Leakages From Foreign Aid

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By B. R. SHENOY

Foreign Aid and Third Plan—I

FOREIGN aid must cover the gap between domestic savings and the proposed investment outlay of the third Plan (Rs 11,250 crores). With our currency reserves (Rs 276 crores on July 22, 1960) close to the legal minimum (Rs 200 crores), there is next to no room to draw on reserves.

The third Plan has placed domestic savings at Rs 7,200 crores, on the assumption that the rate of saving will rise, in 1965-66, the last year of the Plan, to 11 per cent and national income, expanding at an annual rate of over 5 per cent, to Rs 17,000 crores. This seems unrealistic. The wet-blanket effect of growing statism on the national product and its bias for spending may not permit national income to grow faster than 3.5 per cent (compound) and the rate of saving may not exceed 8.5 per cent. On this basis, domestic savings may be of the order of Rs 5,900 crores and the foreign aid necessary to cover the resources deficit Rs 5,350 crores.

The Plan estimate of the need for foreign aid is Rs 3,200 crores, of which Rs 2,500 crores will go into the Plan proper, Rs 200 crores being utilized to finance buffer-stocks of food grains and Rs 500 crores for repayments on past aid. If the latter items of finance may be drawn from foreign aid, total aid requirements, on our estimate of savings, will be Rs 6,050 crores ($12.7 billion), or well above twice the aid of $1 billion per year—reportedly contemplated by the U.S. Democratic Party Convention. Foreign aid would, then, represent not 31 per cent but the major part (54 per cent) of the investment outlay.

Though the Planning Commission agrees that investments are limited by the sum of domestic savings and foreign aid, it assesses the amount of the latter by assumptions of the "foreign exchange components" of the investments, instead of by deducting domestic savings from the projected investments. In the process (and in combination with an overassessment of domestic savings by Rs 1,300 crores), its estimates of aid have fallen short of needs by Rs 2,850 crores.

Rupee finance and foreign exchange finance are mutually capable of substitution over a wide range, as changes in prices and availabilities may produce shifts from import goods to home-made goods and vice verse in Plan investments. Inflation, by adding to the non-Plan demand for imports and by eating into exports, may widen balance of payments deficits beyond Plan estimates. This renders assumptions of foreign exchange components of investments arbitrary and unreliable as our own experience has illustrated. The first Plan actuals showed an annual average surplus of Rs 32 crores in the balance of payments, as against an anticipated deficit of Rs 180-200 crores per year. Investment being balanced by savings and foreign aid, the foreign exchange needs of the Plan were fully met by market availabilities. The second Plan had envisioned drafts of Rs 200 crores from the currency reserves and foreign aid of Rs 900 crores. Actually, as a result of inflation, foreign aid (Rs 1,182 crores) alone exceeded the sum of the two and the draw-down of the reserves was about Rs 590 crores.

Productive debts should be self-liquidating. By adding to capital they should augment the national product, expand exports and produce sufficient trade surpluses for debt amortization. The necessity felt in the third Plan for amortization payments wholly by borrowing (and some "rescheduling"—de facto default by negotiated postponements—of debt service payments recently) raises the presumption that past loans have not been employed fruitfully.

Circumstantial evidence seems to support this. Our balance of payments deficit during the first four years of the second Plan sky-rocketted to Rs 1,466 crores from Rs 216.5 crores in the pre-

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BEG DENIES CONTACTS OUTSIDE JAIL

JAMMU, Aug. 18.—Mirza Afzal Beg, accused in the Kashmir Conspiracy Case, today denied having entered into correspondence while in Kud jail with conspirators outside and said that there were rigorous searches by jail guards and complete censorship by the intelligence department.

Beg, who was the Revenue Minister in Abdullah's Cabinet, was replying to a question by the Special Magistrate, Mr N. K. Hak, whether, while in Kud Jail, he, Sheikh Abdullah and others used to meet in Abdullah's room to write replies to letters from outside conspirators and after consulting each other provide guidance to them.

Beg said that the censorship and the searches were so rigorous that even war criminals could not have suffered such humiliation as the accused did in Kud Jail. Even in colonies, he added, such treatment could not be meted out to the people.

Beg then gave in detail the geography of Kud Jail and said that one dining-cum-sitting room was common to all the accused, who used to take their food in it and listen to the radio provided in this room. "It is carrying a joke to an extreme to say that we met in this room to consult each other, conspire and reply to letters sent from outside. On the basis of my personal knowledge and on the basis of facts, I say that such a conspiracy referred to in the court's question is not only impractical, but it did not even strike our imagination to act like that."

Referring to the searches conducted by what he described as "semi-military Central Reserve Police," Beg said that even cooked food, sometimes sent to him from his home in Anantnag, was stirred for letters and notes.

Even their personal letter were censored by the Central Re serve Police. This was a menta torture. "We learnt to suffer it a Congressmen did during India' freedom struggle—Congressme who had declared that such prac tices will be abolished in fre India."

He said that they had gon through all this suffering for t sake of "our country's freedom."

Beg said that a conspiracy ha been levelled against them so th the issue of right of self-determ nation for Kashmir was avoide

"These stories have been manu factured by the puppet Gover ment of Kashmir," he said.

Beg said that his slogan wa that the people of Kashmir we the *final* arbiters of their destin India's own stand in regard Kashmir's accession was precisel the same—that the Kashmiri peo ple should settle the accessio question in a free and imparti plebiscite under the auspices the United Nations without an coersion from inside or outside.

This demand, he said, had bee registered by the Security Counc and had the backing of t world. The Plebiscite Front, which he was the founder-pres dent, also stood for a peacef [illegible] of the Kashmir [illegible] [illegible]. It would be a mad man who would ha bour secret designs therefo

There was neither any sense nor any need for a conspiracy as was alleged.

Beg repeated his allegation again today that crores of rupees from India were spent to secure approval for the August 9 incidents and the so-called confirmation of Kashmir's "fraud" of an accession to India.

He said that if the prosecution did not believe it, let an election be held under an independent authority and "I say it without fear of contradiction that those who confirmed Kashmir's accession to India and of whom the prosecution is proud and whose pockets were filled with crores of rupees will not be able to find a proposer and seconder for their nominations in Kashmir and the people will vote for the Plebiscite Front."

This situation, Beg said, was more due to the conduct of the ruling National Conference and the Democratic National Conference.

Beg denied any contacts, direct or indirect, with any underground organization.

He said, as far as he knew, other accused like Sheikh Abdullah, Ali Shah, Ghulam Mohiuddin Hamdani and Mohiuddin Zargar had also no connections with any underground organization.

He said this in reply to a question that after the arrest of Abdullah and other accused, Begum Abdullah, Ali Shah, Mohammed Amin and other accused and supporters had set up a secret under-

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ceding four years. This is accounted for principally by accelerated imports of investment goods and partly by large imports of food grains. It embodies, too, payments for illicit imports, as these are not free gifts. To fight shy of discussing this last phenomenon (and its counterpart of concealed incomes) is to miss a significant factor in Plan economics, in particular, the economics of foreign aid. Payments for illicit imports get embedded in our balance of payments deficits as such payments are generally found by under-invoicing exports and over-invoicing imports. Excepting certain items, notably P.L. 480 imports, and maybe also imports under some World Bank loans, it is not possible wholly to prevent the use of this technique, despite the painstaking vigilance of exchange control.

The balance of payments deficit of the first four years of the second Plan was made good by Rs 540 crores of drafts on currency reserves and the rest from foreign aid (Rs 977 crores). It follows that some of the aid (and the drafts on reserves) financed illicit imports, though the magnitudes are unascertainable. If we place gold inflows at an order of two million ounces per year, they may account for about Rs 225 crores of foreign exchange during the four years. The drastic cut of 36 per cent in private imports in two years added to the illicit traffic a large variety of consumer goods—watches, fountain pens, spices, certain finer textiles, playing cards, cigarettes, razor blades, photographic accessories and so on.

Food Supply Up

P.L. 480 imports and, partly, aid utilized to pay for the imports of investment goods were not free from leakages. During the first three years of the second Plan, the supply of food grains—domestic output plus imports—rose by 5.1 per cent per year (from 65.8 million tons in 1956 to 75.8 million tons in 1959) or faster than the rate of increase in money supply (3.85 per cent). It rose faster, too, than the combined annual rates of increase in population (1.91 per cent) and per capita real income (1.92 per cent). And yet food grain prices rose, during the period, by 19 per cent. This suggests that P.L. 480 imports went into inventories of traders and farmers, not into capital formation through financing expansions of employment. The Customs valuations of investment goods imports acquired from foreign aid would overstate the amount of the effective capital formation from such aid as allowances must be made, first, for the element of over-invoicing in this figure and, secondly, for the construction of idle excess capacity. Excess capacity is estimated at 35 per cent in the major and medium irrigation works, of a lesser order in the power projects and at an average of 40-50 per cent in 40 industries. Immediately, excess capacity is a waste.

Leakages of foreign aid to finance non-Plan imports are principally the outcome of two factors, inflation and a too rapid expansion of the public sector, which induce and sustain pro-Plan imports. Inflation, by stimulating consumption retards the flow of savings. The effort to protect savings from corrosion by rising prices causes their diversion into gold hoards, concealed exports of *capital and less essential urban* property. Rising prices also enhance speculative activity and part of the savings gets drawn into inflated inventories. When inflation is accompanied by controls some transactions become "black" and give rise to "black" incomes, savings from which add to the demand for gold and other wasteful uses of capital. The traffic in import licences, fictitious inter-sales of import goods to absorb the gaps between their landed costs and market prices, and controls over sugar, food grains, cement, steel and other commodities, may cause "black" incomes of the order of Rs 200 crores per year.

Corruption Danger

When the public sector expands faster than the availability of personnel with competence and character to man enterprises with disposal over huge sums and employment benefits, there is danger of the spread of corruption. Part of public sector "investments" may get lost through inefficiency, extravagance and neglect and a part is apt to get converted into corrupt payments, augmenting the volume of easy spending and wasted savings. Thus, when a public sector project is accounted to cost Rs 100 crores, the value of the physical assets created may be less than this sum, though the margin may vary with projects. If so, to the *extent of the margin*, savings and foreign aid appropriated for the projects get wasted. Public sector investments rose from Rs 1,560 crores in the first Plan to Rs 3,650 crores in the second Plan and are placed at Rs 6,200 crores in the third.

In such a context, total investments will fall short of the sum of domestic savings and foreign aid, as part of the aid will have been drawn into providing the foreign exchange counterpart of the misdirected domestic savings. The quest for gadgets to prevent this leakage of aid is futile. The mechanics of the leakage rests on over-invoicing and under-invoicing (and on the retention for home use of potential export output) which it is not practical to prevent. The mechanism operates continually and its accumulated effect—heavy payments deficits—assumes the status of a *fait accompli*. The economy would somehow reach out for the foreign aid to cover the deficits or the Administration will seek such aid, to tide over the "crisis," from friendly nations.

Supervision and "leak-proof" accounting, sometimes resorted to (e.g. by the World Bank) to ensure against the "dissipation of foreign aid, may handicap access to specific aid for non-Plan uses. It cannot eliminate the phenomenon of leakages. First, all foreign aid is not "tied" to specific projects. Other loans—general