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India's Expanding Economic Ties to Japan and Western Europe



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An Intelligence Assessment

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India's Expanding Economic Ties to Japan and Western Europe

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An Intelligence Assessment

This paper was prepared by [Redacted] Office of
Near Eastern and South Asian Analysis. Comments
and queries are welcome and may be directed to
the Chief, South Asia Division, NESA [Redacted]

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India's Expanding Economic Ties to Japan and Western Europe [REDACTED]

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Key Judgments

*Information available
as of 21 June 1988
was used in this report.*

The value of trade between India and Japan and Western Europe has grown by more than one-third since Prime Minister Rajiv Gandhi introduced his economic liberalization program in 1984. The program has reduced import restrictions on some foreign goods and improved India's attractiveness to the developed countries as a trading partner. India is encouraging the expansion in trade despite a growing trade deficit because New Delhi believes that only by importing the capital goods and sophisticated technology items that Western nations offer can it modernize its own industrial base and boost exports. [REDACTED]

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India is likely to look increasingly to Japan and Western Europe instead of the United States for the high-technology goods it seeks because it believes these countries are willing to sell the items unencumbered by the regulations and licensing restrictions that delay delivery of US technology. We believe Prime Minister Gandhi's preference for US equipment—particularly computer and military items—will help the United States remain an important trading partner for India over the next few years, but Washington faces stiff competition from other Western nations. Japan replaced the Soviet Union in 1986 as India's second-largest trading partner, excluding military goods, and is in a good position to surpass the United States in a few years. [REDACTED]

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New Delhi has encouraged trade relations with Japan and Western Europe by being more open to foreign investment and joint ventures. India has traditionally emphasized self-reliance and discouraged imports, but it recognizes that it can achieve its economic development plans only by looking to others for help. India sees foreign investment as a source of industrial development, and collaborative projects as a means of acquiring technology. [REDACTED]

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India sees drawbacks to opening its markets to exports from Japan and Western Europe just as it does with the United States. India is wary of becoming a dumping ground for foreign goods, particularly Japanese, and resents Japanese and West European reluctance to open their markets to more Indian goods such as textiles and agricultural products. New Delhi is concerned that Western businesses are unwilling to relinquish their control and give India a more equitable role in joint ventures. Indian leaders also are facing new political questions about opening their markets to the West. Opposition leaders argue increasingly that such moves forsake India's

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traditional emphasis on self-sufficiency, are leading to domestic business failures and higher inflation, and are increasing the prospects of unemployment. [redacted]

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New Delhi's enhanced economic relationship with Japan and Western Europe is not likely to replace India's ties to the Soviet Union in the near term. Most of India's commercial imports from the Soviet Union—oil and raw materials—are not goods that Japan and Western Europe can readily supply. Furthermore, India is not likely to abandon the Soviet Union as a trading partner in goods that can be supplied by Japan and Western Europe—such as semifinished products, machinery, and equipment—as long as Indo-Soviet trade is conducted in rupees and allows India to preserve its hard currency. [redacted]

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The pace of India's growth and capacity to purchase Western goods and technology depends, in large part, on its foreign payments position. We believe any significant deterioration in the trade deficit will lead to immediate restraints on all but essential imports. New Delhi probably will try to ease the deficit by tying future imports to increasing exports and may open the economy to greater foreign investment. [redacted]

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Should India be forced to restrict foreign imports, we believe Western Europe would be affected first. The West Europeans have made their greatest market inroads in sectors where a less technologically advanced Indian production capability exists. Japan also may be affected by the high value of the yen, but bilateral aid—if continued at current levels—would help Tokyo maintain exports to India. India's sizable trade surplus with the United States probably would protect bilateral trade between the two countries. [redacted]

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Scope Note

India has increasingly looked to the developed countries to help it acquire the modern machinery and high technology necessary to achieve its goals of modernizing its industrial sector and increasing and diversifying Indian exports. This paper discusses prospects for continuing the growth in trade with Japan and Western Europe and assesses the effect of that growth on India's trade relations with the United States and the Soviet Union.



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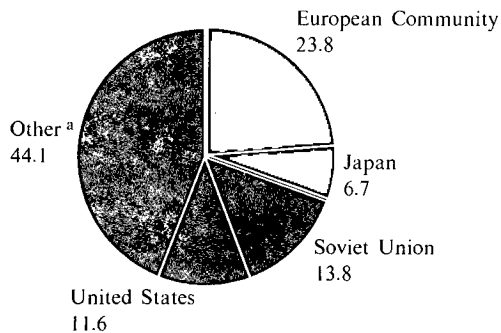
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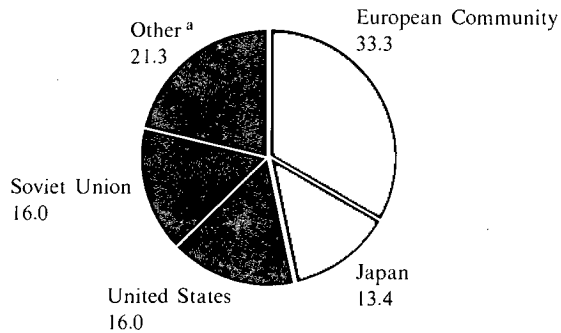
Figure 1
India: Share of Trade, 1980 and 1987

Percent

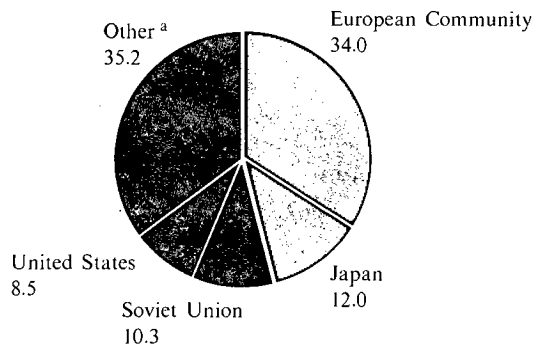
Exports to India, 1980
Total=US \$13.8 billion



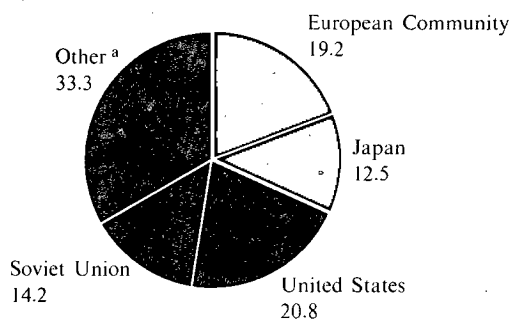
Imports from India, 1980
Total=US \$7.5 billion



Exports to India, 1987
Total=US \$16.5 billion



Imports from India, 1987
Total=US \$12.0 billion



^a Other consists of Africa and OPEC countries.

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India's Expanding Economic Ties to Japan and Western Europe

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Introduction

Since Prime Minister Rajiv Gandhi's election in 1984, India has accelerated its program to secure modern capital goods and technology from abroad to help meet ambitious economic development plans. Gandhi believes that increased access to modern equipment and skills will spur industrial modernization and result in more efficient and competitive domestic production. India hopes to boost its exports and counter its rapidly growing trade imbalances. New Delhi has increasingly looked to Japan and Western Europe as well as the United States for the technology and financial assistance necessary to meet its goals.

India's export growth has not kept pace with the country's rising imports. Exports to Japan reflect only a moderate increase when compared with India's rapidly increasing imports, and Indian exports to Western Europe have declined since 1982. Sales to Japan grew from about \$1 billion in 1980 to \$1.5 billion in 1987. Exports to Western Europe have been erratic over the last eight years. After peaking at \$2.6 billion in 1982, they fell to \$2.4 billion in 1987. India's main exports to these countries are raw materials, such as iron ore, textiles, handicrafts, and agricultural products.

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Trade Balance

Indian trade statistics indicate that Japan and Western Europe are becoming increasingly important to India as a source of goods and equipment. The value of India's two-way trade with Japan has increased by almost 85 percent since 1980, reaching about \$3.5 billion in 1987, and India's imports from Japan have more than doubled in value since 1980, accounting for \$2 billion in 1987. Japan is the second-largest overall trading partner behind the United States, excluding military equipment, and is the largest exporter to India. Tokyo replaced Moscow as second place in 1986.

New Delhi is attempting to boost its sales to Japan and Western Europe by diversifying its exports to include more electronics, consumer goods, machinery, and other types of manufactured equipment. All of these sectors face highly competitive markets, however, in which the high price and poor quality of Indian goods make it difficult for New Delhi to compete. US Embassy reporting indicates that New Delhi's key target industries—electronics, machinery, and other types of manufactured equipment—showed virtually no growth in 1987.

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Facilitating Ties

Foreign Assistance. The Japanese and the West Europeans believe financial assistance is a strong incentive for India to keep open its large capital-goods market, and, therefore, they are increasing their commitment of concessional and commercial aid, according to the US Embassy. Most of the financial aid provided by Japan and Western Europe is heavily weighted toward large-scale projects in energy, communications, infrastructure, and manufacturing—key areas for India's development efforts. Project assistance from these countries usually includes funds to cover some of the foreign exchange costs of importing equipment

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India's total trade with Western Europe has increased 40 percent since 1980, reaching \$8 billion in 1987. India's largest West European trading partners are West Germany, France, and the United Kingdom. These nations supplied 70 percent of India's West European imports in 1987, accounting for \$5 billion, and received more than 65 percent of India's West European exports. Much of the growth in Indian imports from Western Europe has been in the capital-goods sector, primarily office equipment and industrial machinery.

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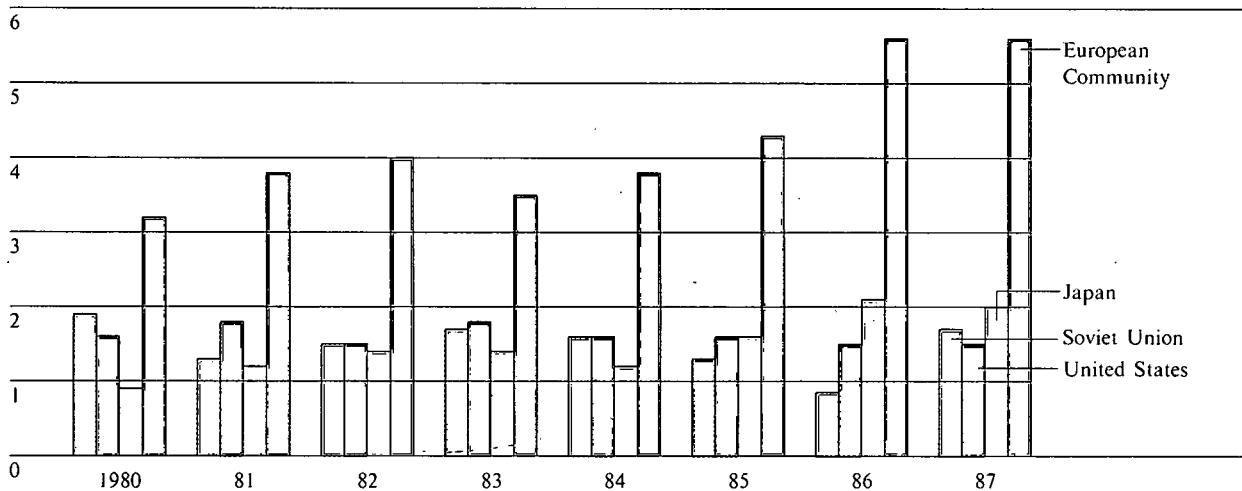
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Figure 2
India's Trade with the United States, Japan, European Community,
and the Soviet Union, 1980-87

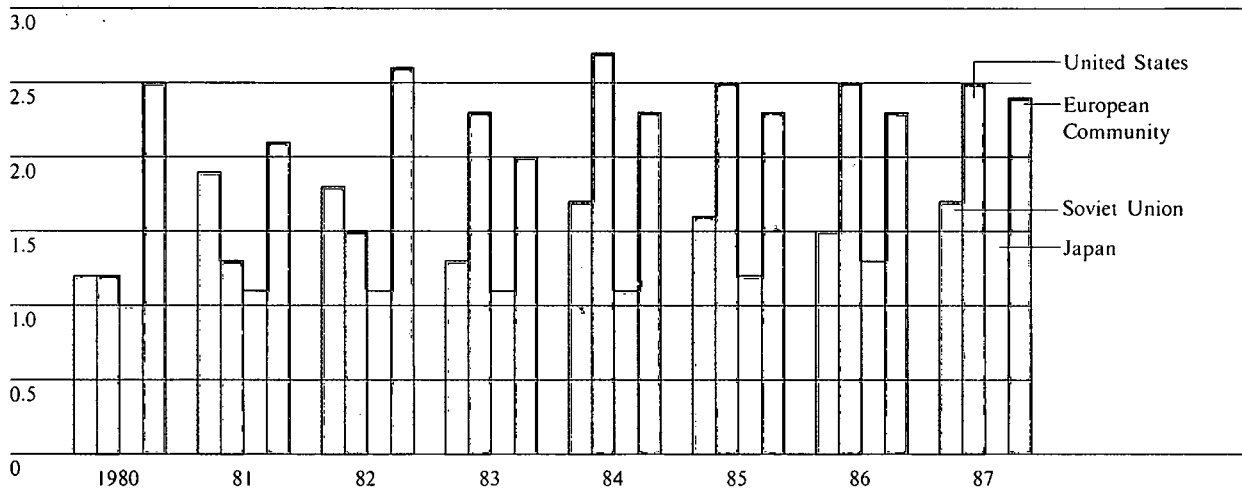
Billion US \$

Note scale change

Exports to India



Imports from India



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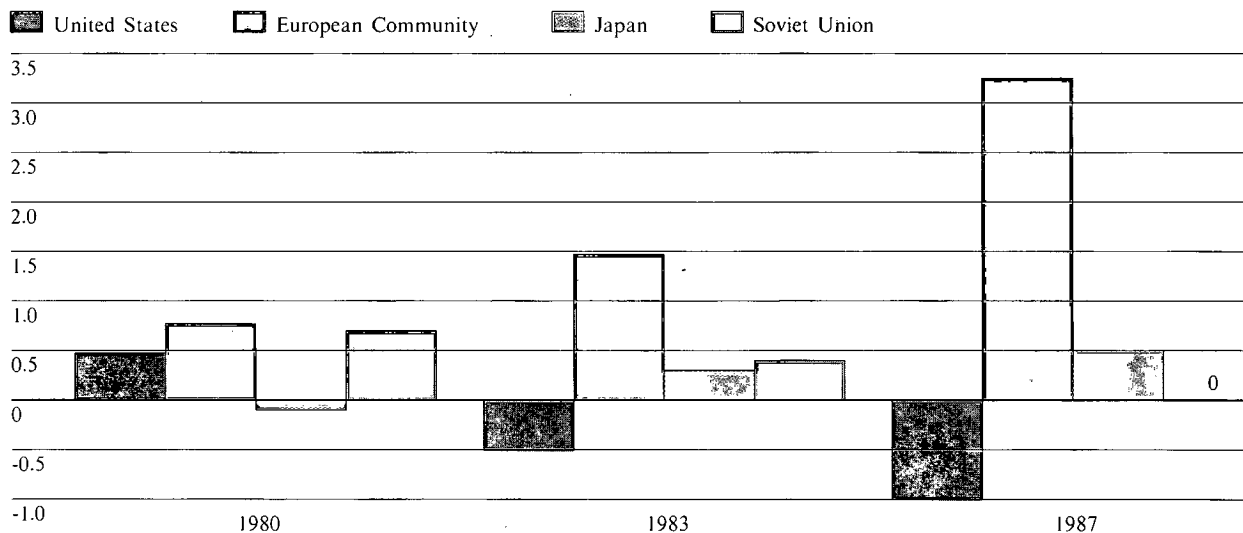
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Figure 3
India: Trade Balance, 1980, 1983, and 1987

Billion US \$



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and machinery. For example, press reports indicate that 60 percent of West German assistance to India in 1988 was used for project funding. [redacted]

Japan is India's largest Western bilateral aid donor. In the last year Japan has pledged almost \$700 million in assistance, including more than \$200 million in drought relief. Prime Minister Gandhi in April used the opening of the six-month Festival of India in Japan to solicit additional Japanese financial assistance for India's economic development. Gandhi received a warm reception and was promised an \$80 million loan to upgrade a steel plant. India probably will receive additional funds as Japan moves to loan a larger share of its trade surplus to developing countries. [redacted]

Aid from Western Europe is provided through multilateral organizations as well as bilaterally. India is the largest single beneficiary of multilateral aid from the European Community (EC) to developing "nonassociated" countries in Asia.¹ The Community's aid programs are varied and provide funds to pay for West European imports as well as promote technical cooperation—such as a joint research project to develop alternative energy sources for India. The programs also provide funds for emergency drought and flood relief. In 1986 total EC aid amounted to about \$100 million with funds split almost evenly between food aid and technical assistance. [redacted]

¹ Associated countries are members of the Lome Convention, which mainly consists of African, Caribbean, and some East Asian states. They receive most of the Community's assistance. [redacted]

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Growing Trade With Selected European Countries

West Germany. West Germany became India's largest West European trading partner in 1986. The two countries have more than doubled the volume of bilateral trade over the last decade. West Germany is India's only major West European trading partner to increase its volume of Indian imports. At the same time, West German trade statistics indicate exports to India have more than tripled since 1977, with 60 percent of the growth occurring since Prime Minister Gandhi assumed office in 1984. Major West German exports to India include organic chemicals, machinery, and sheet steel. Industrial machinery and components account for more than half of these exports.

[redacted]

Much of the growth in trade between India and West Germany can be attributed to significant increases in technical collaboration and West German investment in the Indian economy. Bonn also has increased concessional aid. The aid will be used for a variety of projects, including energy, transportation, high technology, ecological, and poverty alleviation projects. The aid benefits West German business because, as the US Embassy in New Delhi notes, it is tied to purchases of West German goods.

France. France, like West Germany, has seen its trade with India expand rapidly over the last decade. Although Indian exports to France have fluctuated since 1977, Indian imports of French goods have increased almost six times, with 73 percent of that growth occurring since 1984. This growth rate is somewhat inflated by major purchases of military goods in 1985, including Mirage 2000 jet fighters and Dauphin helicopters, according to the US Embassy. Even without these military purchases, there has been a steady upward trend in Indian imports of French goods.

India is eager to expand its exports to France and eliminate the imbalance in bilateral trade. According to press reports, New Delhi is encouraging an increase in collaboration in an effort to repeat the success it

had with the West Germans. The two sides continue to discuss new trade agreements, especially in military and high-technology sectors like computers and telecommunications. Arrangements to help the Indian telephone industry develop the ability to manufacture sophisticated telecommunications equipment are near conclusion.

India selected the French aviation firm Dassault in late 1987 as primary consultant in designing India's Light Combat Aircraft (LCA). Although the state-owned corporation, Hindustan Aeronautic, Ltd., will maintain control over the program and oversee the LCA airframe construction, Dassault's involvement guarantees that Western technology and subsystems will be incorporated in the aircraft's final design.

United Kingdom. The United Kingdom has traditionally been India's primary trading partner in Western Europe, but trade between the two countries since the early 1980s has grown at only half the rates of West Germany and France. In fact, the volume of Indian exports to Britain has declined since 1977. The US Consulate in Calcutta reports that Britain's loss of its dominant market position is a result of several factors, including less attractive financing and the inability of small British firms to compete with other Westerners who can offer higher quality technology at a cheaper price.

As with other West European trading partners, Britain is trying to increase exports to India through joint ventures and investment. According to US Embassy reporting, Britain had the third-largest number of new collaboration projects approved and was the third-largest foreign investor in the Indian economy in 1986. London hopes to boost its economic ties to India by negotiating a Memorandum of Understanding (MOU), according to press reports. The MOU would help facilitate the sale of British high-technology items by removing steps required to get exports approved.

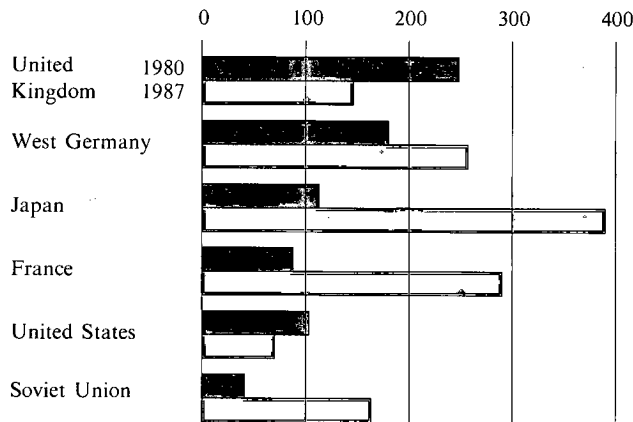
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Figure 4
Sources of Disbursed External Assistance,
1980 and 1987

Million US \$



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Bilateral assistance from Western Europe is substantial. West German aid to India in 1987, slightly more than \$380 million, was at the highest level ever, according to US Embassy reporting. In addition, India and France signed a \$583 million credit package in 1986 to help New Delhi finance several projects, including construction of a gas pipeline, purchase of helicopters, and building a hydroelectric power plant. [redacted]

Because Japan and Western Europe focus their technical and financial assistance in the same areas, they also pool financial resources on occasion. According to US Embassy reporting, Tokyo's chief agency for providing concessional loans for economic development, the Overseas Economic Cooperation Fund (OECF), provides assistance to several major projects that are jointly financed with West European nations. For example, the Japanese are funding two fertilizer plant projects: one with Denmark and the International Development Agency (IDA); the other with the

United Kingdom and IDA. In addition, OECF is providing funds for the purchase of pipeline materials in cooperation with West Germany and Italy as well as funds to cover the actual construction costs with France and the United Kingdom. [redacted]

Foreign Company Involvement. The Japanese and the West Europeans view joint ventures as a means of boosting trade and have found New Delhi increasingly receptive. Business ventures with companies from Japan and Western Europe cover the spectrum from simple licensing agreements to equity participation. New Delhi looks to joint ventures with foreign companies as a means of acquiring operational know-how and access to foreign technology. Gandhi has recently indicated that more direct foreign investment might be approved to permit greater industrial modernization without putting additional strains on India's foreign payments position. A major increase in foreign investment is likely to be opposed by conservatives in the government who have long been concerned that a large foreign presence would threaten India's locally owned industries and would undermine its tradition of self-reliance. [redacted]

West European joint ventures with India are growing, but continue to trail far behind US efforts. For the last seven years US firms have had the largest number of joint ventures approved by New Delhi. In 1987 New Delhi approved 212 US, 149 West German, and 122 British joint-venture proposals. On the other hand, Indo-Japanese business joint ventures fell to 71 in 1987, as compared with 111 in 1986. Tokyo blames the drop in part on bureaucratic redtape, according to the US Embassy, but New Delhi has expressed its disappointment that Japanese investment focuses more on increasing sales to India and less on manufacturing in India. During his visit to Tokyo in April, Gandhi promised, according to US Embassy reporting, that India would improve its investment climate, and the Japanese said they would send an economic delegation to India later this year to explore new areas of bilateral cooperation. [redacted]

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India: Estimated Balance of Payments, 1983-87^a

Million US \$

	1983	1984	1985	1986	1987
Trade balance ^b	(5,700) ^c	(4,500)	(7,170)	(5,870)	(6,420)
Exports, f.o.b.	9,600	10,050	9,026	9,805	12,080
Imports, c.i.f.	15,300	14,550	16,196	15,675	18,500
Net services and transfers	2,850	2,855	3,109	2,570	2,780
Of which:					
Worker remittance ^d	2,600	2,630	2,600	2,600	2,400
Tourism		414	820	1,020	1,290
Interest payment ^{b c}	1,160	1,330	1,540	1,750	1,310
Current account ^b	(2,850) ^c	(1,645)	(4,061)	(3,300)	(3,640)
Principal repayments	940	1,010	1,430	2,015	2,525
Grant aid	367	342	414	350	318
Disbursed medium- and long-term loans	3,176	3,449	3,696	5,090	5,265
Direct investment	63	62	65	200	120
Change in reserves	889	263	547	73	366

^a Fiscal year beginning 1 April.^b Excluding military.^c Parentheses indicate negative numbers.^d Because of Indian reporting methods, private transfers are included in worker remittances' totals.^e Including payments to IMF on nonresident deposits.**Emerging Opportunities**

Gandhi's economic modernization program offers numerous opportunities for Japan and Western Europe to expand their trade ties to India. We believe New Delhi will emphasize foreign collaboration and direct investment in such areas as telecommunications technology, heavy industry, and defense and space.

India's ambitious plans for improving its telecommunications network will probably be a prime area for Japanese and West European involvement. New Delhi is seeking to upgrade and expand its communications capabilities to broaden its international economic ties and lure international banks and businesses into India. India has primarily looked to Japan to improve its communications capabilities. Japan's major trading houses—Mitsui, Mitsubishi, Sumitomo, and Nippon Electric—are providing India with the required technology and equipment for telecommunications projects, which include satellite communications systems,

optical fiber links, and mobile radio systems. A significant portion of Japan's OECF's concessional loans are earmarked for telecommunications projects.

West European nations are getting involved in India's communications efforts. France agreed to manufacture sophisticated telecommunications equipment in conjunction with Indian telephone industries and has provided a substantial financial credit package to implement the projects. West Germany is assisting India's efforts to increase the communications network's capacity by offering sophisticated fibers optic technology to India. India also receives substantial financial assistance for these projects from multilateral lenders. In 1986 the World Bank provided more than \$500 million in financial assistance for India's telecommunications projects.

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New Delhi may look to Japan and Western Europe to help modernize its heavy industry. In his recent trip to Tokyo, Gandhi asked for additional Japanese assistance in expanding and modernizing India's Burnpur steel mill. Included in the project will be modern steelmaking equipment and a power plant that will not only power the mill but also feed excess electricity into a statewide power grid. India also is seeking foreign assistance to expand its production of low-grade steel. US-made equipment is on trial in India. US Embassy officials report that, although it is considered by Indian steel officials to be better than that offered by its principal West German competitor, the US equipment is also more complicated and does not function well on India's poor-quality fuel. [redacted]

India's efforts to upgrade its military forces and improve its domestic defense industries will provide several opportunities for West European firms. New Delhi has contracted the French firm Dassault to help design the airframe of the Indian Light Combat Aircraft and plans to seek additional Western components for the planes, according to US Embassy reporting. New Delhi also is working with the Germans on coproduction of diesel-electric submarines and is exploring the possibilities of working with the British on the design of a third aircraft carrier. [redacted]

Drawbacks to Expanding Trade

Although India is eager to expand its trade relations with Japan and Western Europe, we believe it sees several problems associated with pursuing ties too vigorously. India remains wary of becoming a dumping ground for foreign goods, particularly Japanese made, such as simple computers and other consumer electronics equipment. Indian officials note that, before the late 1970s, bilateral trade between India and Japan was nearly balanced. By 1987, however, India had a trade deficit with Japan of \$500 million. New Delhi's trade deficit with Western Europe also grew from \$700 million in 1980 to slightly more than \$3 billion in 1987. [redacted]

India resents the fact that Japan and Western Europe have not shown more interest in opening their markets to a wider variety of Indian goods, such as textiles and agricultural commodities, despite frequent complaints and meetings designed to address the problem. Most

Western countries also are reluctant to boost Indian imports because of the poor quality of Indian goods and slow delivery schedules. [redacted]

Japan and Western Europe have found it difficult to deal with India's bureaucracy. Despite Prime Minister Gandhi's personal commitment to modernization and stronger economic relations with the West, US Embassy officials say many bureaucrats cling to the Indian objective of self-reliance. The bureaucracy, trade unions, and others are concerned that modernization will reduce jobs. As a result, some bureaucrats delay approval of investment proposals and licenses or ignore new policy directives to secure their positions.

Not all the inefficiencies are on the Indian side, however. According to US Embassy reporting, Tokyo's aid missions are understaffed and frequently have difficulty disbursing the funds. As a result of these problems, we believe India may not receive all of the aid promised. [redacted]

New Delhi's efforts to increase imports of modern capital goods and technology from the West have raised questions among the political opposition about Gandhi's commitment to self-reliance. They fear that competition from Western companies could deny Indian firms the profits necessary for expanding their own production as well as for research and development. They also argue that India's rapidly rising import bill and deteriorating foreign payments position are making the country excessively dependent on foreign countries. These concerns are muted so far but could prompt Gandhi to reconsider his position on foreign imports if the opposition becomes more vocal. [redacted]

Outlook and Implications for the United States

We believe Japan and Western Europe will continue to make major economic inroads in India and that Japan is in a good position to become the country's largest bilateral trading partner in a few years. The prospect of large new markets opening as a result of liberalization will encourage both Japan and Western Europe to continue exploiting opportunities for joint ventures and direct investment. [redacted]

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India's High-Technology Shopping List

India may increasingly look to Japan and Western Europe for the high-technology equipment because it believes these countries may be more willing to sell sensitive technology than the United States. New Delhi is eager to secure items for commercial industrial use and research in the following areas:

- Supercomputers. India has purchased a Cray XMP/14 supercomputer for data processing and meteorological forecasting, which the company believes will be delivered by October. India is seriously interested in a second Cray machine. US Embassy officials, however, are concerned that New Delhi may consider a Japanese machine for its next supercomputer, especially if the Japanese offer incentives such as less stringent safeguards and a quicker licensing process.
- Microelectronics production technology. India has active very-large-scale-integration (VLSI) and very-high-speed integrated circuits (VHSIC) research programs and seeks items suitable for fabricating sophisticated devices primarily from West Germany as well as from Japan and France. For example, India seeks software and source codes for computer-aided VLSI design. US controls restrict the transfer of such technologies and equipment.
- Fiber optics production technology. New Delhi lists fiber optics as a high priority for upgrading India's severely strained telecommunications network, and seeks foreign technology to boost weak indigenous capabilities. New Delhi particularly wants production technology for high-speed (140 megabits per second or higher), long-distance transmission links. New Delhi also seeks other technologies and equipment in data communications.
- Composite materials production technology. India's push into advanced composite materials, both for defense-related aerospace applications and for civilian uses, has prompted Indian requests for production equipment and technology from the United States, Japan, and Western Europe.

- Mainframe computer manufacturing technology. New Delhi is seeking cooperative programs with US computer manufacturers for a joint venture in hardware manufacturing and software design. Control Data Corporation negotiated a \$500 million deal for production of its medium-size mainframe computers in India. Digital Equipment Corporation is discussing a deal for Indian production of its Micro VAX II. Despite the optimism over prospects for future negotiations, New Delhi recognizes that its access to US computer technology will be limited by US licensing requirements. The Indians, therefore, are exploring potential projects with both Japanese and West European firms. [redacted]

New Delhi is eager to acquire sensitive defense-related technologies. India, however, has the ability to produce many of these items, given enough time. The military production technologies that are the most important to New Delhi's military development include:

- Ballistic missile guidance and control systems. India, in our judgment, can develop many of the technologies needed for ballistic missile production, but it needs assistance with advanced guidance systems, thrust vector controls, and heat shield/reentry vehicle technology. We believe New Delhi is shopping for technology, probably intended for its ballistic missile program, in France, West Germany, and Japan.
- Light Combat Aircraft subcomponents. [redacted] the Indians are seeking flight control, avionics, and weapons systems for the LCA from the United States, the United Kingdom, and France. The French firm Dassault is contracted to design the airframe and will undoubtedly campaign hard for additional French systems. [redacted]

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The competition among the United States, Japan, and Western Europe for shares of India's capital goods and high-technology market, in our judgment, will become intense over the next few years. We believe India may be attracted to Japanese and West European markets because it believes these countries may be more willing to sell items less encumbered by the regulations and licensing restrictions that delay delivery of US technology. These countries, in turn, are laying the groundwork for fiercer competition by adopting trade strategies that will meet the commercial needs of India. They are establishing greater government-support networks for domestic firms and are offering enticing financial packages to India to support the purchase of the goods. [redacted]

The pace of India's growth and capacity to purchase Western goods and technology will, in large part, depend on its foreign payments position. We believe significant deterioration in the trade balance will lead to immediate restraints on all but essential imports. New Delhi is not likely to significantly increase foreign borrowing to cover greater deficits because its debt service ratio—conservatively estimated at 30 percent by the US Embassy—exceeds what most government officials consider a prudent level. We believe New Delhi will try to ease deficit problems by tying future imports to increasing exports and may open the economy to greater foreign investment.

[redacted]

Should New Delhi be forced to restrict foreign imports because of continuing foreign exchange problems, we believe the West Europeans would be affected first. The West Europeans have made their

greatest market inroads in sectors where a domestic Indian production capability, although less technologically advanced, exists. As a result, import restrictions, if they become necessary, are more likely to be imposed in the sectors where rapid West European growth has occurred instead of in the high-technology sectors. Japan also may be affected by the high value of the yen, but bilateral aid, if continued at promised levels, and access to unique high-technology items would probably help Tokyo maintain exports to India. The wide range of US economic ties to India and the significant trade deficit Washington is running with New Delhi would probably limit the effects of a cutback on Indo-US trade relations. [redacted]

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India's expanding trade relations with Japan and Western Europe will not significantly affect Indo-Soviet trade relations. India has not looked to the Soviets for the high-technology goods it seeks. US Embassy reporting indicates most Indian businessmen consider Soviet goods inferior to those from developed countries. New Delhi views commercial ties to Moscow as economically beneficial, however, because most Indo-Soviet trade is conducted in rupees and helps India preserve its hard currency. New Delhi gets about one-third of its petroleum imports under this arrangement. [redacted]

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