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3 July 1947

~~AD EGG COMMITTEE~~

MEMO FOR FOREIGN ASSISTANCE

INDIA

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BACKGROUND

I. Analysis of the situation in the country.

The British Government will probably transfer power in 1947 to two governments in India (Hindustan and Pakistan) instead of to a single Government of India as the British and the Congress Party have consistently desired. However, in the light of the inevitable interdependence of the two prospective Indian nations, especially from the standpoint of security and economics and in view of the impracticability of discussing alternative means of reaching U.S. objectives in India on the basis of innumerable political contingencies (which may prove to be only temporary), this report has been prepared on the basis of India as a whole.

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A. Basic Forces.

1. Primary Interest in Basis of Independence.

The British Government announced on June 3, 1947, that Dominion status would be granted to India by August 15, 1947, thus advancing the date of transfer of power from June 1948 as announced in February 1947. Although the June 3 statement did not preclude negotiations for a united India, it established a procedure whereby the areas containing populations predominantly Muslim could set up a constituent assembly for the purpose of drafting a constitution for Pakistan. Meanwhile, both the Congress Party and the Muslim League are participating in the Viceroy's Council which is functioning as an interim government and handling problems on an all-India basis.

a. Probable Partition. Both the British and the Congress Party would like to preserve the unity of India, but the apparent unanimity of agreement with the June 3 statement indicated that the British are not prepared to coerce the Muslim League's popular following to accept unity against its will and that the Congress Party is not prepared to fight both the British and League on the issue. Although the League claims for Pakistan the five provinces of Assam, Bengal, Sind, the Northwest Frontier, and the Punjab and the British-administered territory

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of Baluchistan (containing 20 percent of India's area and 23 percent of its population), those areas or portions of them that choose to do so will be free to join the present constituent assembly. While it is still open to the Leagues to join the Constituent Assembly, present prospects are that it will insist on setting up a new constituent assembly for Pakistan, and in fact both the Punjab and Bengal legislatures have voted for partition and the setting up of a second constituent assembly. Consequently there will probably emerge in August 1947 two separate governments in India, Hindustan and Pakistan, both with dominion status. Present indications are that the title of Viceroy will be eliminated and that a single Governor-General will be appointed for both dominions. Once dominion status is conferred, either or both dominions in India will have the right to sever completely ties with the British Commonwealth. It is too early to judge what course either dominion will follow after August 1947.

#### b. Factors Affecting Future Government.

All the parties appear concerned to avoid civil war although local struggles for control in the Northwest Frontier Province and over the division in the Bengal-Assam and Punjab areas seem certain to continue. When Bengal and the Punjab are partitioned, a Congress Party central government will control virtually all of India's industrial areas and a substantial portion of the cultivated agricultural land, and will be ready to cooperate with any quasi-independent Muslim areas or Indian states that might emerge. Close or effective cooperation, on the other hand, between the Muslim areas in eastern Bengal and northwestern India, or among the Indian states of Hyderabad, Mysore and Travancore would be virtually impossible to obtain. M. A. Jinnah, despite his recent demand for a division of the army, envisages future Indian cooperation for defence, while League papers have repeatedly argued that there will be a broad field for mutual cooperation apart from the administration of Muslim majority areas. At present, however, it appears certain that the Indian army will be divided between Hindustan and Pakistan. The degree of cooperation between these two areas is extremely difficult to predict at this stage; and development, from civil war to a unified high command, is possible. Despite

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indications that certain Muslim and States areas may wish to remain indefinitely within the British Commonwealth, such an arrangement would encounter difficulties in view of the strong feeling for independence amongst Indians of all communities and the inevitable prejudice that would result in Britain's relations with the rest of India where Britain's major commercial and industrial interests lie.

2. Social and Economic Problems. The traditionally low standards of living of India's workers and peasants, relieved temporarily during the war, are being progressively depressed by the steadily rising price levels coupled with postwar unemployment. Ineffectual cloth rationing together with abuses in food collection and distribution in scarcity areas add to the general unrest. The Congress Party is committed to a thoroughgoing attack on economic, social and political grievances, but it is deterred at the moment by the concern for achieving independence and unity. The Communist Party of India is taking full advantage of the inactivity of Congress groups to call attention to grievances of all kinds in an effort to build up its popular following.

While Indians generally are anxious to reduce their dependence on foreign capital and technical assistance, there is a growing recognition, particularly in business circles, of the value and necessity for such aid during the years ahead. At the same time it can be expected that there will be continuing concern that foreign assistance be diverted from business management services to developing new fields of industrial activity, that it be largely limited to amounts that India can repay within a short-term period (10 to 20 years), and that assistance at high interest rates be kept at a minimum.

## B. Objectives and Methods of Other Great Powers

1. Britain. The British Government, recognizing the impossibility of maintaining her control of India by force in the face of the popular demand for independence, is attempting to effect withdrawal under conditions which will leave India geographically intact and enjoying both an effective government and

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a viable economy. The decision to withdraw is apparently irrevocable except in so far as it may be qualified by mutual agreement. Britain hopes that there will be a minimum disturbance to her trade and other economic interests in India, and that some arrangement for mutual assistance for security will be realized. Much depends in this connection on the successful outcome of negotiations related to the liquidation of India's sterling balances, and on the general acceptability of the procedure by which Britain transfers power. Britain is endeavoring to develop an independent army or armies completely officered and manned by Indians as an effective defence force, and contemplates the development of an alternative defence base in East Africa to balance Britain's strategic hold at Singapore.

2. USSR. Russia is encouraging Indians to rid themselves immediately of all British political and military control. Moscow casts doubt on British intentions and accuses Britain of fomenting communal strife and of seeking to perpetuate imperial control through the Indian states. Russia is endeavoring also to stimulate India's already great interest in Soviet achievements in applied science, agriculture, and education as examples of what can be accomplished under a planned economy. On the international level Russia is cooperating with India in the United Nations on the basis of their common hostility toward Britain, and opposition to colonialism and racial discrimination.

Russia's plans to push India toward Communism in connection with an agrarian revolution scheduled to accompany the expulsion of British control are not working out. Britain's departure is occurring prematurely, and in view of the importance of promoting Indian good-will internationally, it is apparent that the communization of India is, at present, fairly low on Russia's list of priorities. The Communist Party of India is making itself a nuisance by fomenting unrest at every opportunity and, while its political influence is not great at present, its compact and well disciplined organization could probably make itself felt out of all proportion to its numbers under conditions of confusion or during periods of great stress.

II. Analysis of assistance already received, including most recent data available.

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**A. Analysis of political and economic premises on which economic aid was based.**

Any economic aid which India has received since 1941 from the United States or other foreign countries has been indirect, that is, as related primarily to the war effort of the United Nations. The accumulated sterling balances of India indicate that, in financial terms, that country has provided more economic assistance to Great Britain than she has received from Great Britain.

**B. Summary of assistance given.**

India has received no direct or not economic assistance from foreign countries since the end of the war. Under the Lend Lease and Surplus Property Agreement of May 16, 1945 between the U.S. and India, the latter obtained a considerable quantity of trucks, machinery, airfield installations, etc., which will assist in the implementation of India's development plans. However, India does not consider this as direct aid inasmuch as she feels that her reciprocal aid to the U.S. during the war was equal if not more than the aid received from the U.S.

The American OIC program has established libraries in India containing such needed American reference volumes and has assisted the exchange of cultural and informational materials such to the benefit of better understanding and cooperation between the two countries.

**C. Economic assistance pending or contemplated.**

None.

**III. U. S. Objectives in India.**

**A. General.** It is the aim of the United States to inspire greater confidence in institutions and policies of the western democracies; to support the development of complete Indian self-government based on the principle of equal rights and self-determination of peoples; to dispel the existing fear in India of the spectre of American economic imperialism; and to foster greater understanding and cooperation between the two countries. It is our policy (1) to encourage moderate progressive, non-communist groups and to prevent the development of chaotic conditions in India which would facilitate the spread of communist ideologies, strengthen the Communist party organization in India, and invite greater Soviet activity in India;

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(2) to assist economic and industrial development in India as a means of raising the standard of living and strengthening resistance to Soviet influence, and (3) to encourage the participation and independent action of India in the activities of the UN and of all of the specialized agencies.

B. Specific. India's close adherence to the principles of the International Trade Organization is highly desirable, and the U.S. anticipates the conclusion of an early trade agreement with India. A consular convention is expected to be negotiated in the near future. A taxation agreement is also under consideration, and it is hoped that a Treaty of Friendship, Commerce, and Navigation may be negotiated late in 1947 or in the following year.

#### IV. Consideration of alternative means of reaching objectives.

##### A. Economic.

The alternative economic means of realizing the objectives of the United States with respect to India cannot be considered as sufficient substitutes within themselves. For the period of the next three to five years, the chief complementary alternatives would include:

1. Investment of private Indian capital in productive domestic enterprises.
2. Abolition of the Empire "dollar pool", and free convertibility of current sterling income.
3. Convertibility of some part of India's accumulated sterling balances.
4. Implementation of the ITO charter.
5. Foreign or international loans.

These complementary alternatives will be discussed in Section VI below.

##### B. Political

The basic, political means of reaching U. S. objectives in India are stated in section V of this report, and as they are considered essential and attainable, discussion of alternative means is impracticable. Certain objectives

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might be realized through closer relations between the UK and India, but the present state of the UK's economy and continuing widespread Indian antipathy for the British render this alternative impractical for the period under review.

Alternative political means of reaching U. S. objectives in India listed below may be regarded more accurately as complementary measures.

1. Close economic and strategic cooperation between Hindustan and Pakistan and the Indian States is virtually essential if stability and progress are to be attained. The U. S. can assist in the realization of these conditions by withholding recognition from those Indian States which might seek complete independence and thereby preventing Balkanization of the subcontinent. Furthermore, the U. S. might prescribe stable conditions of government in Pakistan as a prerequisite for establishment of diplomatic relations between Pakistan and the U. S.

2. Indian fear of dangers arising from investment of foreign capital may be eliminated or at least diminished through better understanding in India of American methods and motives. That understanding can be improved through our educational and informational progress in India and through a more tolerant and tactful approach by American business interests.

### C. United Nations

The United Nations provides a useful vehicle for furthering United States policy objectives with respect to India. Independent, active participation by India in the United Nations and its specialized agencies will enhance its status as an independent nation, and will identify India with the states which are seeking to maintain peace through effective international cooperation and action. Friendly relations between the two governments can be furthered by United States support of Indian membership in the Councils, Commissions, etc., of these bodies and by United States support of proposals designed to extend the services of these organizations to India. Some of these services can, as the organizations enter into full operation, help to improve economic and social conditions in India, and thus contribute to India's political stability. The specific ways in which each of the agencies might be of assistance in achieving U. S. objectives are set forth in Addendum of June 10 to SSMCC 300 (of April 24).

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(The effect of the partition of India on Indian membership in the United Nations and its specialized agencies is being studied and will be described in detail in a later draft of this report).

V. Magnitude, nature and timing of the measures required within the next three to five years to reach these objectives.

A. Economic

Since no special measures are recommended to meet the somewhat unstable but not critical economic situation of India, no discussion of the magnitude, nature and timing of the economic measures required within the next three to five years to meet United States objectives in India is called for. In other words, the presently existing and usual forms of economic aid, which are discussed in Section VI following, are considered adequate, although doubtless falling short of maximum Indian aspirations.

B. Political

It is anticipated that a Consular Convention will be concluded in 1947 and that a taxation agreement and a Trade Agreement will also be concluded in 1947. If two separate and distinct states emerge in India, all agreements may have to be duplicated, inasmuch as the United States desires friendly relations with all communities in India whatever the constitutional pattern may be.

A Treaty of Friendship, Commerce and Navigation is contemplated in 1948.

The United States will wish to establish an Embassy in the capital of Pakistan if the latter emerges as a separate, independent entity.

C. United Nations

India has been an active member of ECOFAC, and an Indian national serves as its chairman. India has participated especially actively in ECOFAC efforts to promote economic development. The Indian delegate to the ECOFAC (fourth session) was extremely active in supporting the recommendation that the United Nations

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organize a service to provide "technical advice to Member governments". He stressed the fact that India's great need in the next few years would be engineers, scientists and technicians of all kinds. Because of the fear of foreign imperialism in general, the Indian Government (or governments) may increasingly show a desire to call upon international agencies for aid in carrying out the technical aspects of development programs.

India also actively supported the establishment of the Economic Commission for Asia and the Far East, and an Indian national has been appointed Executive Secretary.

India will also probably continue to urge international action through PTO or ITO with respect to certain commodities in which India is especially interested--such as wheat, rice, and cotton. A U.S. policy which enables India to achieve some of its objectives with respect to such commodities, without at the same time departing from a policy designed to meet our over-all trade objectives, would have an indirect benefit upon India.

#### D. Other

In view of the present appreciable volume of mis-information concerning the United States and even anti-American comment appearing in Indian newspapers, it is important that the OIG program in India be strengthened. Under the provisions of the Fulbright Act, funds acquired from the sale of surplus property may be expended in Indian rupees to finance studies, research, instruction and other educational activities of or for citizens of India in American schools outside the United States and its possessions. It is considered highly important that this Act be implemented for the benefit of Indo-American relations. If the Mundt Bill (H.R. 5342) passes, it will make possible the appropriation of United States funds for the exchange of students, teachers, trainees, etc., for assistance to schools, libraries, and community centers in India, and for other similar purposes such as the provision of American technical experts to the Government of India as advisers and the dissemination in India of information about the people, institutions and policies of the United States.

#### VI. Probable availability of economic aid from existing courses under present policies.

The various alternative means of accomplishing economic

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objectives of the United States with respect to India should be considered as interdependent. The effectiveness of each means will be conditioned by the implementation of the others. It is judged that any reasonable combination of the economic alternatives listed below, although probably falling short of India's aspirations for economic assistance, would provide for sufficient internal stability to satisfy the minimum of American objectives.

#### A. U.S. sources

Even if the uncommitted funds of the Export-Import Bank were not somewhat limited, as is the case, India's reliance upon this source of developmental capital would have to be comparatively small. The United States policy of the Eximbank does not favor duplicative or complementary financing of foreign capital expansion which would normally be the primary responsibility of the International Bank. [Furthermore, as a founding and active participating member in most of the U.S. organizations, India is committed to using international agencies or services whenever possible.] Any funds which the Eximbank might advance India would be likely to consist of comparatively small denominations for special purposes closely related to American trade.

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#### B. Other countries

##### 1. Investment of private Indian capital in productive domestic enterprises.

Traditionally, almost all classes of individuals and families in India have maintained large or small hoards of liquid resources, including gold, silver and jewels. Whereas a part of these hoards have been cashed in recent years for national and other purposes, the remaining treasure may amount to at least several hundred million dollars. These resources may not accomplish as much in the way of expanding India's industrial establishment as some of her nationals optimistically believe, and furthermore, it would be difficult to convince many Indians of the desirability of converting their holdings. Nevertheless, in combination with other measures, a perceptible strengthening of India's industrial economy should follow a program of investment of the available part of these assets. Any privately held foreign exchange in India could follow the same pattern.

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2. Abolition of Empire "dollar pool" and free convertibility of current sterling income.

It is fully expected that the measures listed under the above heading will be realized on and after July 15, 1947. It is not expected, however, that the honoring by the British of their agreement with the United States in these respects, will account for such improvement in the economic situation of India. For all intents and purposes India already enjoys free use of her current income from foreign transactions, but judging by current levels of imports these resources are at present, and will remain for some time to come, inadequate to pay for India's rising imports.

3. Convertibility of some part of India's sterling balances.

No one knows what proportion of India's approximately \$5 billion credit to the United Kingdom the latter will be able or willing to convert into free foreign exchange. From the moral point of view good reasons can be advanced why any amount between zero and the full amount of these sterling balances should be converted by Britain, either on July 15, 1947 or at some later date. Realistically considered, however, within the next three to five years the United Kingdom will have the ability to convert only a small part of its obligation to India. The experience since V-J Day has been that the sterling balances have been reduced by some \$400 million. It is practically certain that the United Kingdom's performance in this respect in the immediate future will not compare favorably with this record. Britain's situation is less comfortable now than it was a year ago and there is no substantial relief in prospect for her. Therefore, it would appear reasonable to assume that India's sterling balances will not be reduced by much more, and possibly by less, than \$35 million (or \$140 million) per annum during the next three to five years. In this connection it is not even necessary to consider the probability that part of the Indian sterling balances will be canceled since such action would have very little, if any, effect upon the real economic alternatives open to India during the period under consideration.

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International sources

1. Implementation of the ITO charter

Undoubtedly the multilateral acceptance of the

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general principles of non-restriction of international trade will work to improve India's economic situation in the long run. Since the world will probably continue to be a seller's market for the immediate years in prospect, India would not require any particular changes in world trade arrangements in order to accumulate dollar or other convertible balances. In other words, the prospects are for continuing passive trade balances for India, so that her situation will not be greatly improved by the reduction of trade restrictions or by agreement on other factors within the purview of the International Trade Organization. Of course, if more normal conditions (for India) return toward the latter part of the period under consideration, India should reap substantial benefit from positive balances of trade accentuated by a rational world trade organization and the absence of restrictive measures.

### C. Foreign or International Loans.

One of the more ambitious plans for increasing India's economic income, the Bombay Plan, contemplated securing foreign capital advances to the extent of about \$2.3 billion, the balance of the 15-year industrialization program of about \$33 billion to be secured from conversion of sterling balances (for industrial imports from the United Kingdom), favorable balance of trade, hoarded wealth, native savings, and "new money". Native savings and "new money", envisaged in the Bombay Plan, are estimated at \$24 billion, or more than two-thirds of the total \$35.3 billion required for the Plan. Most observers, both inside and outside of India, regard the Plan as overly ambitious and expect actual accomplishments during the next 15 years to fall considerably short of the planners' ideal.

Besides the unrealistic or poor economics of excessive reliance upon "savings of the people" and "New Money", the Bombay Plan overestimates India's ability to secure capital from abroad. In the first place, private capital (for all practical purposes, American) has shown no enthusiasm for investment opportunities in India. It is felt that the developing discrimination against foreign capital in that country, plus the uncertainties of its political future, will discourage any substantial flow of American capital funds to India. In view of the general economic

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outlook of India, including the poor condition and productivity of its labor force and of other unfavorable factors of production, foreign private capital will only be attracted in quantity when it is apparent that the latter will be provided with strong incentives, if not special treatment, by the Indian authorities. The Government of India appears unwilling to change the domination of its domestic economy which it feels would be entailed by overtures making dollar or other foreign investment attractive. Consequently, it would seem that only a small amount of the large influx of foreign capital contemplated by the Bombay Plan will be accounted for by private investors.

More specific  
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The chief sources of international funds which might be made available to develop Indian industry or to support the Indian economy or currency consist of (1) International Bank for Reconstruction and Development, and (2) International Monetary Fund.

The demands upon the funds of the International Bank in the foreseeable future are likely to be much greater than its capacity to provide capital. This means that the criteria upon which it will approve specific loans must be more severe than otherwise. A prime requirement, bearing upon the maintenance of a permanent revolving fund for the Bank, will be that the applicant country be able to meet service and amortization charges when they come due. In India's case, it seems likely that the directors of the Bank will severely discount the optimism as to India's industrial future which is entertained in some quarters. Within the next three to five years, then, a relatively sound loan of say \$100,000,000 to \$200,000,000 might be countenanced by the Bank.

The resources of the International Monetary Fund are reserved for somewhat special contingencies. Advances of key currencies may be made in order to tide a particular country over seasonal or short-run difficulties, which might otherwise threaten the stability of its currency. India's reliance upon this source, (as in the case of the Bank) will be conditioned by the demand and supply of key currencies, plus the limits specified in the Fund's charter, such as the quotas and withdrawal limits.

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India's ability to use the Fund will be quite limited during the period under consideration. As reported by the National (U.S.) Advisory Council Staff Committee (Working Group on Par Values) in its November 27, 1946 study on the "Par Value of the Indian Rupee", the maximum of India's possible reliance upon the Fund is \$100,000,000 per annum.

### 5. Reparations transfers

It is not considered likely that reparations removals, either from Germany or Japan, will contribute much to the strengthening of India's economy.

## VII. Additional measures required from the United States.

### A. Economic

It has been indicated in other sections of this paper that the situation in India is not at present, nor is likely to be within the next three to five years, so critical as to necessitate special appropriations of American public funds in order to safeguard United States security by extraordinary measures of financial aid to India.

Although no direct measures of financial assistance are likely to be required, India may be expected to continue making heavy demands upon the United States for grain. While India will pay for in cash, but any severe reduction in our present rate of grain shipments to India would be deeply resented and would foster anti-American propaganda.

## VIII. Nature of arrangements with the foreign government to assure accomplishment of our objectives in taking such measures.

As no direct assistance is contemplated, the question of such arrangements does not arise.

## IX. Possible emergency situations which should be anticipated and recommended course of action of U.S.

A. Internal disorder after British hand over control, in the form of labor difficulties in Hindustan, tribal disorders in the northwest frontier area of Pakistan, or conceivably (though improbably) civil war between Pakistan and Hindustan if and after the Indian army is divided along communal lines may develop.

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Requests for ordnance supplies might be made upon the U. S. in such instances. American supplies should be provided on a cash basis and upon assurance that their use will be for the purpose of stabilizing responsible, non-communist governments. ✓

D. Failure of sterling balance settlement and efforts to obtain funds from the International Bank might seriously hamper Government of India plans for industrial development and higher living standard. In the event of such difficulties, favorable consideration should be given to an Eximbank loan for the purpose of articulating Indo-U. S. trade which would at the same time assist India's development plans. X

E. Effects upon India and upon U. S. foreign policy in U. S. refusal to grant aid which might be requested in case of emergency.

A. Economic

Failure of the Government of India to implement plans for development might weaken the present Government which is favorably inclined toward the United States and bring more radical elements to power.

Continuation of poor living conditions might foster further unrest upon which radical elements thrive.

Lack of new agricultural equipment with which to expand India's own agricultural production will soon present demands upon the United States for grain. Failure of U. S. to provide required grain may well produce unfavorable publicity. Efforts, therefore, should be made to assist the expansion and improvement of Indian agriculture through provision of farm machinery and technical assistance. India is prepared to pay for such assistance.

B. Political

Chaos in India would almost necessarily strengthen communist activity, and Soviet infiltration will take advantage of the opportunity. The present Government is opposed to the Communist Party of India and may be expected to fight its growth. Weakening of the present moderate political leadership in India would give the Communist Party a new lease on life.

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India is the largest political unit in southern Asia and still has promise of being the most stable. It is friendly toward western powers at present.

An unfriendly India would probably affect our relations with the whole of South East Asia. If Soviet expansionism or aggression should in future lead to a need for strategic bases in that area, an unfriendly India, and particularly a pro-Soviet India, would probably render such bases untenable.

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