# FEDERAL RESERVE BANK OF NEW YORK

# MONTHLY REVIEW

APRIL 1961

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## The Money Market in the First Quarter

Financial markets came under a combination of diverse influences during the quarter. Persistent evidence of sluggish business performance and the impact of official statements and actions designed to lower long-term interest rates contributed to a rise in bond prices over much of the quarter, although by the close of the period the market was influenced by the better business sentiment that appeared to be developing. The Treasury, in March, achieved a significant amount of debt extension through a successful advance refunding with only a moderate impact on prices of intermediate and long-term securities. Meanwhile, the concentration of Treasury borrowing in the short-term area was offset by other influences which expanded demand so that, after moving temporarily higher, short-term rates returned to about their end-of-December levels before moving up again at the close of the quarter. Bank credit exhibited a relatively strong behavior, particularly on the investment side, while mortgage rates, under the cumulative impact of monetary ease and recent official actions, seemed to have receded by the quarter's close.

Bank reserve positions remained comfortable over the quarter, while the money market was moderately easy, except for occasional firming tendencies and one period of marked ease. Bank positions firmed somewhat in February, following a period of considerable ease brought on by a storm-connected rise in float in late January, but grew easier once more in early March. While the money market banks were substantial purchasers of Federal funds over much of the period, funds were readily available from the country banks and the effective rate on Federal funds was at 2½ per cent or below on most days. Rates on loans to Government securities dealers by major New York City banks were generally posted in ranges of 1¼-3 per cent through January, 2¾-3½ per cent in February and early March, and 2-2¾ per cent thereafter.

Around the middle of the quarter, on February 20, the Federal Reserve System announced that open market operations were being broadened to include transactions in Government securities outside the short-term area. This change from the practice of recent years, during which transactions for the System Account except in correction of disorderly markets were made in short-term United States Government securities, was authorized by the Open Market Committee in the light of conditions that developed in the domestic economy and in the United States balance of payments with other countries.

### BANK RESERVE POSITIONS

Market factors released a substantial volume of reserves to member banks in January, as the large post-holiday return flow of currency to banks and the decline in required reserves resulting from the seasonal debt repayment were only partially offset by the usual decline in float and by a gold outflow. In February, however, market factors withdrew reserves, on balance, reflecting a rise in "other deposits" at the Federal Reserve Banks, a decline in float, and a reduction in bank holdings of vault cash. Some $65 million in reserves was absorbed by

#### STATISTICS ON THE GOVERNMENT SECURITIES MARKETS

The United States Treasury Department and the Federal Reserve System have inaugurated a new program for publishing statistical information on the United States Government securities market and dealer operations in it. The data which are to be published on a regular basis include daily closing bid and asked prices for Government securities and yields on such securities, as well as weekly daily-average figures on the volume of transactions, positions, and financing of all Government securities dealers who are reporting such information to the Federal Reserve Bank of New York. Along with the initial release of current data on March 30, 1961, figures back to September 1960 were issued for each of the series except prices.

The current price data will be available each afternoon after the close of the market at the Information Desk of the Federal Reserve Bank of New York. The weekly data will be available at the Information Desk after 4 p.m. each Thursday. Requests to be placed on the mailing lists for any one or all of the weekly releases should be addressed to the Market Statistics Department, Federal Reserve Bank of New York, New York 45, N. Y.

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**Table I**
**Changes in Factors Tending to Increase or Decrease Member Bank Reserves, March 1961**
In millions of dollars; (+) denotes increase, (−) decrease in excess reserves

| Factor | Daily averages—week ended | | | | | Net changes |
|---|---|---|---|---|---|---|
| | March 1 | March 8 | March 15 | March 22 | March 29 | |
| **Operating transactions** | | | | | | |
| Treasury operations* | − 50 | + 122 | + 4 | − 76 | — | — |
| Federal Reserve float | − 32 | − 226 | − 65 | + 257 | − 256 | − 322 |
| Currency in circulation | + 91 | − 28 | − 107 | + 14 | + 112 | + 82 |
| Gold and foreign account | − 39 | − 34 | − 33 | + 40 | + 24 | − 42 |
| Other deposits, etc. | − 8 | + 8 | + 39 | + 46 | − 2 | + 83 |
| Total | − 38 | − 156 | − 163 | + 280 | − 121 | − 198 |
| **Direct Federal Reserve credit transactions** | | | | | | |
| Government securities: | | | | | | |
| Direct market purchases or sales | + 32 | + 154 | + 228 | − 139 | − 140 | + 135 |
| Held under repurchase agreements | − 66 | − 67 | − 13 | − 5 | — | − 151 |
| Loans, discounts, and advances: | | | | | | |
| Member bank borrowings | − 57 | + 44 | − 45 | + 3 | + 26 | − 29 |
| Other | — | + 1 | − 1 | + 1 | − 1 | — |
| Bankers' acceptances: | | | | | | |
| Bought outright | + 2 | − 1 | + 1 | − 1 | + 1 | + 2 |
| Under repurchase agreements | − 2 | − 1 | − 1 | — | — | − 4 |
| Total | − 91 | + 131 | + 167 | − 139 | − 115 | − 47 |
| **Member bank reserves** | | | | | | |
| With Federal Reserve Banks | − 129 | − 25 | + 4 | + 141 | − 236 | − 245 |
| Cash allowed as reserves† | + 100 | − 315 | + 150 | − 14 | + 90 | + 11 |
| **Total reserves†** | − 29 | − 340 | + 154 | + 127 | − 146 | − 234 |
| **Effect of change in required reserves†** | − 16 | + 91 | + 50 | − 252 | + 249 | + 122 |
| **Excess reserves†** | − 45 | − 249 | + 204 | − 125 | + 103 | − 112 |
| Daily average level of member bank: | | | | | | |
| Borrowings from Reserve Banks | 50 | 94 | 49 | 52 | 78 | 65‡ |
| Excess reserves† | 678 | 429 | 633 | 508 | 611 | 572‡ |
| Free reserves† | 628 | 335 | 584 | 456 | 533 | 507‡ |

Note: Because of rounding, figures do not necessarily add to totals.
* Includes changes in Treasury currency and cash.
† These figures are estimated.
‡ Average for five weeks ended March 29, 1961.

market factors during the five statement weeks ended March 29, reflecting primarily a continuing contraction in float (interrupted only by the usual midmonth expansion), largely offset by declines in required reserves, in "other deposits" at the Reserve Banks, and in currency in circulation.

Over the quarter as a whole, market factors supplied some $240 million in reserves, on a daily average basis, while System open market operations absorbed $350 million, much less than the usual absorption during this period. On a Wednesday-to-Wednesday basis, from December 28 to March 29, System holdings of United States Government securities declined $537 million, on balance, reflecting a $260 million net decline in outright holdings and a $277 million reduction in holdings under repurchase agreements. Total System holdings of securities maturing in less than one year increased by $414 million, those in the one- to five-year maturity range declined by $1,024 million, and those maturing in over five years were up by $72 million. This reflected, in addition to System open market operations, System participation in the March advance refunding and the automatic movement of securities holdings into shorter maturity ranges.

Both total reserves and required reserves of all member banks declined somewhat less than usual, on a daily average basis, between December and March. Free reserves averaged $580 million over the quarter, little changed from last quarter's average of $579 million, while excess reserves fell by $34 million to $670 million, and average borrowings were down $35 million to $90 million.

## BANK CREDIT

Bank credit presented a relatively strong picture during the quarter. While loans dropped quite sharply in January, as securities dealers, finance companies, and others repaid their heavy December borrowing, they moved up far more than is usual in February. Much of this rise was due to the banks' purchase of about $1 billion in consumer receivables from a large mail-order firm, with the proceeds placed largely in time deposits. Even excluding this transaction, however, loans and particularly business loans were up by more than in most recent years. Real estate and consumer loans (excluding the same large transaction) continued sluggish. On the investment side, the banks showed a substantial counterseasonal absorption of Government securities in January, and liquidated an unusually small amount in February, while purchasing, net, a record amount of other securities. Total credit over the two months, consequently, was down by only $0.8 billion, a smaller decline than in any other recent year and a strong showing even without the large transaction in consumer receivables.

The strong business loan performance continued into March at weekly reporting member banks, as business borrowing moved up over the tax date at roughly the pace of the past two years. Meanwhile, Government securities holdings underwent particularly wide week-to-week swings.

The moderate but counterseasonal rise in holdings of Government securities through mid-March contributed to the maintenance of the weekly reporting banks' liquid asset ratios (that is, the ratio of short-term liquid assets to net deposits) in mid-March at roughly their December levels, in contrast to sharp seasonal declines in all other recent years but 1958, when banks added very substantially to their Government securities holdings. The banks' loan-deposit ratios, similarly, showed a slight decline between December and March, compared with increases in all other recent years but 1958.

In line with the relatively strong behavior of bank credit, the daily average money supply, on a seasonally

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adjusted basis, rose by $0.7 billion between the second half of December and the first half of March. This brought the money supply to 0.3 per cent above its year-before level and to 1.3 per cent above the low point of last June. Time deposits, meanwhile, continued their sharp rise, registering a 10 per cent annual rate of increase since last June. This expansion was considerable even if one excludes the effects of the single large transaction in consumer receivables, which added some $700 million to time deposits in February. Toward the close of the quarter the expansion of time deposit totals began to reflect also the volume of new negotiable time certificates of deposit issued to corporations by the New York City banks beginning in late February.

The persistent rise in time deposits has been part of a further strong growth of total "personal" savings, including savings and loan shares and United States Government Savings bonds. The nonbank public's total holdings of such relatively fixed-interest assets rose by $15.3 billion in the twelve months through January. Nonbank holdings of marketable United States Government securities maturing within one year, on the other hand, on which interest rates have declined considerably, were reduced by $7.4 billion during the twelve-month period, reversing much of the $10.9 billion rise of the previous year. In the aggregate, therefore, the nonbank public's total liquid asset holdings, seasonally adjusted, rose by $8.5 billion or 2.2 per cent during the twelve months ended January, with the rise since the low point last May amounting to $11.0 billion, or 4.3 per cent at an annual rate.

## SECURITIES MARKETS

Bond prices moved upward over much of the quarter before turning down again at the quarter's close. While expectations of an early economic upturn injected a note of caution into the market in early January and late March, the greater part of the quarter was dominated by persisting evidence of recessionary tendencies and by the efforts of the new Administration to deal with this situation, both of which brought about a more confident atmosphere in the capital markets. Rates on short-term Treasury securities, on the other hand, first rose in response to Treasury short-term borrowing and the inauguration of negotiable time certificates of deposit by large banks and then declined sharply in the first three weeks of March, owing mainly to the lack of pressures over the quarterly tax date. By the quarter's close, however, bill rates were again moving upward.

The rise in Treasury bill rates during the opening days of the year was mild and was partly reversed before mid-month, so that the quarterly rollover of $1.5 billion one-year bills was easily accomplished by the Treasury on January 11, and $500 million in new cash was also raised in the weekly bill auctions without halting the steady decline in rates (to 2.17 per cent on three-month bills by January 26).

This mild downward movement of rates was emphatically reversed by a 40 basis point rise over the following five weeks. The primary upward influence on bill rates in early February was probably the Treasury's February refunding operation, in which the absence of pre-emptive rights delayed any derivative reinvestment demand for bills from the holders of the maturing securities, and the $400 million overallotment subsequently resulted in some net sales of bills. Market psychology was also affected by the President's statement suggesting the desirability of higher short-term rates, especially on foreign official time deposits, in view of the balance-of-payments situation. Later in February the Federal Reserve System announced that, in view of the balance of payments and the domestic situation, open market operations were being conducted in United States Government notes and bonds of varying maturities, some of which would exceed five years. This announcement, coinciding with the inauguration of negotiable time certificates of deposit by New York banks, which offered the prospect of a potential competition to bills, added momentum to the rise in rates that brought the three-month bill rate to 2.60 per cent by March 1.

In early March, significant changes on the domestic and the international scene produced a stronger tone in the bill market so that rates again moved lower under the pressure of vigorous demand. Strengthening influences on the domestic scene took the form primarily of relatively

**Table II**
**Short-Term Interest Rates**

| Date | Average issuing rate on new Treasury bills | | Bankers' acceptances 90-day unendorsed bid rate | Commercial paper 4- to 6-month offered rate | Sales finance company paper 60- to 89-day offered rate |
|---|---|---|---|---|---|
| | 3-month | 6-month | | | |
| **1960** | | | | | |
| Dec. 30* | 2.234 | 2.429 | 3 | 3⅛ | 2⅝ |
| **1961** | | | | | |
| Jan. 9 | 2.385 | 2.602 | 3 | 3 | 2⅝ |
| Jan. 16 | 2.358 | 2.530 | 3 | 3 | 2⅝ |
| Jan. 23 | 2.230 | 2.422 | 3 | 3 | 2⅝ |
| Jan. 30 | 2.299 | 2.497 | 2⅞ | 2⅞ | 2⅝ |
| Feb. 6 | 2.374 | 2.566 | 2⅞ | 3 | 2⅜ |
| Feb. 10* | 2.462 | 2.652 | 2⅞ | 3 | 2⅜ |
| Feb. 20 | 2.496 | 2.688 | 2⅞ | 3 | 2⅜ |
| Feb. 27 | 2.594 | 2.779 | 3 | 3⅛ | 2⅝ |
| Mar. 6 | 2.485 | 2.674 | 3 | 3⅛ | 2¾ |
| Mar. 13 | 2.352 | 2.455 | 3⅛ | 3⅛ | 2¾ |
| Mar. 20 | 2.278 | 2.471 | 3⅛ | 3 | 2⅝ |
| Mar. 27 | 2.392 | 2.576 | 3 | 2⅞ | 2½ |

*Because of the holidays on January 2 and February 13, 1961, the Treasury bill auctions were held on December 30, 1960 and February 10, 1961, respectively.

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light corporate liquidation of securities holdings before the mid-March tax date. Moreover, with a somewhat smaller than usual portion of the March tax anticipation bills utilized for tax payments, a sizable reinvestment demand for bills emerged around the March 22 redemption date of the maturing tax anticipation bills. This demand, plus easier bank positions and temporary reinvestment by several large borrowers in the capital market, brought rates down steadily despite some competition from the new time certificates of deposit. Some of the March pickup in demand, particularly for longer bills, was also attributed by the market to foreign buying. Strong bidding in the March 13 auction brought the six-month bill rate to within 10 basis points of the three-month rate, but the spread widened to about 20 basis points in the following two weeks.

Toward the end of the quarter, on March 23, the Treasury announced a cash offering of $1.5 billion of September 1961 tax anticipation bills to be auctioned on Tuesday, March 28, and dated April 3, with 50 per cent credit to Tax and Loan Accounts permitted commercial banks. In addition, the Treasury added $100 million to the March 27 weekly bill auction and stated it might raise an additional $200 million in the auctions of the following two weeks. The $2 billion in one-year bills maturing April 15, it was further announced, would be rolled over in full.

Responding to this prospective enlargement of supply, Treasury bill rates ended their three-week decline and moved up smartly. Average issuing rates of 2.392 and 2.576 per cent were established on the 91- and 182-day bills, respectively, in the Monday, March 27 auction, both up 11 basis points from the previous week. A good interest developed in the following day's auction of September tax anticipation bills, with the average issuing rate at 2.473 per cent as banks bid to obtain the resulting Tax and Loan Account credits. Reflecting the value of these deposits, initial trading of the new bills took place in a 2.57 to 2.60 per cent range, as bank liquidation was only partly offset by demand. The bill market moved higher during the remaining days of the month, to close at rate levels some 10 to 25 basis points above their end-of-December positions.

In the market for Treasury notes and bonds the turn of the year brought a note of caution, due to some expectations of an imminent economic upturn. Additional depressing factors were the situation in Laos and Cuba, the continued gold outflow, and uncertainties over the fiscal policies which the incoming Administration might follow. In this atmosphere, prices declined sharply until around mid-January, when evidence of persistent sluggishness in business activity set off a rise in prices that continued with some brief interruptions well into March. In early February the price rise was encouraged by the absence of an intermediate issue in the Treasury's refunding and, more importantly, by the President's statement that a lowering of long-term rates would be desirable as a stimulant to the economy. Later in the month, the market was affected by the Federal Reserve System's announcement on the broadening of open market operations. After a temporary rise of as much as 1¼ points in prices of intermediate and longer maturities, the market hesitated for a few days, pondering the extent and objectives of System actions, but moved up once more in early March influenced by news of further layoffs and a decline in stock prices.

The five-week-long upward trend in bond prices came to a halt around mid-March, as a feeling spread that the bottom of the recession had perhaps been reached and that an upturn might be starting. This was reinforced by news of a leveling-off in the industrial production index, after six months of continuous declines, by a pickup in housing starts, and by the stock market's rise to new highs in heavy trading. Sentiment was also affected by conditions in the market for tax-exempt bonds, where congestion developed as a steady flow of new offerings added to already-heavy inventories, bringing the "Blue List" of dealers' advertised inventories to an all-time high.

The main focus of market interest during the second part of March was the Treasury's highly successful advance refunding, which offered issues maturing in five or six years in exchange for issues maturing in fifteen to twenty-nine months. The offer was announced late on the afternoon of March 15 for subscription on March 20 through 22 and delivery March 30. In this operation, $3.6 billion of new 3⅝ per cent bonds maturing November 15, 1967 was subscribed for by holders of the 2¼ per cent bonds maturing June 15, 1962, the 2¼ per cent bonds maturing December 15, 1962, and the 2⅝ per cent notes maturing February 15, 1963, while $2.4 billion of new 3⅜ per cent bonds maturing November 15, 1966 was taken up by holders of 2½ per cent bonds scheduled to mature August 15, 1963. The total included $579 million of subscriptions by the Federal Reserve Banks and Government Investment Accounts. In the aggregate, therefore, about $6.0 billion of Treasury debt was moved from the 1962-63 to the 1966-67 maturity area, lengthening the average maturity of the marketable debt by a month and a half to about four years and seven months. There was only a moderate downward adjustment in prices of outstanding intermediate-term bonds on announcement of the refunding offer. Prices of the new 3⅜ and 3⅝ per cent bonds remained firm in "when-issued" trading and gained

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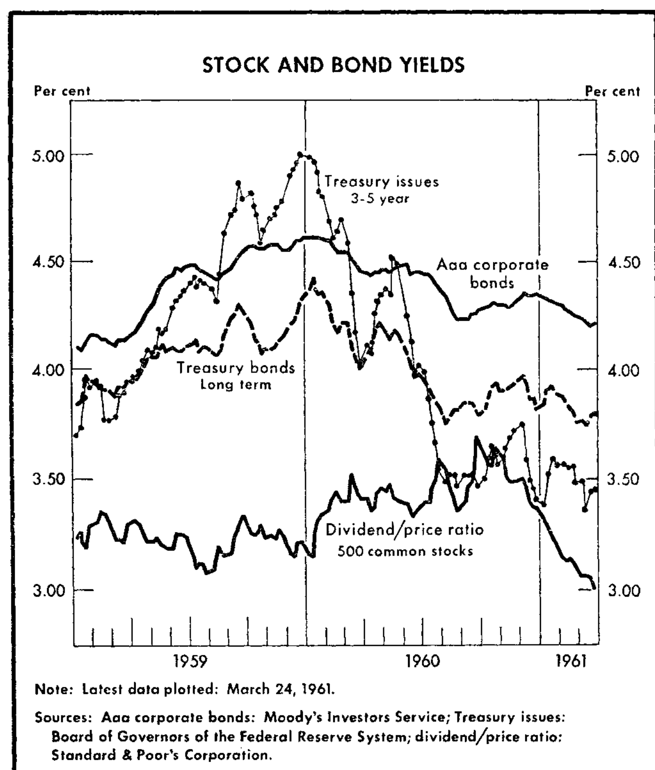
$^{10}/_{32}$ and $^{2}/_{32}$, respectively, by the month's close. Over the quarter as a whole, prices of long-term bonds were down by $^{4}/_{32}$ to $^{30}/_{32}$ of a point, while intermediate maturities were generally $^{2}/_{32}$ to $^{22}/_{32}$ of a point lower.

The Treasury announced on March 26 that $15 billion of Series E and H Savings bonds purchased between May 1941 and May 1949 and still outstanding may be held for another ten years and will earn 3¾ per cent interest. These bonds originally earned 2.90 per cent if held to maturity and have been earning from 2.90 to 3.47 per cent during their first ten-year extension.

While prices of corporate and tax-exempt bonds generally followed the same movements as those of Treasury bonds, there were important differences between the corporate and tax-exempt markets. The light calendar and sparse inventory of corporate bonds — with new issues totaling only $630 million for the quarter, compared with $1,480 million in the previous quarter and $890 million a year before—kept prices steady through the early January period of caution and contributed to pronounced buoyancy through February. In the tax-exempt market, by contrast, inventories were heavy and the volume of new offerings was particularly large—totaling $1,950 million for the quarter, compared with $1,160 million the previous quarter and $1,620 million a year before. Prices of tax exempts moved moderately downward in early January, consequently, and responded only minimally to February's strengthening influences. By early March, the advertised inventory of dealer offerings reached the highest level in the series' 25-year history and its dampening effects were felt in the corporate and Treasury bond markets as well. By mid-March, the corporate calendar was also beginning to increase, as the low yields on new offerings—about the lowest in two years—attracted a spate of refunding offers. One $70 million 5½ per cent 1994-dated utility issue originally issued in 1959 at a price yielding 5.35 per cent was refunded in late March into a 1998 maturity at a reoffering yield of 4.32 per cent and was well received. Both corporate and tax-exempt markets were somewhat heavy in March, therefore, with a slight edging-off in prices. At the quarter's close, yields on Moody's sample of seasoned Aaa-rated corporate issues were at 4.22 per cent, down from 4.35 per cent at the end of December, while yields on Aaa tax exempts stood at 3.30 per cent, up from 3.11 per cent at the year's close.



Note: Latest data plotted: March 24, 1961.
Sources: Aaa corporate bonds: Moody's Investors Service; Treasury issues: Board of Governors of the Federal Reserve System; dividend/price ratio: Standard & Poor's Corporation.

Considerable interest during the quarter was centered on the mortgage market, as a number of official measures were taken to stimulate residential construction by accelerating the downward movement in mortgage rates. While the weakness in construction during this, as compared with earlier recessions,[1] has been attributed by some observers to a playing-out of postwar housing demands, others attach greater importance to sluggishness in the supply of mortgage credit and to the continued high level of mortgage rates.

The total net flow into mortgages fell to $15.4 billion in 1960 from $19.2 billion in 1959, although clearly either demand or supply forces, or both, could have been responsible. This decline reflected in part the $700 million smaller net rise in 1960 than in 1959 in the mortgage holdings of savings and loan associations. Although associations absorbed a record inflow of savings, particularly over the second half of 1960, they used some of these funds to repay the previous year's borrowings from the Federal Home Loan Banks and other sources and to build up their cash balances. Mortgage lending by commercial banks also fell off considerably, to $0.7 billion in 1960 from $2.5 billion in 1959. The increase in Federal National Mortgage Association mortgage holdings also tapered off during 1960, to $0.6 billion, from the record $1.6 billion in 1959, when purchases were swollen by operations under a special temporary program authorized by Congress. While insurance companies' net mortgage acquisitions were up slightly for 1960 as a whole, each

[1] See "The Business Situation" in this *Monthly Review*, p. 59.

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month's volume after August was smaller than a year before, and the January 1961 rise was nearly 40 per cent below that of January 1960.

It was quite late in 1960 before net mortgage acquisitions by savings and loan associations caught up with their pace of a year earlier. By January 1961, their acquisitions were up by 15 per cent over the year-before level. Commercial bank mortgage holdings, however, were unchanged in January and February, while FNMA on balance absorbed funds in February by selling more mortgages than it purchased.

To stimulate construction activity and a downturn in mortgage rates in line with the President's early February statement, several official actions were taken. The maximum rate on Federal Housing Administration-insured home mortgages was reduced by ¼ per cent. FNMA increased its purchase prices on mortgages by a full point and its sale prices by 2½ to 3 points, in order to make more funds available to the mortgage market. The Federal Home Loan Bank Board increased the amounts that member savings and loan associations may borrow from their Home Loan Banks and widened their lending powers. In addition, conferences were held between Government and savings and loan officials over the possibility of reducing the associations' dividend rates to facilitate a lowering in their rates on mortgage loans. With these several actions, and the cumulative impact of monetary ease, there were some signs by the quarter's close of a more substantial improvement in the mortgage market. One nation-wide survey in late March indicated that home mortgage rates had declined by ¼ per cent in most areas over the past three months, with those in some high-rate areas—Florida and southern California—down by as much as ½ per cent. Residential construction outlays turned up in March, following two successive monthly increases in housing starts.

## The Business Situation

The over-all pace of economic activity has changed little within the past two months, and there have been some further indications that the recession may be bottoming out. Declines in the more important indicators have become fewer in number and smaller in size, and some key series have either leveled out or turned upward. While these developments have led to a widespread expectation that the turn-around may come some time within the current quarter, few business analysts have forecast a strong upturn, and businessmen themselves apparently anticipate only a mild increase in sales during the year. Thus, even if an upturn is soon to begin, a serious question remains as to whether the ensuing expansion will be vigorous enough to bring a substantial reduction in unemployment from the current high level.

In some lines, orders and sales have already shown signs of improvement, to some extent reflecting a step-up in government spending as well as expanded private demand which was bolstered, in part, by rebounds following unusually bad weather and pre-Easter buying. Even these latter factors may provide a timely stimulant to economic activity if they cause an expansion in output rather than simply a further liquidation of inventories. In many industries, however, large stocks of finished goods have continued to act as a buffer, tending to moderate, or even to preclude, the gains in output and employment which might be expected from upturns in sales. This has been the case, for instance, with automobiles, even though the inventory picture there was improving late last month. Steel, on the other hand, is one industry where expectations of a seasonal upturn in demand of final users—notably the construction industry—appears to have triggered a more general improvement in orders and production. Thus, steel output has moved up moderately from the January low point, even after allowing for normal seasonal advances.

### FIXED INVESTMENT DURING THE RECESSION

There are some tentative indications that residential construction activity may be on the verge of a revival. Housing starts (seasonally adjusted) rose in both January and February despite the severe weather, leading to a modest increase in residential construction spending in March. Until recently, the performance of this sector has been weak relative to that of earlier recessions (Chart I). Private residential construction outlays moved erratically downward from July 1959 through the early part of this year, whereas during the 1957-58 recession construction expenditures were roughly level, and in 1953-54 there was a relatively early upturn.

It has been suggested that, because the backlog of postwar housing demand has been satisfied, home building may have become significantly less responsive to credit

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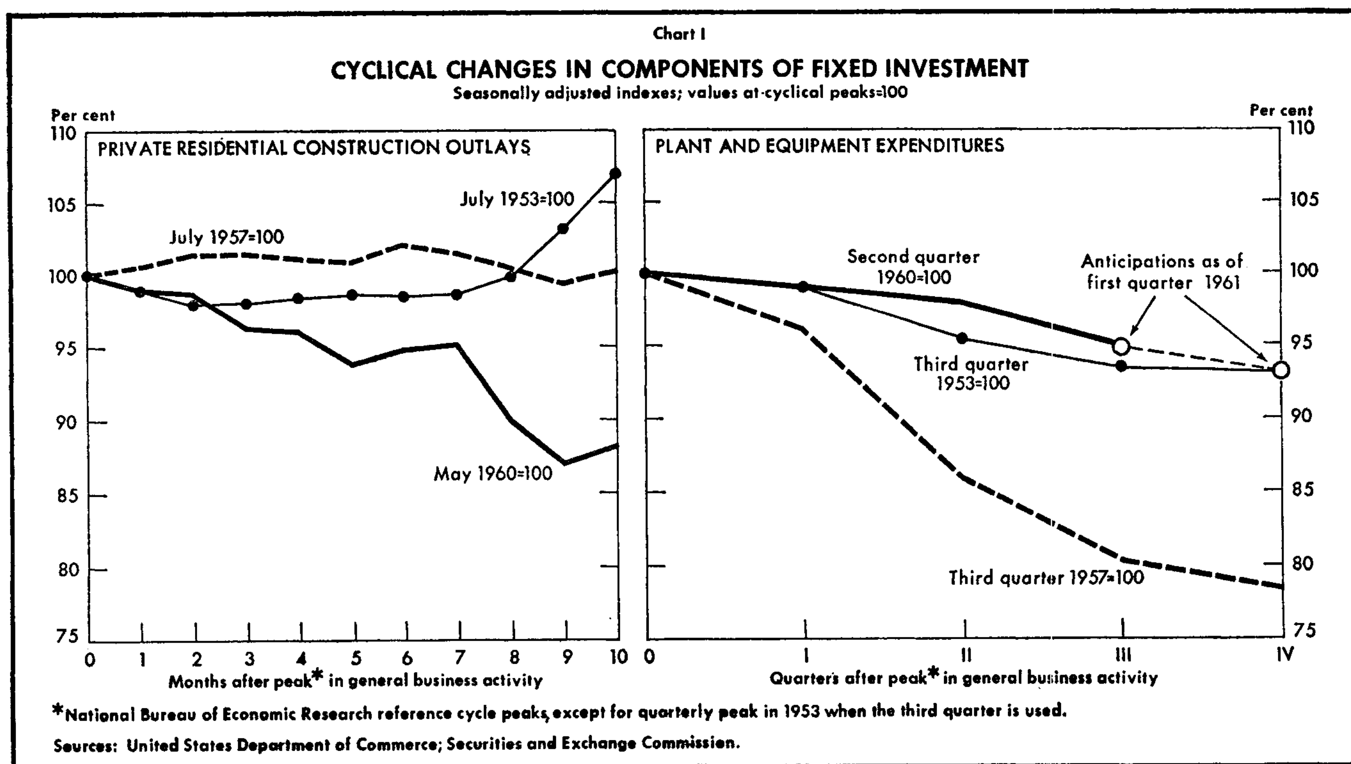
inducements. In support of this argument, it is pointed out that in 1960 some slight easing of credit availability to the housing sector occurred even prior to the general business peak during the second quarter, whereas in earlier recessions an easing of mortgage credit had not occurred until after the start of the business downturn. On the other hand, mortgage interest rates in early 1960 had reached a much higher level than they had prior to the previous business downturns, while the easing in such rates, though starting sooner, progressed more slowly during the current recession. Now there are indications that a more substantial shift in the tone of the mortgage market may finally have occurred—a result of the cumulative impact of the general easing in credit conditions since early last year, along with the recent counter-recession actions of the Federal Government (discussed elsewhere in this *Review*)—so that a more decisive test of the strength of the underlying demand for housing may be close at hand. The next several months probably will show whether the recent rise in housing starts points toward a revival in residential construction, or whether it is just another erratic swing in this volatile series.

Recently, the Federal Government has also acted to stimulate public construction by accelerating the supply of funds available during the current half year for highways and post office buildings. Total public construction outlays had already moved markedly upward during 1960, but declined somewhat during the first quarter of 1961 as a result of reductions in spending for highways and nonresidential buildings.

In contrast to indications that both private residential and public construction may show growing strength in coming months, businessmen's plans for plant and equipment spending suggest a continuing decline through the first half of the current year. The total contraction in such outlays during this recession remains, however, quite mild in comparison with the previous recession (see Chart I). According to the latest survey of business plans for fixed investment, taken by the United States Commerce Department and the Securities and Exchange Commission in February, spending was expected to slip by 3 per cent in the first quarter of this year and by another 2 per cent in the quarter just begun. Planned outlays for the whole of 1961, however, are only 3 per cent below the actual 1960 level (although 7 per cent below the level anticipated early in 1960), which implies an upturn some time during the second half of this year. The anticipated mild decline from outlays of $35.7 billion in 1960 to $34.6 billion in 1961 contrasts with a 17 per cent actual drop (from $37.0 billion to $30.5 billion) between 1957 and 1958.

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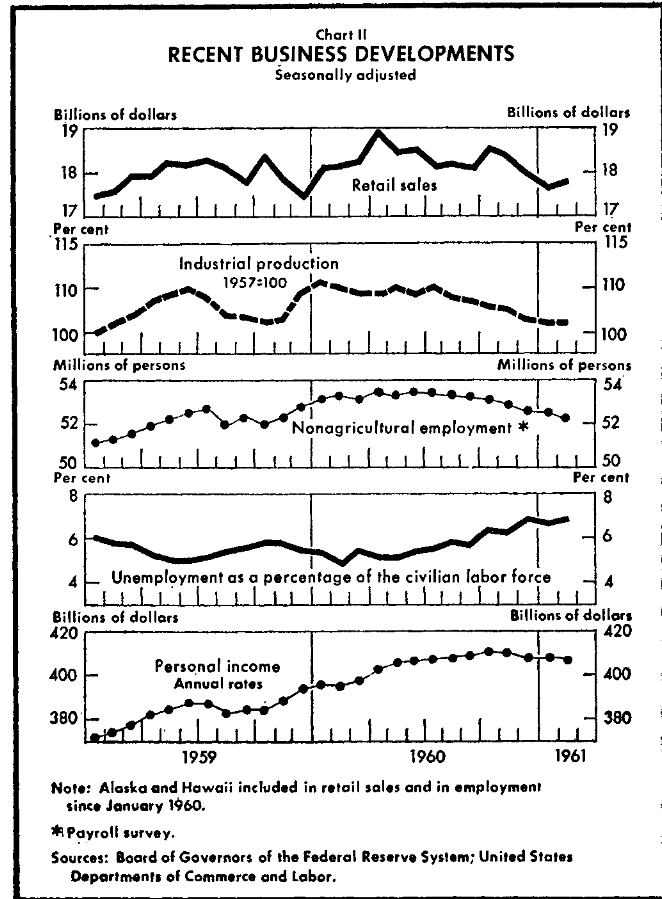
### OTHER DEVELOPMENTS

Sales of new cars are another significant type of spending which has recently turned up. A sharp rise in automobile sales during the final days of February left the total monthly rise of almost 2 per cent in average daily sales somewhat short of the usual seasonal gain, but after two months of sharp declines it was an encouraging sign. It served, moreover, to cut slightly into distributors' excess stocks. In the first part of March, automobile deliveries appeared to be holding at the improved level but did not seem to be achieving new gains.

Department store sales in February improved even more than auto sales, rising contraseasonally and contributing to a 1 per cent gain in total retail sales. It is probable, however, that this gain—the first since last October (see Chart II)—was largely a reflection of such special factors as better weather and a pickup in spending preceding an early Easter. Department store sales in March appear to have maintained the improved February pace but not to have shown further advances.

Small gains in both retailers' and manufacturers' sales in February had little effect on total inventories of finished goods, but manufacturers' stocks of materials once again declined. Manufacturers' new orders also rose in February, for the first time since September. The rise resulted primarily from an expansion of defense contracts, while other orders were about unchanged—but the absence of change was itself an improvement, compared with declines in previous months. It may reflect more favorable expectations for sales and production and consequent strengthening in orders for materials where current stocks have already been drawn down to minimal levels. Such developments appear to have resulted, in particular, in a slightly increased flow of orders for steel and other primary metals.

Thus far, small increases in sales and orders have cushioned the decline in total manufacturing activity, after seasonal adjustment, but have not reversed it. The total industrial production index edged down in February by only ½ of 1 per cent (and on a rounded basis the index was unchanged). The latest decrease was substantially smaller than in other recent months, as increased output of primary metals and electrical machinery partially offset fairly widespread reductions elsewhere. The most significant reduction was in passenger car output, which was accompanied by sharp cuts in ordering of materials by the automobile industry. As a result, steel output slipped back slightly in early March before rising again in the middle of the month. Automobile production in March showed about the usual seasonal expansion.




Note: Alaska and Hawaii included in retail sales and in employment since January 1960.

* Payroll survey.

Sources: Board of Governors of the Federal Reserve System; United States Departments of Commerce and Labor.

Manufacturing employment, seasonally adjusted, fell further in February, paralleling the decline in output. Employment in several other sectors also declined, leaving a total of 276,000 (½ of 1 per cent) fewer people on payrolls than in the preceding month. In contrast, total nonagricultural employment, including household and self-employed workers, edged up very slightly. This may reflect, in part, increased employment among women who may be supplementing family income where the usual breadwinner was unemployed or working only part time. The small rise in total employment was insufficient, however, to absorb an increase in the labor force that was somewhat more than seasonal. As a result, the seasonally adjusted unemployment rate returned in mid-February to the high December level of 6.8 per cent. It rose further in March to 6.9 per cent.

Total personal income in February reflected the decline in payroll employment and in business income, falling by $0.7 billion to a seasonally adjusted annual rate of $405.9 billion. This was more than the decline of $0.3 billion (revised figure) that occurred in January but smaller than December's relatively marked drop.

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# The German and Dutch Revaluations

Effective March 6, as reported in the last issue of this *Review,* the German Government raised the value of the mark to 4.00 per dollar from 4.20—a 5 per cent appreciation in terms of the dollar. Swiftly following the German action, the Dutch Government, effective March 7, likewise raised the external value of its country's currency by approximately 5 per cent—changing the guilder's rate from 3.80 to 3.62 to the dollar.[1]

The appreciation of both currencies occurred against the background of a continuing high level of domestic economic activity, with strong wage and moderate price pressures, and persistent external surpluses that had been aggravating the inflationary tendencies. Under such circumstances, a country's authorities are faced with a serious dilemma. On the one hand, monetary restraint, which tends to be accompanied by high interest rates, is clearly indicated from the domestic point of view. On the other hand, such a policy often stimulates foreign investors in search of attractive loan and investment opportunities to place their funds in that country. The consequent influx of foreign funds, which is particularly likely to occur under conditions of international currency convertibility, adds to the balance-of-payments surplus and swells bank liquidity, which tends to offset the domestic aims of monetary management. Revaluation therefore is intended to cut a Gordian knot. For both Germany and the Netherlands, it is expected to moderate the upward pressures on internal costs and prices by encouraging imports and discouraging exports, thus expanding the supply of goods and services, intensifying competition in the domestic market, and helping at the same time to reduce the two countries' large balance-of-payments surpluses. In the case of Germany, the revaluation of the mark should also help bring to a halt the inflow of short-term funds that had reached massive proportions, not only because of interest rate advantages but also in anticipation of the exchange rate adjustment. In addition, the possibilities for a reduction in Germany's heavy accumulation of reserves are also strengthened by the planned expansion of foreign-aid outlays, which according to official spokesmen will not be affected by the revaluation.

Germany's strong international economic position is reflected in the spectacular rise in the German Federal Bank's gold and foreign exchange holdings, which climbed about $2 billion in 1960 and by the middle of March 1961 had reached $7.8 billion.[2] One of the major elements contributing to this strength has been the very large trade surplus. While this surplus declined very slightly in 1960 to $1.3 billion from the 1959 record, it had again risen markedly during recent months. In the first two months of 1961, in fact, it was almost twice as large as a year ago, with exports rising 13 per cent and imports only 5 per cent. The rapid expansion of exports —equal in 1960 to about 17 per cent of gross national product—has been aided by the strong foreign demand for such German products as machinery, cars, and other specialized finished goods that are sold by German producers on highly competitive terms. On the other hand, the growth in imports, vigorous as it has been in the case of industrial products, has been slow for food products where quota restrictions and various controls continue to impede the international flow of goods. Imports of food products, representing over 26 per cent of the German import bill, thus increased by only 4.5 per cent last year, compared with 19 per cent for imports as a whole.

Expenditures by United States and other NATO forces stationed in Germany have been no less important in the reserve rise. In 1960, such expenditures amounted to more than $1 billion, slightly higher than in 1959, when about 80 per cent came from United States troops. Over the past year and a half the influx of private short-term capital further enlarged the German external surplus. Mainly in response to domestic monetary tightness, German banks in 1960 reduced their foreign short-term assets by $300 million, to $340 million, while increasing their short-term borrowings abroad by $230 million, to $310 million. Although the downward trend in foreign short-term assets has apparently been reversed since the end

[1] The two governments effected the change in the value of their currencies by taking two steps—declaring a new par value to the International Monetary Fund and adjusting the central banks' buying and selling rates for foreign currencies accordingly. Under the IMF Agreement, member countries must consult the Fund for changes in par values, but the Fund cannot object to changes of less than 10 per cent from the initial par value. Member countries also undertake to maintain effective exchange rates within 1 per cent of either side of parity. The previous German par value had been effective since January 1953, the Dutch par value since September 1949.

[2] For a fuller discussion of Germany's international economic position in recent years, see "Germany's Balance-of-Payments Surplus", *Monthly Review,* December 1960, p. 206.

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of October, the rapid expansion of the banks' short-term borrowing abroad continued at least through January, the latest month for which published data are available. In addition, a large volume of private short-term funds was moved into Germany by German industry directly, since manufacturers could borrow at lower interest rates abroad. Furthermore, payments for imports were delayed and payments for exports speeded up, in part because of the persistent revaluation rumors. Short-term capital movements other than those handled through banks are included in the German balance of payments under "errors and omissions". This item accounted for about $650 million, or approximately a third, of official reserve gains in the thirteen months ended January 31. Altogether, the German payments surplus had become so large by the time of the revaluation as to endanger monetary stability within Germany as well as to create a major imbalance in world financial relationships.

Although the mark revaluation has tended to overshadow the guilder appreciation, the Dutch balance of payments also has displayed remarkable strength on both current and capital accounts over a prolonged period. In a statement before parliament explaining the guilder revaluation, the Dutch finance minister pointed out that the current account has registered substantial annual surpluses since 1951, except in 1956 and 1957. In 1960, the current-account surplus amounted to $360 million. One of the principal causes of this surplus has been the growing strength of Dutch exports. In 1960, the country's exports increased 12 per cent over 1959 and were 50 per cent above the 1955 level. Imports, on the other hand, were only 41 per cent higher than in 1955. As a result, the traditional Dutch trade deficit has narrowed considerably, averaging about $440 million annually during the past three years as against approximately $840 million in 1955-57, and has been more than offset by the Netherlands' equally traditional and usually substantial net earnings from services and the profit remittances on its foreign investments. The resultant current-account surplus has exerted considerable pressure on the country's productive capacity and the labor market. If the Netherlands had not followed the German move, this surplus, and thus the strain on the Dutch economy, would have further increased, since about 22 per cent of Dutch foreign trade is with Germany. (The prices of German goods in the Netherlands, for example, would have tended to rise, and Germany might have absorbed even more of the Netherlands' products.) The inflationary aspects of the current-account surplus, furthermore, had been intensified by large foreign purchases of Dutch securities (about $300 million net in 1960). Reflecting these developments, the Netherlands Bank's gold and foreign exchange reserves climbed last year by about $420 million to a record high of $1,820 million.

In Germany, reactions to the revaluation of the mark conflicted sharply. Savings banks, life insurance companies, and retail enterprises generally welcomed the action as a move to help stabilize the price level. However, leaders of industries with sizable export interests understandably were somewhat apprehensive about the appreciation. The shipbuilding, coal and metal-ore mining, and steel industries, in particular, expressed fears that their profitable export business might be impaired seriously. The government and the other advocates of revaluation, however, do not share these industries' dark prognostications and, on the whole, expect only a moderate slowing-down of the rapid growth of exports. Such a slackening, it is pointed out, should not harm the national economy, especially since the inflow of new orders in most industries has for some time exceeded capacity production rates.

Dutch financial and industrial circles likewise had mixed reactions to their government's decision. A leading spokesman for trade and industry stated, however, that, in view of the reduced prices of Dutch imports and the very high import content of Dutch industrial products (imports are equal to about 40 per cent of the gross national product), the competitive position of Dutch exports in world markets would deteriorate only slightly. Agricultural exports and the Dutch service industries, including ocean and air transport, as well as the developing small-car industry, are expected to be affected most directly. The revaluation's total effects on the current-account surplus, according to the Minister of Economic Affairs, might be to reduce that surplus by about $50 million (or about 15 per cent). The minister also announced that the government would make efforts to assure that the benefits of the revaluation in terms of lower consumer prices would be realized fully. Retail stores reportedly have already reduced prices of imported products, such as coffee. It is thus hoped that the price rise previously foreseen for 1961 will not wholly materialize and, consequently, that wage pressures will also ease somewhat.

The German and Dutch revaluations at first created a great deal of uncertainty in the foreign exchange markets, touching off heavy buying of currencies considered at the time to be additional candidates for revaluation. Much of this buying was of Swiss francs; as indicated by the Swiss National Bank, nearly $300 million had moved into Switzerland during March 6-15. The German mark was also in heavy demand, as official assurances that the currency would not be revalued further were apparently not

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immediately convincing to speculators. The German Federal Bank's gold and foreign exchange holdings rose $125 million during the week ended March 7, which included two trading days after the appreciation, and another $206 million during the following week. A large part of the funds that moved to Switzerland and Germany—and to a lesser extent to France, the Netherlands, and Italy—was apparently obtained by conversions from sterling and by transfers of dollar deposits from England. The severe pressure on sterling, however, eased notably following the categorical denial by Britain's Chancellor of the Exchequer of any intention to devalue sterling. In related actions, denials of any intention to revalue were issued by French, Italian, and Swiss officials. The European exchanges quieted further after a joint statement on March 13 by the governors of eight leading European central banks on the occasion of their monthly meeting at the Bank for International Settlements. The governors noted that "rumors about possible further currency adjustment have no foundation" and that "the central banks concerned are cooperating closely in the exchange markets".

In a world of currency convertibility, the revaluation of a major currency can easily unsettle the foreign exchange markets temporarily by touching off large-scale international movements of funds. Such movements are almost entirely of a speculative nature and do not reflect the basic positions of the currencies involved. Under such conditions, it is clearly incumbent upon the authorities of each country—acting singly or cooperatively—to counteract the temporary disturbances, thus giving commercial and financial interests everywhere the opportunity to consider the new situation in a calm atmosphere. Toward the end of March, it became clear that such a calmer appraisal was taking place, resulting in a growing recognition that the German mark and Dutch guilder appreciations had strengthened substantially the outlook for future stability of the international payments system. As stated, with regard to the mark, by United States Secretary of the Treasury Douglas Dillon on March 27, there is "no need whatsoever for any further alteration" and "a further alteration would serve no useful purpose". Exchange rate stability among major currencies is indeed a vital factor in the sound growth of international trade and investment.

## India's Economic Development and Balance of Payments

India this month begins the third of her five-year development plans. Progress under the first two plans has been substantial, with real national income expanding 40 per cent in the last decade. Industrial production has risen by 50 per cent or more during the last five years, while extensive investments in public utilities, transportation, heavy industries, and education and welfare have created the foundation for further and sustained expansion of both industrial and agricultural production. The limited growth, however, of agriculture itself—still the mainstay of the country's economy—is cause for serious concern. Furthermore, and perhaps even more serious at present, the development program has subjected the Indian economy to considerable inflationary strain. Prices have moved steadily upward and inflation has superimposed new demands for foreign exchange on the already large foreign exchange requirements arising from the basic capital needs of development.

The new five-year plan will benefit greatly from experience under the two earlier plans. At the time of independence in 1947, India was primarily an agricultural and textile manufacturing country dislocated by geographical partition and split by internal strife. In 1951, when the first five-year plan was launched, per capita income amounted to only $55 annually. Like other underdeveloped countries, India was faced with the vicious cycle of low incomes and low levels of saving and investment, each perpetuating the other. To break this cycle, a large-scale effort at official planning and directing of economic activity was undertaken. During the first and second five-year plans a number of miscalculations were inevitably made. However, as pointed out by last year's special mission to India and Pakistan under the sponsorship of the International Bank, much seems to have been learned from these earlier efforts. This mission, composed of three distinguished bankers—Dr. Hermann Abs of West Germany, Sir Oliver Franks of Great Britain, and Mr. Allan Sproul of the United States—also stated in its report to International Bank president Eugene Black that Indian development policies have become increasingly pragmatic, and that economic progress to date suggests that development may now move forward at an

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**Table I**
**Actual and Planned Levels of the Indian Economy**
**At 1957-58 prices**

| Income and related items | 1950-51 (year before start of first plan) | 1955-56 (last year of first plan) | 1960-61 (last year of second plan, estimated) | 1965-66 (last year of third plan, estimated) | 1970-71 (last year of fourth plan, estimated) | 1975-76 (last year of fifth plan, estimated) |
|---|---|---|---|---|---|---|
| National income (billions of dollars) | 19.5 | 23.1 | 27.9 | 36.0 | 46.8 | 62.1 |
| Net investment (billions of dollars) | 1.0 | 1.7 | 3.1 | 5.3 | 7.9 | 11.0 |
| Net investment as a percentage of national income | 4.9 | 7.3 | 11.0 | 14.6 | 16.9 | 17.7 |
| Domestic saving as a percentage of national income | 4.9 | 6.8 | 8.0 | 12.0 | 15.0 | 17.5 |
| Population (millions) | 361 | 391 | 431 | 480 | 528 | 568 |
| Per capita income (dollars) | 54 | 59 | 65 | 75 | 89 | 109 |

accelerating pace. While hopeful for this result, however, the mission emphasized the need for prompt and decisive fiscal and monetary action to cope with inflationary pressures.

India's third plan calls for investments totaling the equivalent of about $4.4 billion a year, or 50 per cent more than under the second plan. Planning officials estimate that this will require foreign assistance, including private capital, of $1.3 billion per year, compared with about $650 million annually (or half as much) during the second plan. Needs on a similar scale are also foreseen for the fourth plan, which begins in 1966. Whether India will actually receive the aid she is seeking and raise sufficient domestic resources remains uncertain, and the development program may have to be adjusted accordingly. It must be remembered, however, that India is a country of more than 430 million people—or as many as the combined populations of Africa and Latin America—and that its population is growing by 9 million persons every year. Thus, success of India's development program would be a milestone in the world's battle against poverty.

## THE DEVELOPMENT PROGRAM

India's development program calls for national income to grow about 5 per cent per year from the start of the first plan in 1951 to the end of the fifth plan in 1976. If realized, this will mean a tripling of national income and a doubling of per capita income (to about $110 annually) over the same period. As indicated in Table I, these goals are expected to be achieved through substantial increases in net investment and domestic saving. In terms of 1957-58 prices, net investment is to rise to $11 billion annually by 1975, compared with about $3.1 billion at present and only $1 billion in 1950. To finance this expansion, while eliminating the need for foreign aid by 1975, domestic saving would have to rise to about 17.5 per cent of national income, compared with roughly 8 per cent at present and 5 per cent in 1950. Assuming that national income grows by the hoped-for 5 per cent annually in the meantime, savings could reach the 1975 target if 25 per cent of all additional income is saved. Any slower rate of income growth would require that an even larger proportion of additional income be saved.

The amount of saving and investment necessary to achieve a given increase in national income cannot, of course, be precisely estimated. Critics of India's development program have claimed, for example, that a smaller investment would suffice if it were concentrated less in heavy industry and more in agriculture and light industry. Defenders of the program, on the other hand, point to India's favorable cost position in steel and machinery and some other heavy industries as evidence that large-scale investments in these industries are likely to make the greatest contribution to economic growth. All are agreed, however, that economic development depends greatly, although by no means exclusively, upon substantial additions to the nation's capital, including both the machinery, equipment, and materials used by the labor force, and the improved health, vigor, and know-how of the workers themselves.

The success of any development program, of course, hinges primarily upon a nation's own efforts. On the other hand, India's present low per capita income—about $70 per year in current prices—makes it difficult to increase investment rapidly without external aid. Furthermore, specialized resources and skills have to be imported. India's own output of modern capital equipment, for example, is still quite small. As with many other underdeveloped countries, India has been unable to expand her exports sufficiently to pay for even those imports of equipment, material, and know-how that are most essential for her investment and production plans.

Despite these obstacles, India's initial experience with planning for economic growth was very favorable. During the first five-year plan, agricultural and industrial output exceeded the targets set for them, even though investment fell behind schedule. Moreover, India's balance-of-

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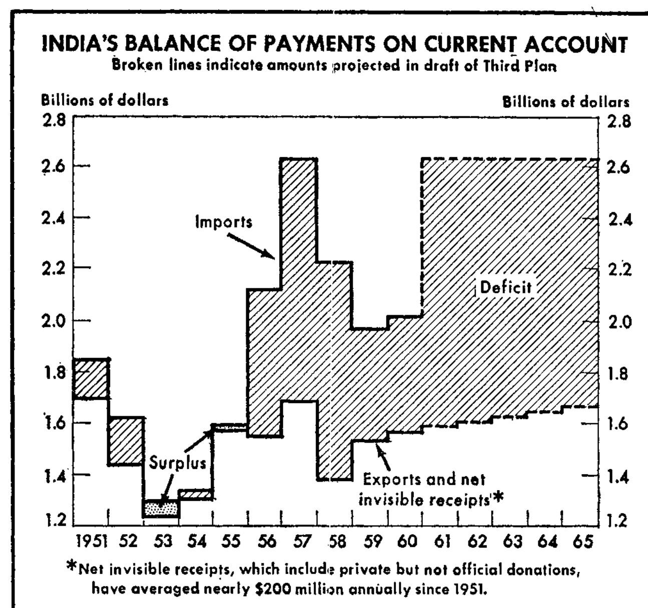
payments deficit on current account amounted to only $275 million for the entire five years. Favorable weather conditions led to record harvests, export earnings increased during the Korean war, and financial prudence was exercised throughout. Understandably, this success led to more ambitious targets for the second plan. Moreover, the bumper harvests created the impression—later proven incorrect—that the agricultural problem, which had been given top priority, was largely solved.

Emphasis in the second plan thus shifted to the expansion of basic industrial capacity. The plan was designed, in fact, to give India a large, diversified, and integrated industrial system within twenty years. Industrial investment was to be concentrated in steel, cement, aluminum, chemicals, coal, and railways. The second plan, however, has fallen substantially short of its targets. Investment in government-owned facilities has remained 15 to 20 per cent below schedule, and the growth of national income has lagged even more, partly because farm productivity and income have risen only slightly. Bottlenecks have developed in several key sectors such as coal and steel and have slowed progress elsewhere. The steel shortage, for example, has delayed the construction of fertilizer plants, thus contributing to the lag in agricultural production.

The third plan follows essentially the same over-all strategy as its predecessor, with heavy emphasis again to be given to basic industries, particularly machine tools and chemicals. It is widely believed in India that the country can most fully realize its considerable potential by expanding its already substantial manufacturing base, and by increasing exploitation of its large reserves of iron, coal, and other natural resources. The growth of the machine tool industry, in particular, is expected to speed up the mechanization of other industries and increase their output. At the same time, it is also increasingly realized in India, and frequently stressed by foreign observers (including the Abs-Franks-Sproul mission), that efforts to raise agricultural productivity and output are as basic as industrial progress to the success of the total development effort. Thus, the third plan devotes a substantially larger proportion of investment to agriculture than did the second plan.

In judging foreign exchange needs for the third plan, the lessons learned during the previous plan will have to be kept in mind. It had been hoped that, during the years of the second plan, the balance-of-payments deficit on current account could be held to a total of about $2.4 billion, or an average of $470 million a year. Imports of steel, machinery, and equipment were expected to raise the deficit to a peak of $730 million in the third year (1958-59), and then to taper off as the construction of new steel plants and the re-equipment of the railroads were completed. Foreign aid and foreign private capital were expected to finance about $1.7 billion of the deficit, while the remaining $700 million was to be met by drawing down the nation's foreign exchange reserves. As is evident in the chart, however, imports shot up much more rapidly than anticipated, and by the end of the third year the current-account deficit had exceeded the estimate for the entire five years. Aid receipts utilized during the second plan are now estimated at about $3.2 billion, and exchange reserves have declined by $1.3 billion.

A relatively minor part of the unplanned increase in imports in the second-plan period consisted of defense equipment. More importantly, imports of food have expanded greatly as a result of a series of poor harvests coupled with rising consumption as incomes rose (about half of any increase in consumer income in India tends to go into the purchase of food). An even larger part of the excessive rise in imports—and thus of the decline in international reserves in 1956-58—reflected, however, sharply increased purchases of capital goods by private business. Indeed, when the government stepped up the issuance of import licenses for capital goods, the response of private industry was immediate and substantial. When, on the other hand, import controls were tightened again under the pressure of necessity in 1958, and the excess demand that had been permitted to develop was thus diverted to the home market, inflationary pressures mounted rapidly. Price and allocation controls were



*Net invisible receipts, which include private but not official donations, have averaged nearly $200 million annually since 1951.

imposed, but they only repressed the symptoms of pressure while intensifying the problems of resource allocation. These experiences strongly suggest that the import demand generated by growth itself had been underestimated. They further indicate that the degree of monetary and fiscal restraint imposed so far has been inadequate to perform the admittedly difficult task of restraining additional investment and consumption in an economy starved for both.

### EXPORT PROMOTION

An expansion of exports would undoubtedly go a long way toward solving the balance-of-payments pressures likely to arise during the third plan. Efforts to expand the supply of goods available for export, however, are likely to be severely handicapped by the strength of domestic demand, which easily absorbs India's total output of many goods and yields profits at least as high as those available in the export markets. Another barrier is the relatively large portion of India's traditional exports for which there seems little or no growth in world demand. As a result, the draft outline of the third plan projects only a 15 per cent export growth by 1965, or a rise to about $1.5 billion per year from the present $1.3 billion.

In recent years, jute and cotton textiles and fibers have accounted for about 40 per cent of India's total exports, and tea for another 25 per cent. Other food products and tobacco have made up about 10 per cent, and the remaining 25 per cent has consisted largely of primary commodities and simple manufactures, such as ores (6 per cent) and leather goods (4 per cent). Metal products account for only 2 or 3 per cent of the total, and about half of these are handicraft-type items such as decorative brassware. Unfortunately for India, world trade in cotton textiles has fallen steadily in the face of rising domestic production and extensive protection of local industry elsewhere. The volume of world jute exports has been held down by severe competition from substitute materials and from changes in methods of handling commodities formerly transported and stored in burlap bags. World consumption of tea is growing only modestly.

Government steps to encourage exports in the last several years have included elimination of most export restrictions and duties, the rebate of duties on imports consumed in the production of exports, the introduction of export credit insurance, internal transportation subsidies for exports, and studies of overseas markets and marketing requirements. The government has also entered into a number of bilateral trade agreements and has established a state trading corporation.

Sales to the United States and Europe now account for about two thirds of India's exports but have changed little in recent years. Tariff barriers and the competition of established suppliers are sometimes major obstacles to Indian producers seeking to sell to these nations. Partly for the same reasons and partly because other developing countries have balance-of-payments problems of their own, Indian exports to the rest of Asia and Africa and Latin America have actually tended to decline. India's trade with the Communist world, on the other hand, has expanded considerably, with attractively packaged Soviet-bloc offers serving as an opening wedge. Communist-nation purchases rose from 4 per cent of India's exports in 1957 to 8 per cent in 1959, and have since continued to climb.

During the third plan, an attempt will be made to achieve a five- to six-fold increase in the export of such durable goods as agricultural implements, diesel engines, electric motors, sewing machines, air conditioners, and refrigerators. A major share of the rise in such exports is likely to reflect increased purchases by American and European buyers. At the same time, the draft of the third plan also states that arrangements already negotiated are expected to be the basis for further growth of trade with Soviet-bloc countries. Even if the hoped-for increase in durable goods exports is realized, these types of products will still account for a relatively small part—perhaps 5 per cent—of India's total exports. In another decade or two, however, India's growing industrial capacity should be an important factor in her export capacity. Sales of ores and metals are also likely to expand significantly. Exports of iron ore are scheduled to increase from 3 million tons (valued at $30 million) in 1960 to 10 million tons in 1965 as a result of new investments in mining, transportation, and port facilities. These investments will also contribute to increased exports of manganese, chrome, and other minerals.

### IMPORT SUBSTITUTION

Because of the difficulties in the way of an expansion of India's exports, most investment under the third plan is intended to raise the output of goods that would otherwise have to be imported to meet essential consumer needs or to carry out the development program. In terms of specific goods, domestic output has already begun to displace much of what was imported into India in quantity until a few years ago. Steel, for instance, accounted for 12 per cent of total imports in the 1956-57 fiscal year, but for only 5 per cent of a somewhat smaller total in 1958-59. Within another two years, steel imports are expected to be virtually eliminated. Nearly all of India's crude oil and many petroleum products are now imported at a cost of about $200 million per year. Newly

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discovered oil fields and the construction of pipelines and refineries now under way, however, should within a year permit one third of current petroleum needs to be satisfied from domestic sources. Recent drillings in western India have spurred hopes of new discoveries adequate to meet all domestic needs, and the government has liberalized its oil policy to encourage new exploration by foreign oil companies. Imports of cotton and other agricultural commodities have fluctuated with changes in domestic production, but will be greatly reduced if the intensified drive to boost agricultural production is successful.

Except for food, India's consumer goods are now largely produced at home. The very limited increases in agricultural output and the rising demand for food, however, have lifted food imports (mostly wheat, rice, and other food grains) to about 20 per cent of India's total imports, compared with 10 per cent in 1956-57 and only 4 per cent in the final year of the first plan (1955-56). Most of these additional food imports have been made possible through the purchase for rupees of commodities owned by the United States Government and made available to India under Public Law 480. Thus, reduction in food imports also depends upon increases in India's agricultural output. The third plan aims at self-sufficiency in food grains by 1966.

Expansion of the domestic output of capital goods has been given a high priority in economic planning, but the limited supplies of such goods are expected to be a bottleneck to more rapid industrialization for some years. Therefore, as much exchange as can be spared will undoubtedly continue to be used to import capital goods, which during the second plan have accounted for roughly one third of India's imports.

It is realized, of course, that substitution of any one or even broad groups of domestic for imported products does not necessarily reduce the total demand for imports. To accomplish the latter objective, stringent curbs on the aggregate claims on resources of government, businesses, and consumers are required. However, even with the maximum amount of import substitution that is realistically conceivable and with strict fiscal and monetary controls, India's total import requirements are likely to rise over the decades. As the Indian economy moves toward progressively higher stages of development, new types of imports necessary to sustain this progress will outweigh, in all likelihood, import economies achieved in other areas.

## INDIA'S CAPITAL ACCOUNT

India's expected earnings of about $1,500 million per year from exports and invisible transactions during the third plan are just enough, according to Planning Commission calculations, to cover "maintenance imports". These are defined as "inescapable" imports of raw materials, intermediate products, and food grains purchased with foreign exchange, as well as capital goods required to maintain present productive facilities. The Planning Commission therefore estimates that the third plan will require about $6,730 million of foreign assistance, including private capital. This total includes $4,410 million to finance imports of capital equipment to expand productive capacity, $1,050 million to meet repayment obligations, and $1,270 million in imports of United States agricultural products.

Substantial new foreign-aid commitments will be needed fairly soon if India is to launch many of the new projects scheduled under the third plan. While unspent balances of aid commitments are estimated to have stood at about $3 billion at the end of March 1961, this total included $1.1 billion of commitments for surplus food products from the United States as well as $500 million of Soviet-bloc promises of aid over the entire third-plan period that will not be available for expenditure until specific agreements have been reached. The remaining $1.4 billion of outstanding balances will provide a cushion to maintain the present pace of capital-goods imports during the initial period of the third plan, but these funds have largely been allocated for completion of second-plan projects.

Official aid is expected to be supplemented by a growing inflow of private equity and loan funds from abroad. In view of the great interest being shown in the Indian market by American, European, and Japanese investors, the private capital inflow may amount to as much as $500 million in the next five years, or several times the pace during recent years. The United States has supplied half of India's total official aid receipts (see Table II), but this is only a partial measure of its role in India's development. While virtually all other aid agreements have provided loans repayable in the currency borrowed, this has been true of no more than one fifth of United States aid, even if allowance is made for the rupees made available for the use of the United States under P.L. 480 agreements. Furthermore, much of the United States aid could, until very recently, be spent freely anywhere in the world. Aside from aid received through international organizations, this has not been the case with most other loans or grants.

## QUESTIONS FOR THE FUTURE

India, as already indicated, must find a way to curb inflationary pressures and to achieve a more efficient use of available resources, including foreign exchange. During

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the second plan the cost of living has risen about 30 per cent and wholesale prices 25 per cent, despite the selective use of price controls and allocation systems. The climb in the cost of living has been appreciably slowed in the past year, but wholesale prices have continued to move steadily upward. Credit demands have been exceptionally strong for more than a year; stock prices also spurted until September 1960, when margin requirements were introduced and set at 50 per cent.

The primary source of inflationary pressure has been deficit spending by the government. During the first two years of the second plan, more than one third of plan expenditures were financed by borrowing from the banking system, primarily from the Reserve Bank of India. The expansionary effects of this borrowing upon the domestic demand for goods and the money supply were greatly dampened by the excess of imports over exports and the related decline (until October 1958) in foreign exchange reserves. Once the cushion of reserves had been depleted, however, continued borrowing to meet budget deficits began to be reflected in a speedier growth of the money supply.

The monetary authorities have tightened credit conditions somewhat within the past year. As a result, the prime lending rate has risen to 5½-6 per cent from 5 per cent, and the call money rate to 5 per cent from about 3½ per cent. One reason for the earlier hesitancy to apply stronger restraints on credit was concern over the effect of higher interest rates on the cost of servicing the government debt. Currently, however, the need to check inflation is apparently being given greater emphasis.

While the draft of the third plan schedules further government borrowing from the banking system, the amount involved is only half as large as during the 1956-61 period. At the same time, the plan calls for additional taxes that are expected to raise government revenues by 30 per cent, with all of the increase to be allocated to the third plan. (While tax collections will also grow due to the expansion of the economy, the additional receipts from this source will be largely absorbed by rising non-plan government expenditures.) However, even after imposition of the new taxes—which are almost entirely excise and import levies—there is considerable question whether tax receipts will be sufficient to avoid further inflation, and the possibilities for finding additional sources of revenue will have to be closely explored.

**Table II**
**Economic Aid to India by Country or Institution***
**In millions of dollars**

| Aid by country or institution | Aid utilized | | | Authorized balance outstanding March 31, 1960 | Authorizations made between April 1, 1960 and March 24, 1961 |
|---|---|---|---|---|---|
| | To end of first plan, March 1956 | April 1956 through March 1960 | Total through March 1960 | | |
| United States: | | | | | |
| Loans repayable in dollars | 189.7 | 34.4 | 224.1 | 126.8 | 123.8 |
| Loans repayable in rupees* | 4.8 | 186.9 | 191.7 | 153.3 | 231.6 |
| Grants | 88.2 | 141.0 | 229.2 | 263.8 | 5.6 |
| Agricultural surplus sales† | — | 738.5 | 738.5 | 238.5 | 1,334.7 |
| Total United States | 282.7 | 1,100.8 | 1,383.5 | 782.4 | 1,695.7 |
| Russia: | | | | | |
| Loans | — | 137.9 | 137.9 | 542.2 | 125.0 |
| Grants | — | 2.4 | 2.4 | — | — |
| United Kingdom: | | | | | |
| Loans | — | 173.1 | 173.1 | 42.5 | 126.0 |
| Grants | 0.1 | 0.9 | 1.0 | 0.1 | — |
| West Germany: | | | | | |
| Loans | — | 152.5 | 152.5 | 44.6 | 219.1 |
| Grants | — | 0.7 | 0.7 | 3.7 | — |
| Canada: | | | | | |
| Loans | — | 33.0 | 33.0 | — | — |
| Grants | 41.4 | 100.8 | 142.2 | 23.0 | 25.0 |
| Japan—loans | — | 8.3 | 8.3 | 49.6 | — |
| Norway—grants | 1.4 | 3.2 | 4.6 | — | — |
| Australia—grants | 10.9 | 12.9 | 23.8 | 1.9 | — |
| New Zealand—grants | 0.7 | 6.1 | 6.8 | 0.4 | — |
| Czechoslovakia—loans | — | — | — | 48.5 | — |
| Rumania—loans | — | — | — | 11.0 | — |
| Yugoslavia—loans | — | — | — | 40.0 | — |
| Poland—loans | — | — | — | — | 30.0 |
| International Bank for Reconstruction and Development—loans | 71.0 | 390.7 | 461.7 | 130.4 | 70.0 |
| Ford Foundation—grants | 4.7 | 7.8 | 12.5 | 9.9 | 7.4 |
| United Nations Special Fund—grants | — | — | — | 2.8 | 6.0 |
| Total—all sources | 412.9 | 2,131.1 | 2,544.0 | 1,733.0 | 2,304.2 |

* All loan agreements call for repayment in the currency loaned or other hard currencies, except for certain loans by the United States. Also, Russia has indicated that she may be willing to accept goods in repayment for some loan obligations.
† Measured by delivery of commodities to India, minus expenditure of rupee sales proceeds other than for grants or credits to India.

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According to some students of India's tax structure, there is room for significantly increased income tax levies along with improved tax collection procedures. Agricultural land is also taxed relatively lightly, although institutional and legal obstacles to improvements in this area are formidable.

Continued heavy reliance on price controls and government allocation systems raises questions about the efficiency with which India's resources are being utilized. Capital-goods prices in particular have been kept down through low interest rates and the control of prices of capital goods sold by government enterprises. Furthermore, such goods have been given preference under the import allocation system. It is thus not surprising that the designers of new plants for India emphasize rapid mechanization, which raises a number of questions in view of the existence of a large reservoir of unemployed and underemployed labor.

The need for basic social and cultural changes during the next several development plans is widely recognized in India. The adjustments of the past decade are impressive, but social patterns and customs change slowly. Moreover, the changes have mostly occurred in urban centers, with the countryside little affected.

Much has been done to make India more attractive to foreign investors, although official approval is not given to all potential investments. Efforts to get even more private foreign capital might well reduce the need for intergovernmental aid. India's exchange needs would also be eased if a way could be found to mobilize the population's large gold holdings, or at least to prevent them from growing. Estimates of the amount of gold imported into India outside official channels since 1948 run to $400 million and higher. Privately owned gold, much of it in the form of jewelry, may range upward from $3.5 billion in value.

On balance, it appears that India's goals for economic development will require increased foreign aid along with an improved use of available resources. This, indeed, was one of the conclusions of the Abs-Franks-Sproul mission, which stated that "a very substantial increase in foreign assistance" above the amounts provided during the second five-year plan would be required to make India's development plans effective. In deciding whether to provide the full amount of aid requested by India, the developed nations will, of course, have to consider the needs of other underdeveloped areas, as well as the need for defense outlays and the additional manifold demands on their productive capacity. The Free World, however, has a very heavy stake in the rapid development of this, the most populous of all the countries now striving to speed their economic growth within a framework of democratic institutions and patterns of life. Increased aid for India and, indeed, other underdeveloped nations, and a more equitable sharing of the load among the industrial countries are thus pressing international matters. The future course of world history will undoubtedly be strongly influenced by the degree of success of the developing nations in their efforts to raise living standards while furthering political freedoms.

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