. But meanwhile two crises would intervene.

By mid-September it was becoming apparent that India was suffering a severe drought -- by the time the 1965-66 crop year was over, it would prove to be one of the worst of the century; foodgrains output would be down 20 percent from the preceding year, and the need for PL480 imports would be radically augmented. Also by mid-September, however, efforts were being made to bring a brief Indo-Pak war to a close. Immediately upon its outbreak early in the month the US cut off military assistance, including pipeline flows, to both sides and, although it let the economic-aid pipeline flow, it suspended the making of fresh economic aid commitments. With India's US food aid as well as economic assistance already on hold and the start of the Fourth Five Year Plan presumably only six months away

> it had become a matter of both near-term and medium-term urgency for [the Indians] to secure the resumption of American aid. And in the eyes of the Food Minister as well as his American well wishers, the place to start was with the firm establishment of his new agricultural strategy. Subramaniam had failed fully to sell the Planning Commission ... and Finance Minister T.T. Krishuamachari was vehemently opposed ... But the Prime Minister supported ... in part because of the need to break loose the whole aid log jam. The question was whether Subramaniam could bring the strategy to the Cabinet ..., obtain a vote to accept the program and spread it before the Parliament in the confidence that it would trigger renewed consortium-wide support.[6]

Subramaniam's ability to carry his colleagues (less TTK) undoubtedly was enhanced by the drought. The latter not only increased the need for food aid, it concentrated their attention on agriculture. Particularly after Subramaniam

---

5 The Union Planning Commission and economic ministers joined by the chief ministers of India's states.

6 Same source and retention of rights as in footnote 3.

had made a spirited defense in Parliament of the US right to delay PL480,[7] the Cabinet's concern over the drought muted its rancor over the US aid suspension. What was at issue now was Subramaniam's ability to carry LBJ.

Here the Freeman connection became important. Negative messages were still reaching the President from that quarter. For example, on October 23, in the Secretary's absence and at the President's direction, Under Secretary John Schnittker sent over a paper he summarized as follows:

> 1. India has failed to live up to a commitment to this Government and to her own people, in failing to reach her food production goals.
>
> 2. India has not given fertilizer and food production the attention or the investment promised in her plans and required by her people.
>
> 3. India's key failures have been in fertilizer, pesticides, producer incentives, credit, and seed varieties.
>
> 4. For the future (and aside from population policy) fertilizer production is the crucial factor. Better performance will require a dramatic approach -- one not at all apparent in India's plans today.
>
> 5. The U.S. must use all possible leverage to improve India's performance. Food assistance must be contingent on specific actions which are in the interest of India and the Free World, but which India will not take of her own accord.[8]

Subramaniam came to Washington in November to seek extra PL480. He saw the President, but, in a sense, more important, he saw Freeman and saw him again at the end of the month in Rome, where they both were attending the biennial conference of FAO. Subramaniam sold Freeman on himself and on his program, and Freeman sold the President. But first, in their Rome discussions, whether to satisfy Johnson or himself, the Secretary insisted on a detailed

---

[7] The US purpose was not, he said, to pressure India on Kashmir. He did not deem it "interference in affairs of India for USAID to insist on scrutiny of our agriculture production programs which would make us independent of PL480." Embassy message from New Delhi 11/8/65, NSF file, NSC History, LBJ Library, Austin.

[8] NSF, NSC History, LBJ Library, Austin.

written understanding between them -- what became the secret, and for many years remained the secret, "Treaty of Rome." Although its bilateral character was closely held (we in the Delhi Mission had a chance to comment on it telegraphically) the substance was shortly in the public domain because this was the program that Subramaniam, having sold his cabinet colleagues as soon as he returned, presented as the New Agricultural Strategy to the two houses of Parliament December 6 and 7.

In lecturing in Australia in the late 70s, Subramaniam remarked that in his negotiations with the Americans he agreed only to "steps we had already taken and that we proposed to take."[9] This was substantially right, although the undertakings with respect to fertilizer production were arguably more explicit than would have been the case had the Indians been left to their own devices. At the same time, this comment deserves to be followed by a brief aside on the subject of fertilizer expansion, which was highly newsworthy at the time but in fact was less conflicted than was commonly perceived.

No one in the mid-60s doubted, especially with the demands of HYVs, that India needed radically increasing supplies of fertilizer, and at the time there was no real argument with the proposition that this meant radical expansion of domestic fertilizer production -- especially of the physically and financially dominant nitrogenous fertilizers. One contentious question was whether the technology should be indigenous or imported (temporarily, because of major breakthroughs in new ammonia-urea processes, the answer, to the dismay of self-reliance advocates, had to be, imported). But the greater and overlapping issue concerned organizational modes: public-sector or private-sector, and how

---

[9] C. Subramanian (1979). The New Strategy in Indian Agriculture, Six Lectures to the Master's Programme in Agricultural Development Economics, Australian National University, New Delhi: Vikas, p. 53.

much room for foreign private investment? There was those on both sides of the aid bargain who approached these questions with ideological fervor -- some dedicated public-sector advocates among Indian ministers and officials, some committed private-sector, foreign-investment partisans on the US side.

But most of the key players on both sides were pragmatists. Their view was that so much fertilizer expansion was needed that there was room, indeed a demand, for all modes -- public-sector, private, foreign-private, and various mixes, including cooperatives, in between. This was the predominant view in AID/Washington, the White House, USDA, the Embassy and Mission in Delhi as well as, on the GOI side, of the Food Minister, his excellent Agriculture Secretary, B. Sivaraman, the Planning Minister and the Prime Minister. And US aid assisted all aforementioned varieties of fertilizer plants.

For a time, as I try to spell out in the longer piece to which I have referred, our fairly harmonious position on this matter was camouflaged by the high drama attributed to the so-called "Massive Fertilizer Program" for the construction of a multiple set of matching nitrogen plants put forward by a consortium of US firms headed by the Bechtel Corporation. But there always was rather less to this initiative than met the eye. It fizzled out in May 1965 with few traces -- except that in the aftermath of the Bechtel episode, Indian leaders were doubly concerned to demonstrate their receptivity to the right kind of foreign investment in fertilizer and therefore perhaps went somewhat further in that regard in the New Strategy than they otherwise would have done.

It is time, then, to summarize the substance of the deal that was done in the "Treaty of Rome" and broadcast in the New Strategy.

> The "Treaty" provided that investment in agriculture would be increased 40 percent in the coming year and during the Fourth Five Year Plan (1966-67 through 1970-71) would be raised above the Planning Commission's projection. India would adopt ambitious

> fertilizer consumption targets. Fertilizer production, including foreign private investment in same, would be actively promoted, and to this end geographic and other restraints in fertilizer distribution would be removed; goaded by a cabinet committee to expedite private including foreign private fertilizer manufacture, licensing procedures would be simplified and the GOI would not require government participation in private-sector fertilizer plants. The government undertook a thorough shakeup of the agricultural credit system, which hence forward would accommodate more alternatives outside the cooperative sector. The government committed itself in terms of specific acreage and target tonnages to the intensive areas approach. These favored areas would have first call on seed, fertilizer, and other inputs. "Price policies would be reviewed periodically to ensure a continuing favorable relationship between the price of foodgrains and the price of purchased inputs such as fertilizer." The Food Corporation would move into high gear, with the Centre now developing and implementing "a rational food policy." The "Treaty" wound up with further rhetoric about the commitment of everyone on the Indian side from the Prime Minister on down to the priority of agriculture -- and then, finally, addressed its one petition to the U.S.: "Minister Subramaniam emphasized the critical importance of reaching (an expanded fertilizer imports) target, stating that, in view of the severe limits on the availability of foreign exchange...immediate United States aid is imperative."[10]

As soon as the Indians' formal adoption of the new strategy was relayed to LBJ, with Orville Freeman's seal of approval as well as our own, the President authorized the release of 500,000 tons of wheat to keep the food pipeline from developing a large bubble and, as well, the resumption of AID nonproject lending with a $50 million fertilizer loan. For the latter, however, we were directed to extract from the Indians a series of undertakings essentially repeating the elements of their own just-adopted strategy. To avoid embarrassment we did this through a secret side letter -- that, however, was leaked to the press within a couple of weeks, when the disaffected Finance Minister Krishuamachari broke with the Prime Minister before Mr. Shastri went off to Tashkant to reach a peace settlement with Ayub Khan and had his fatal

---

[10] Same source and retention of rights as footnote 2. Quotations are from the "Treaty" document in the NSF, NSC History file, LBJ Library, Austin.

heart attack.

Before these untoward events I wrote an assessment of the whole agricultural reform transaction to Robert Komer of the NSC staff that was, I must say, distinctly upbeat:

> The Administration has a right to feel proud of the progress of its India policy since I wrote you a month ago about the problems of aid resumption. The U.S. has helped engineer what could be a breakthrough for Indian agricultural expansion:
>
> The new near-term and longer-term agricultural program that Subramaniam, with Shastri's support, pressed through the Cabinet and announced in Parliament the week of December 5 has more solid context and promise than any comparable program since independence. It is more radical in its emphasis on:
>
> - fertilizer imports
> - enlistment of foreign private investment in fertilizer, pesticide, and seed production, and
> - resort to the free market, especially for fertilizer distribution,
>
> than anyone could have safely forecast even two months ago.
>
> Certainly the timing and probably the content of the new program owe much to U.S. pressure -- both our recent generalized pressure in behalf of agricultural self-reliance and the specific negotiations that reached high gear in the Freeman-Subramaniam Rome talks...
>
> In some ways the most auspicious development of all has been the GOI reaction to our performance conditioning of the $50 million fertilizer loan:
>
> - the assurances we asked were all sensible, all economic, all in the Indians' own interest...
>
> - nevertheless our list of conditions was a yard long and of a kind that would have made the Indians bridle a few months ago.
>
> - not only did the GOI give all the requested assurances ... it gave the assurances briskly and cheerfully ...
>
> - obviously the negotiation was facilitated by the fact that the Indians had just adopted most of the conditions on their own the week before. But the fact that they had done this and then immediately observed the way good self-help pays off should speed the acceptance of similarly

conditioned assistance in the future.[11]

3b. Indian agriculture: follow-through and modalities (1966-68)

My end-of-1965 assessment of the agricultural-reform venture turned out to be too euphoric -- but not with respect to India's implementation of the undertakings or the effects on economic performance. The follow-through was extensive and strong, in part because of an outstanding performance by the bureaucracy. The Congress Party took a bad buffeting in the parliamentary election of February 1967; Subramaniam, for one, lost his seat; and the Cabinet that was reconstituted around Indira Gandhi, the Prime Minister who had succeeded Shastri, found itself, as to new initiatives, almost stalemated for two years. But as the result partly of foresight, partly of luck, an exceptionally strong and risk-taking set of senior economic officials (de facto headed by Agriculture Secretary Sivaraman) was in place, and they boldly ran the course that had been set.

While still in place, Subramaniam imported a whole shipload of Mexican seed wheat, which the internal research establishment, itself undergoing rapid development, converted into indigenous HYVs. In the succeeding year or two prices were indeed provided at incentive levels; in fact, with the new technologies, a farm lobby began to form so fast that soon the Agricultural Prices Commission found itself having to suggest moderation to pro-farmer state chief ministers. The Food Corporation moved incrementally toward a national system of food management. The intensive areas got their input priorities, and agriculture got its increased financial allocations. Fertilizer distribution

---

11 Memorandum for Mr. Robert Komer, the White House, December 28, 1965. Declassified 5/23/78. NSF, NSC History, LBJ Library, Austin.

was freed and partly privatized. A growth of 15 percent annually in fertilizer consumption was achieved and sustained, supported by imports as needed and by aggressive pursuit of the domestic-production, including foreign-private-investment, agenda. Sivaraman himself led an investment-hunting expedition in North America and Europe. Many of the investors were hesitant, and to nudge them toward decision, the GOI put an end-of-'67 deadline on some of the inducements offered. But total plant construction of all organizational modes rose fast enough to keep the domestic fraction of total supply increasing.

Whether and how much of a positive effect the new strategy had on Indian food and agriculture output has been much debated. This is not the place to probe the question in detail. By now, I think, the conventional estimate suffices. The impact of the new strategy certainly was concentrated on water-controlled areas and was greater, especially in the early years, on the wheats than on the rices. But as to impact on total agricultural production, the new strategy replaced the diminishing availability of new land. Thus output was able to stay ahead of population growth and the country, which had seemed incapable of building a buffer stock ten years earlier, had, by the mid-70s, without any general worsening of income distribution, built a substantial buffer.

The other "effects" question so often asked about the Green Revolution is whether it had adverse consequences distributionally. The answer is complicated and mixed, but I submit that it is not needed for our particular purposes, for they are to assess the effectiveness of policy-based assistance in contributing to the success of reform in achieving its announced and intended purposes. And in the mid-60s, for the time being, we were not worried about equity in the Indian countryside. The deficits in total output were so grave that reform was aimed single-mindedly at growth. Actually, by 1968-69 the Indians were a half-step ahead of us in getting on the equity wicket. But in judging whether, according to its own terms of reference, aid leverage "worked" in this instance, one must stick to the impact on output.

Where I was excessively euphoric at the end of 1965 was in my assessment of the Indian reaction to our leverage. In part I simply, or wishfully, misread my Indian friends. They were less cheerful and tranquil than they let on. But it is also true that from the beginning of 1966 the modalities of the exercise soured progressively.

Here it is well to specify that, just as there had been two U.S. teams, as to the substance of Indian prospects and performance, there were two associated procedural styles of policy influencing. The style of the President, with USDA urging him on, was the classic mode of preconditioning favored by the IMF and made familiar in recent years by the World Bank's structural adjustment lending: the donor lays down a number of fairly precise reform requirements to which the recipient must agree before he gets the transfer; then his implementation of the undertaking is vetted.

The other mode -- of the on-going dialogue -- only differs in degree logically; but the mood is quite different. There is a continuing discussion of policy issues, conducted most easily by residents in the recipient's capital, in which the donor tries to strengthen the hand of 'right-thinking' members of the recipient government; there is a mutual learning process; and when the recipient, under its own motion, makes a constructive reform decision, the donor then, as we said at the time, pushes on a swinging door: he finds it already open and makes an admiring, celebratory, loan or grant.

We in Delhi preened ourselves some little on the skill with which we operated in the second mode, and we thought the Johnson-Freeman approach very heavy-handed (and also -- this is not quite the same point -- rather naive in the degree to which it thought Indian institutional and other problems could be given unmodified American fixes). But what happened during late 1964 and 1965 was that the two approaches teamed rather nicely in a kind of good-cop, bad-cop pattern. We contributed something to the development of the new strategy. But then Freeman in Rome and Johnson as the ultimate gate keeper provided closure.

It is hard to say to what extent the reasonably amiable psychology at the end of 1965 could have been extrapolated if further souring factors had not intervened -- I return in the paper's conclusions to the question of whether recipient goodwill is an inherently wasting asset. In any event, what is quite clear is that two factors greatly embittered the relationship beyond whatever degree of lurking bitterness it had at the start of 1966. Both of these registered their effect through the modality of so-called "short tethering" that LBJ had adopted in mid-1965, i.e., keeping the Indians on short rations as to PL480 -- three months or less, rather than multi-year agreements -- in order to keep prodding them into greater pro-agriculture effectiveness. The two factors I now cite converted short-tethering into a way of life for the balance of the President's term. Both in their way were bizarre.

First, the weather turned freakish. As noted, 1965-66 was an extremely bad drought. But 1966-67 was almost as bad (worse in Eastern U.P. and Bihar) and to have two major droughts in a row was almost unprecedented. As we shall see, the effects spilled heavily onto the reactions to liberalization-devaluation reform; and in agriculture, within India, they undoubtedly still further strengthened the agricultural priority. But the second drought had two aggravating effects on U.S. PL480 short-tethering. For one thing, it simply increased the need for food aid and, therefore, the scope -- the opportunity -- for short-tethering. In addition, the drought camouflaged and delayed evidence of improving production performance. Green-revolution effects began to show up rather nicely in the numbers for 1967-68, but meanwhile, in November 1966, skepticism had revived and the Freeman-Johnson school was blaming poor crop results on bad new-strategy implementation -- until a special emissary from the Secretary to Delhi agreed that shortfalls were indeed attributable to the weather.

The other "bizarre" factor was the larger-than-life-size of the LBJ personality. The President had many admirable qualities, but, as one who saw him up close for 10 months,[12] I can join the testimony of those who say he also was a born bully. He delighted in making people run scared. Once he discovered the satisfaction of entertaining -- sternly, unresponsively, enigmatically -- ardent pleas from all over for the release of the next tranche of PL480, he became hooked on the procedure. Despite repeated suspicions in the press, there was seldom evidence that his delays were politically motivated, whether in response to Mrs. Gandhi's birthday greetings to Ho Chi Minh or otherwise. But the President continued to stonewall on agreements after, as far as the bureaucracy could see, every concern had been met -- and well after his Agriculture Secretary was urging him to sign. Short-tethering had become self-justifying.

Whereas a good many official Americans were embarrassed by the latter phases of the Johnson performance, Indians with few exceptions were infuriated. Speaking in Australia a dozen years later, Subranamiam, America's greatest

---

[12] As a member of his Council of Economic Advisers in 1963-64.

friend in the 1966 Cabinet, had this reflection:

> ... President Johnson ... said he would release foodgrains, only periodically, month by month, taking into account what we are doing to implement the programs, as if pressure were needed to implement these. The fact that we had to send our requirements of foodgrains to him every month created many difficulties and caused a good deal of irritation...Unfortunately it has to be recognized that America gives generously but does not know how to give...[13]

The Indians were angry over not being given credit for the major reform decisions they had taken and were doing a creditable job of implementing. Their anger was fearful: PL480 shipments at this juncture were life and death matters. At the business end of the stick, my own sense at the time was that PL480 in fact was not the best policy prod (not as good, for example, as a fertilizer loan) because no one, when push came to shove, was going to let people starve to make a policy point. But in interviewing some of the Indian players in recent years I have found only two who shared that confidence. The rest just didn't know what Johnson might do.

The Indians were angry, most of all, because they recognized the bullying. They were being needlessly demeaned. An LBJ apologist would say that he calculated all of this -- that he in fact set out to be a constructive S.O.B. Such is exactly the effect he had. No strategy could have been more effective in galvanizing the Indians into a determination to become agriculturally self-reliant. But it is not a scenario that can be repeated easily, and I am afraid it was partly played that way for the fun of it.

4. India: trade and industrial policy reform (1964-72)

By the mid-60s, critiques of India's overly centralized, overly protectionist, overly capital-intensive, and overly controlled industrial and

---

[13] C. Subramaniam, op. cit., pp. 52-53.

trade strategy, with its over-valued exchange rate, were coming into full voice. Ian Little, a veteran of the Indian scene, was at OECD's Development Centre at work on what became the flagship volume of the general critical literature on trade and industrial policy.[14] Two young Indian economists, Jagdish Bhagwati and T.N. Srinivasan, who would become their country's leading neoclassical, pro-market analysts, both were working for Pitambar Pant, chief of the Planning Commission's Perspective Planning Division, at the Delhi wing of the Indian Statistical Institute. Bhagwati had collaborated with V.K. Ramaswami of the Finance Ministry, writing on domestic distortions, tariffs and subsidies.[15] With Padma Desai he would do the India volume in Little's series.[16] Sruivasan would collaborate with Bhagwati on the India volume in a similar, Bhaawati and Anne Krueger-led series in the 70s.[17] Bhagwati and Srinivasan were sensitizing Pant (like his mentor, Mahalanobis trained as a physicist) to the workings of price systems.

In donor agency circles, C.E. Lindblom of Yale, on loan to USAID/India, finished a devastating detailed analysis of the controls system in 1965. Since 1960 World Bank missions had been writing reports assailing the infirmities and rigidities of controls, the domestic inefficiencies inherent in absolute protection ("banned lists"), and the way allocative distortions, proliferating controls, and reduced export competitiveness all derived from an overvalued currency. Finally, in mid-1965, after spending much of the winter and spring

---

[14] I.M.D. Little, T. Scitovsky, and M.F.G. Scott, Industry and trade in Some Developing Countries, London, Oxford U.P., 1970.

[15] Domestic distortions, tariffs, and the theory of optimum subsidy," Journal of Political Economy, Feb. 1963.

[16] India: Planning for Industrialization, London, Oxford U.P., 1970.

[17] India, NBER, New York, Columbia U.P., 1978.

in India, the World Bank's Bell Mission, with Bernard Bell himself in the lead, provided the 1960s' most comprehensive examination of Indian trade and industrial policy issues.

Among Bell's proposals was an explicit recommendation that the rupee be devalued -- under the circumstances of the time, a sensitive thing to put on paper. As we have seen, quite a lot of the rest of the Bell report dealt with agricultural and rural matters in terms well harmonized with U.S. and, indeed, reform-Indian perspectives. In the trade and industrial area, along with devaluation, the report recommended that controls on industrial licensing be relaxed and that constraints on imports be liberalized.

Even though, in a context of fixed exchange rates, devaluation was a touchy subject, the content of the suggested liberalization reforms surprised no one. At the substantive and personal level such highly trained Finance Ministry economists as I.G. Patel and Ramaswami: readily supported them. (As an official, Patel was concerned about the relation of reform to aid flows, and he was not keen to be read lessons by outsiders.) The senior-most relevant official (as opposed to minister) in Finance at the time was S. Bhootalingam, secretary for coordination and economic affairs. He recalls the liberalization reforms as being so common-sensical as really to have required no encouragement from outside.

But much as I did and do respect Bhootalingam, this seems a bit romantic. There certainly <u>was</u>, as to decontrol, a great deal of inertia in the system. Controls had habit on their side; they served those with appetites for power; they served the corrupt; and, both for officials and for petitioners who knew how to work the system, they served manifold rent-seeking activities that, as to probity, stopped just short of corruption. Thus this was a case where nudging from outside could have an effect, and the aid scenario provided an occasion for making the nudge unmistakable.

The Bank chaired the Consortium (as, of course, it still does). When he became President of the Bank in late 1963, George Woods had inherited the idea for the Bell Mission; by bringing in outsiders he had raised the Mission to a higher level of salience, and he had won acquiescence to such an external vetting from his old friend T.T. Krishmamachari (somewhat to the consternation of some of the Finance Minister's officials and colleagues). Once the findings of the Mission were available in mid-1965, Woods' inclination was to get the whole Consortium to condition much of its further aid on GOI adoption of the sort of liberalization proposed. The largest donor, the U.S., was basically and warmly in agreement. And, fortuitously, its stopping of new aid at the time of the September Indo-Pak War, and the GOI's need to get that flow restarted, focused Indian attention on the Bell recommendations as a latchkey to aid resumption and aid enhancement.

Thus, while Pitambar Pant was being schooled by the two young stars, Bhagwati and Srinivasan, he also was a very practical man, and, according to those who discussed these matters with him, his main motivation for supporting devaluation and the other liberalization reforms was to resume aid and get the substantial aid increases The Fourth Plan, as designed, would require. Similarly, when in 1986 I interviewed L.K. Jha about the sources of the two great reform initiatives of the 60s, he characterized agricultural reform as reflecting mainly Indian ideas and initiatives. But when I asked about liberalization, devaluation, etc., "Oh," he laughed, "that was what George Woods told us we had to do to get aid."

And, indeed, they did it. With Shastri gone, and also with a new Finance

Minister, the new Prime Minister found herself relying heavily on, along with her inherited Secretary, L.K. Jha, the two leading reformers in the Cabinet, Subramaniam and Asoka Mehta. In their experience with the politics of governing at the Centre, both were fairly junior still. But they were confident about the need to press ahead with reform; the donors were eager to see things move in that direction; key officials such as Bhootalingam, Patel and Pant, as well as Jha (some of them her long-time confidants) encouraged it; and she was strongly so encouraged during her trip to Washington at the end of March to meet President Johnson. It was decided that Asoka Mehta would come in late April to do a deal with George Woods, and _he_ did. The deal was that India would adopt an extensive liberalization program, including a devaluation of its own scale and timing. In exchange Woods would undertake to raise $900 million of nonproject funding from members of the Consortium to underwrite or cushion or support the liberalization. The first such provision would be collected with some dispatch. The understanding in many minds, including Asoka Mehta's and my own, was that this would be the first of an annual series of such commitments of some duration (we will return to this rather pivotal point).

Mehta went home with a favorable U.S. press. For a renowned, albeit democratic, socialist, he was remarkably forthcoming about India's receptivity to private foreign investment. On June 6, the surprise having been sprung on most members of the Cabinet only hours before, the GOI announced a devaluation of the rupee from 4.76 to the dollar to 7.5 on, "from the inside," one of 36.5 percent -- and the reverberations began.

There is no doubt, then, that policy-based assistance had much to do _at least_ with the timing of this portion of India's 1960s reform record. Within the limits of this paper, I shall not try to review the case as extensively as

I have that of agricultural reform. I shall focus, rather, on the devaluation -- its economic rationale and on the politics of devaluation, including its timing; on the relation (positive, inverse, or otherwise) between the volume of aid and liberalization reform -- and on the effects of the country's experience with that relationship; and finally, and briefly, on India's follow-through and maintenance of the liberalization initiative.

The mythology is that, while a bunch of single-track donors egged them on, a freshman Prime Minister let two sophomore eager beavers talk her into a terribly unpopular devaluation whose implementation was mishandled; that the devaluation accomplished little or nothing and may have been a mistake even economically; that, in view of the up-coming election, devaluation never should have been announced until it was known that the monsoon at hand was going to be a decent one; and that the devaluation cost the Congress the first semi-defeat in a national election since Independence. Some of this can stand, but, on examination, most of it peels away.

First, the mistaken (implied) monsoon forecast: As indicated already, it was extremely rare to have two major droughts in succession. One would have to be extraordinarily, even dysfunctionally, risk averse to need always to be satisfied that the second-in-a-row was not happening before proceeding with an action whose delay was costly.

Second, as to the alleged bungling: The response here relates also to the alleged unpopularity of the move. Any deliberate, administrative devaluation has to be very closely held to the last minute to avoid speculation and insider trading. But the reason the 1966 devaluation was so offensive to some members of the Cabinet, including the Minister of Commerce, who remained adamantly opposed even in the aftermath (a very awkward circumstance indeed for implementation) was because of the symbolism. And the symbolism of a "failed" rupee was strong -- and unpopular -- because all of this happened in an era of fixed rates. Rate changes were rare, nonroutine, calculated to raise passions -- in contrast, for example, with the successive, completely nontraumatic, steppings down of the rupee in recent years.

Third, as to the economic effectiveness of the devaluation, the effective devaluation was less than the face value because various particular export subsidies and the like were set aside at the time of the June 6 changes. But, even though early implementation was weak, especially on the export side, it generally is agreed the devaluation was needed and, whether de facto or de jure, would have had to come fairly soon. Clean and explicit, it facilitated import liberalization, which in turn began to open up competition and diminish the hothousing of domestic productive and marketing inefficiencies.

As it played out, the devaluation certainly was costly to the Congress in February 1967. The decisionmakers may have miscalculated politically in assuming that the move could begin to register benefits within 7 months. But even this is not clear -- if the non-forecastable second drought had not happened. All that is clear -- returning to the mythology -- is that the case does not prove devaluations, especially ones pushed by outside actors, are inherently bad ideas.

The most transportable aspect of the liberalization reform experience is that involving the relation between reform and external funding and, in turn, the recipient government's reaction to its evolving perception of that relationship. The Indian case (one hopes) is not directly transportable to the present, because part of what was entailed was a reaction to the perceived nontrustworthiness of the donors, in particular, of the U.S. But what transpired is nevertheless illuminating.

There were some straightforward aspects to the funding-reform connection. For one thing, as suggested at the outset, everyone recognized nonproject transfers as the preferred vehicles for policy influence. Both major donors recognized this matter of suitability, and, in order to convey more policy influence, both were prepared to substitute nonproject for project loans in their concessional-transfer portfolios. The Indians did not favor nonproject loans in order to get policy advice, but they accepted the policy advice when it came packaged with nonproject loans because they valued the latter so greatly. Finally, under this heading, there is the interesting question I touched on in the agriculture section: the comparative advantages as policy vehicles of two kinds of nonproject transfers -- general commodity loans and food aid. I will return to this in the concluding section.

Secondly, as to funding and reform, an aspect of the connection question that has been a lively one in discussions of 1980s policy-based assistance was not a deliberate or intentional aspect of the 1960s India case. This is the question of whether good policy advice may not be able to <u>substitute</u> for resource transfers. This is the extremist version of one school of structural-adjustment thought at the World Bank: If they'll just follow our advice vigorously and faithfully enough, they won't <u>need</u> our aid. In most aid circumstances of my acquaintenance this is about 75 percent nonsense, but in any event it was not anyone's overt theory in the 1960s India case. Both major donors recognized a not permanent but on-going need for substantial aid. Further, they explicitly recognized a complementarity between liberalization and nonproject assistance: As the country was freeing up imports, taking on the supplies and spares for higher industrial operating rates and subjecting indigenous efficiency to the tonic of competition, India was for some time going to need more commodity imports on concessional terms. It was legitimate, the donors agreed, for the Indian liberalizers to demand that kind of cushioning.

Such was the central theory of the Woods-Mehta deal in the spring of 1966, and, as noted, the Indians to a man and many of us on the donor side understood that the $900 million nonproject package was to continue for several years. What happened was that inadvertently we began to implement an inverse, not a positive, relation between aid and good policy performance.

The root of the problem here was the U.S., but, in turn, the root had several branches. The President talked constantly about the hostility of Congress to aid in general and South Asia aid in particular. Certainly, there was a good deal of this, but one was never quite sure whether the White House was coping with it or using it. There also was the complication, not mentioned in our agriculture section, of a drive, beginning in late 1966, when American food was no longer in surplus, of trying both to lever our aid partners into sharing the food-aid burden and to count the latter as consortium assistance. We were also leaning on the aid partners, many of whose concessional terms had been stiffer than ours, to grant the Indians debt relief. Finally, leaving aside any residual crankiness that might be attributed to LBJ, it is clear the combined problems of Congressional reluctance to raise taxes and the need to hide more Vietnam costs than were yet meeting the naked eye created very severe budgetary problems.

Given all this, George Woods barely managed to patch together the first $900 million, and then not until November 1966 and only by counting the U.S. aid already given early in the year. The following year the Consortium in general and the U.S. in particular didn't come close. Nonproject assistance was off $300 million or so. On the other hand, this was not so bad, because, thanks to the second-drought-in-a-row, the whole Indian economy had slowed down markedly; it really hadn't needed the second $900 million on time. This was why some of us sat in Washington in September 1967 with the Indian officials who had come for the annual Bank-Fund meetings and said that, whereas, at the time of the Woods-Mehta transaction, the thought had been for a series of at least three years -- $900 million, $900 million, $900 million -- now the sequence looked as if it would be roughly $900, $600 million, $900 million -- and that this ought to do well enough. I.G. Patel, then graduating from chief economist to being Secretary of the Finance Ministry's Department of Economic Affairs, quite specifically agreed. But clearly he was counting on that recovery in the third year.

The following May Patel returned from the Consortium meeting livid. The numbers for that third year, instead of up, were, if anything, down further. The U.S., in particular, he felt, had welshed on its deal. The Indians had been had. While Patel's reaction was sharp and deep, it was not atypical, and if I am not mistaken, this experience had a rather profound effect on GOI economic behavior over the next several years.

The Indians, as developing-country governments went, always had been rather conservative financially, but now they became doubly so. They determined to build a financial cushion against manipulations of a Woods-Mehta type. As a result (I expect to be documenting this over the next few months) you will find that their foreign exchange reserves were raised rather sharply and their developmental public investment spending crimped back significantly in the immediate aftermath of the aid shortfall shock -- and stayed that way for several year.

Finally, a few words on the extent to which India stuck with the liberalization course it set in 1966. I have yet to document the following in detail but have little doubt the thrust is correct. There is a widespread impression that the Indians have not been very serious about liberalization, have temporized and often back-slid. There have, certainly, been some fluctuations in policy. The GOI has remained characteristically cautious about getting short of foreign exchange. Thus it has suspended liberalization measures when resources have tightened and, when it has relaxed controls, has tended, while throwing the apparatus into neutral, to keep the controls machinery ready for reactivation. The Indians have been slow to go for the kind of all-out, 100-percent decontrol that warms true neoclassical hearts.

This said, the record nevertheless will show that the characteristic tilt of Indian industrial and trade policy since 1966 has been liberal. Moves have been cautious and intermittent but usually, when resources have permitted, have favored delicensing, reduced protection, and openings of the domestic market. This was true before Indira Gandhi returned to power in 1980 as well as more clearly thereafter; and it was true before Rajiv's further, quite substantial, and, fairly enduring next steps.

This is a surprising record if one thinks of this pattern of reforms as having been pushed on the GOI in the 60s, with the latter being psychologically bruised in the process. One might have expected to see the implementation of what the government came to see as weak-credibility U.S. and World Bank preachments be dropped like so many hot potatoes. That they were not means they were not, in fact, something foisted on a predominantly unwilling client. Like any successful reforms, they had an effective constituency within the recipient government. The donors helped catalyze the pivotal decisions, but once in place, the dominant disposition has been to retain and build on them.

5. Pakistan: summary of the experience[18]

For a country that figured as one of the birthplaces of the neoclassical backlash against 1950s-type planning and controls, Pakistan experienced, only, some rather limited, chequered, experimentation with policy-based assistance in the 60s. The two major donors were the same as in India. I will deal briefly with the same two realms of reform.

In the case of Pakistani agriculture (these remarks are confined largely to West Pakistan) both USAID and the World Bank were heavily preoccupied, both intellectually and in terms of resource allocations, with mater management issues. This was a remarkably complex and conflicted field. It concerned both irrigation, i.e., water supply and, on the other hand, drainage cum desalination. On the supply side, it posed choices and/or balances between surface water and ground water. On the surface side it posed vast engineering and financial requirements for the Mangla and Tarbela dams. There was a tension over whether tubewells were to supply sweet water or promote drainage. There were overlapping choices to be made between public and private, and larger and smaller, tubewells. There would be allocative choices between funding more water production and funding better water delivery. Across this whole array of issues, often there were different positions -- frequently

---

18 This section largely reflects information and impressions gathered when the writer led a team that prepared, for the World Bank, a report dated January 27, 1986, World Bank in Pakistan -- Review of a Relationship, 1960-1984 (2 volumes). However, the present text, does not directly draw on that "gray-cover," restricted-distribution document. Other members of the team included Irwin Baskind, Ken Bohr, John Burrows, Gene Grossman, Stephen Guisinger, Carl Jayarajah, and Vernon Ruttan.

conflicted -- between the World Bank and its experts, USAID and its experts, and various Pakistani schools of expertise. And a number of these positions kept shifting.

Positions on all the major water issues surely could be called "policies." But they were not the agricultural reform issues central to the Green Revolution. And the donors' cognitive inputs to them were conveyed by project, not nonproject, loans. Moreover, these loans, particularly in the case of the Bank, were large enough to exhaust most of the donor's financial capacity.

As to the Green Revolution reforms proper -- these came along in West Pakistan in the latter 60s, perhaps a step behind developments in northwest India, but they took hold initially very well. West Punjab rice, for example, grown under controlled water conditions in the winter season and mainly for the commercial market, was better adopted to what the International Rice Research Institute currently had to offer than was most rice growing activity in India.. The World Bank was quite limited in its engagement of agricultural reform issues in the middle 60s. It funded the Agricultural Development Bank of Pakistan, partly to promote private tubewells, but considerably to promote faster agricultural mechanization than some careful economic analysts subsequently have concluded was warranted.[19] The Bank also contributed to Pakistan's agricultural university. USAID did a good deal more in a variety of technical assistance connections. But neither managed to help establish a very robust agricultural (or water-management) research establishment. And, with one exception, neither of the two donors managed to lever rural reform with nonproject transfers.

---

[19] CF. Hans Binswanger (1978), The Economics of Tractors in South Asia: an Analytical Review, New York: The Agricultural Development Council and Hyderabad, India. ICRISAT.

The exception concerns the benign cushioning effects that can be attributed to PL480 imports in the early 60s. The availability of these seems, quite clearly, to have emboldened Pakistani officials in their steps toward import liberalization and the abandonment of agricultural price ceilings. At the same time, on the support price side, the government gradually advanced the dates at which it announced the prices at which forthcoming crops would be supported, thereby strengthening the incentive effect.

The one clearcut venture of the donors in the 60s into the policy-based assistance field was that of AID in the matter of trade liberalization. The experience demonstrated that, on the subject of controls, there was an ambivalence in the Government of Pakistan similar to that in such other governments as the Indian. President Ayub himself was an economic liberalizer, as was his Minister of Finance in the early 60s, Mohamad Shoaib. But many of the regime's senior economic officials, like counterparts across the border, were very cautious about dismantling controls.

AID, beginning at least in 1963, began to offer nonproject funding in support of import liberalization and in 1964 Shoaib persuaded his officials to adopt a free list for imports -- 54 raw materials and intermediate goods for industrial production. At the time this was a very promising move. But in 1965 things came apart: the government of Pakistan was deeply disturbed by the request of the United States that a Consortium meeting scheduled for July be postponed. (This was interpreted to reflect unhappiness, partly over the increasing warmth of Pakistan's relations with China, partly over her Rann-of-Kutch difficulties with India.) The officials' worst fears seemed only to be confirmed when the U.S. suspended aid at the time of the September Indo-Pak war.

We have seen that, although India was in a beleaguered aid position at the time, the cause of reform seemed to make its way almost undeterred by the aid suspension. In Pakistan the reaction was more severe. The free list was immediately cut back to 31 items, and new import restrictions were imposed. Minister Shoaib went off to be a vice president of the World Bank. In 1966 after U.S. aid was resumed there was a temporary expansion of the free list again, but then in 1967 the whole liberalization venture was abandoned. The more conservative economic regulators were back in the saddle, and throughout the balance of Ayub Kahn's and, then, Yayha Khan's tenures, the economy's increasing ripeness for a major devaluation was stubbornly resisted.

The World Bank was curiously inert during this sequence. Some give it the credit, as chairman of the Consortium, for talking the members into Pakistan's need for more nonproject money. But surely this was mostly USAID's initiative, and certainly it was USAID's money. The notable thing is that the Bank, unlike its practice in India, never did, at this point, put any IDA nonproject money into support of reforms. Such a commitment might well have made a difference in the 1966-68 period, but the Bank seemed asleep to the opportunity, just as both donors seemed quasi-asleep to the distributional issues (including the inter-wing inequities) that would help tear Pakistan apart.

As to 1960s policy-based assistance in the Pakistan case, then, the scorecard is that neither, really, did much in the agricultural area; and on the trade-industrial side, one made a strong try that was aborted; the other stayed on the sidelines.

6. Conclusions

(1) Policy based assistance (PBA) is here to stay. This cannot be

conclusively inferred from the 1960s South Asia experience, because there was not much of this kind of aid activity <u>before</u> the 60s, and, for bilateral donors, it subsided for a time thereafter. Moreover, although the multilateral development banks during the 70s sensed a mission to do policy kibitzing, they did not, mainly speaking, have access to the appropriate (nonproject) vehicles. Nevertheless, the 1960s cases tended to foreshadow conditions that reasserted themselves in the 80s: first, recipient policies were crucial determinants of development performance; second, donors, therefore, had a right to take an active interest in those policies; third, once an intelligent donor became aware of the policy linkages, it could scarcely refrain from attempted interventions, whatever the rights and wrongs or protocol of the matter.

(2) <u>PBA can be effective, but the nature of the effects depend on the circumstances of the recipient and the style of the donor</u>.

a. The donor cannot impose a program that the recipient government solidly resists. Rather, trading on the nonmonolithic character of the recipient, the donor tries to strengthen the hand of what it perceives as the right-thinking elements of the host government. Thus the donor's function is to <u>catalyze</u> an incipient but obstructed decision, not to play a sustained, on-going policy-tilting role. (See both Indian reforms.) But although the donor's resources usually are welcome, its "strengthening" of a host-government faction may be a political burden for that faction (see the attempts to shield Subramaniam via secrecy). Also (see the Pakistan liberalization case) if, as to the reform, the "anti" factions within the government regain control, PBA can quickly lose effect. The obverse is also true (see Indian liberalization-devaluation): if the locals predominantly favor it, the reform will persist even if the donor-recipient relation goes sour. Finally, to state the obvious (see the World Bank and liberalization in Pakistan) nothing good will happen if the donor doesn't try -- <u>and</u> risk some assets.

b. The overt, conventional PBA scenario is one of persuasion: the donor, however delicately or intrusively, encourages the recipient to follow a preferred course. This can indeed happen. The Indian agricultural "transaction" -- at least up through the end of 1965 -- is a good example.

c. There also can be a more conflicted scenario -- one of provocation -- that nevertheless is benign its near-term impact on the achievement of PBA's announced purpose. Here LBJ's heavy-handed short-tethering is the classic case: it drove the Indians wild, redoubling their determination to become food self-supporting. However, while this S.O.B. model can work, if it's lucky, it also almost guarantees non-reuse. The client will not, soon and cheerfully, start down this path again.

d. The provocation style also can have perverse, unwanted, effects. This was the case with the disappointment of the Indians' funding expectations in the liberalization-devaluation case. It drove them into a counter-productively cautious fiscal mode.

(3) <u>Procedurally there is a choice to be made between the preconditioning and the dialogue modes</u>. As noted. the two played in parallel, or at least in combination, for awhile in the Indian agriculture case. The dialogue is more civilized. Preconditioning may feel more decisive. However, if it is not to become artificial and overloaded, the undertakings it is monitoring must be kept to a small number and be subject to objective measurement.

(4) <u>The dialogue mode has organizational implications</u>. To be done easily and in a more or less sustained way, the dialogue must be centered in the recipient's capital and, from the donor's side, conducted by residents who have

a fair amount of discretion and clout. Thus it better suits a decentralized structure like AID's than a centralized one like that of the World Bank.

(5) The durability of the PBA process and the bilateral-multilateral distinction. Soon after the 1960s Indian episodes, Maurice Williams accused me of having a "cake-of-soap" theory of policy conditioning, and I did not deny it. My argument was that, even if LBJ had not been so heavy-handed and even if we had not allegedly welshed on the financial side of the liberalization deal, our ability to do what we had done in India would have proved to be a wasting asset. The reason was that the only psychologically viable model for an aid relationship between two sovereign peers was that of quid-pro-quo bargaining. But what was the "quo?" Good changes in his -- say, I.G. Patel's policies -- as if I knew better than he did. When I.G. Patel was as well informed as, and a little smarter than, I was, such a scenario was bound to wear thin. The multilateral agency, in which the "donor" is not a peer but a technical specialist partly owned and controlled by the recipient, is in theory a nice answer to this problem. But some of the psychological problem remains, and, in any event, in the case of the development banks, as just noted, the institutions are not decentralized in a way calculated to capitalize on their non-nation-state identities.

(6) The relation between policy advice and resource transfers. As suggested repeatedly, the cases under review confirm the greater suitability of nonproject grants or loans as PBA vehicles. Beyond this, they provide a good deal of supporting evidence for a proposition less at issue in the 60s than recently: for aid agencies policy advice and resource transfers are much more nearly and commonly complements than substitutes. You have to buy yourself a place at the policy table; you have to be able to provide temporary cushioning

for costly and/or painful policy adjustments; and, as a donor, your ability to take new policy-related initiatives is circumscribed if you have little budgetary flexibility.

(7) <u>Finally, there is the question of the suitability of food aid v. other commodity nonproject aid as a PBA vehicle</u>. I continue to think there is not much question about the call here. Food aid, carefully used, can be a good second-best alternative to other aid in this regard -- as, indeed, it is overall. But food aid does have an almost inherently hunger-linked dimension that makes it slightly implausible as a vehicle of leverage. President Johnson had the personality needed for overcoming this disadvantage, but he was an exception.