1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted by the CONTRACTING PARTIES in 1979 (BISD 26S/205-209) to assist the Committee in taking the decision referred to in paragraph 8 of that Declaration.

I. India's previous consultations

2. Nine full consultations and five simplified consultations have been held with India since 1950. The most recent full consultation took place in November 1978; it was followed by simplified consultations in April 1980, June 1982 and May 1984.

3. At the full consultation in 1978, the Committee commended the Indian authorities for the performance of the Indian economy, the significant improvement in the balance-of-payments situation, the comfortable foreign exchange reserve position and, in particular, for the liberalization and simplification of its import régime. The Committee concluded that the overall balance-of-payments situation provided scope for continued liberalization which, together with policies to increase investment, should promote the economic development of India and the interests of its trading partners. However, the Committee was aware that certain restrictive policies in other countries posed problems to the expansion of India's exports. The Committee recommended that India pursue its policy of liberalization and simplification of import restrictions (BOP/R/104).

II. Developments since the last consultation

General

4. India ended the Sixth Five-Year Plan period, in 1984-85, with trade and current account deficits considerably lower than the high levels seen in the early 1980s. The current account deficit was provisionally some 1.2 per cent of GDP in 1984/85. However, the debt service ratio is estimated to have risen from 9 to around 13½ per cent of current receipts in the period. The objectives of the Seventh Plan (1985/86-89/90) - an overall growth rate of 5 per cent, with growth of mining and manufacturing at 6.8 per cent and of electricity, gas and water at almost 8 per cent - imply a higher growth rate of exports (some 7 per cent), and a reorientation of imports. Exports of industrial products, including engineering goods, ready-made clothing, gems and jewellery, are planned to increase rapidly; requiring the easing of constraints both on the demand side (through growth of imports into main markets both in developing and developed countries) and on the supply side (through a substantial transformation of Indian industry from primarily import substitution to a higher degree of export orientation).
5. In the context of these objectives, three significant reports published by the Indian government in 1985\(^1\) made a number of major recommendations on the reorientation of trade policy away from direct controls on the volume and type of imports to a more tariff-based system, and on the need to increase export incentives, both through an adequate structure of drawbacks to compensate for taxation of imported inputs and by maintaining the exchange rate at a competitive level. It was also recommended that trade policy should have greater stability through the announcement of import-export policy for periods of three years instead of annually. Thus, import and export policies were established in 1985 for the period 1985-1988, the government reserving its right to modify them as circumstances might demand.

**Trade Policy 1985-88**

6. The three-year import and export policy announced in 1985 (the first time that a multi-year programme has been undertaken) continues and enlarges the policy of selective liberalization in existence for some years, and eases the complexity of some aspects of trade policy. The main measures contained in the 1985-88 import policy are as follows:

   (a) Abolition of the "automatic licensing" category. Four hundred and sixty seven items previously under "automatic permissible" licensing were transferred to Open General Licence (OGL): the remaining sixty were transferred to "limited permissible". The move to OGL removes the obligation for importers to obtain certificates of past consumption and to apply for import licences. Government departments are now also permitted to import goods for their own use under OGL.

   (b) Removal of fifty-three items from the "canalized" list, of which seventeen (including some iron and steel items, colour television tubes, viscose filament yarn, calculator chips, winchester drives and certain electronic watch components) were shifted to OGL and others to Limited Permissible or Restricted lists. Certain import items such as petroleum and petroleum products, edible oils, iron and steel, non-ferrous metals, newsprint, etc. remain canalized.

   (c) Liberalization of import facilities for computer systems: computer systems up to a value of one million rupees ($83,000 approximately) may be imported under OGL for the importer's own use. Some liberalization of spare parts was also provided for.

   (d) Two hundred and one items of industrial machinery, mainly for use in the automobile, petroleum, leather, electronics, jute manufactures, garments, hosiery, made-up textiles, pen manufacturing, and canning industries, were newly allowed under OGL.

   (e) At the same time as these generally liberalizing measures, some items were moved from less restricted to more restricted import

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\(^1\)Those of the Hussain Committee, the Narasimham Committee and the Long-Term Fiscal Policy Committee.
categories or had import allowances reduced. Thus, a few iron and steel items, vinyl acetate monomer, vinyl acetate, and flint buttons, (previously canalized items) were put into the "restricted" list: having regard to domestic availability, seven items of raw materials and components were moved from "limited permissible" to "restricted" and sixty-seven from OGL or "automatic permissible" to "limited permissible": and import of animal rennet was banned. In addition, the possibilities for import of raw materials under OGL by traders (as against actual users) have been reduced.

7. Since June 1985 a number of further modifications have been made in the operation of import licensing policies: thus in early 1986, OGL conditions were granted on two new types of textile machinery, while a certain number of electronic and chemical products were shifted from OGL or "limited permissible" to "restricted" categories. In February 1986, in order to keep the projected trade deficit for 1985/86 within manageable proportions, big reductions were planned in imports of canalized bulk goods (C/W/494).

8. Some changes have also been made in the structure of import duties. In particular, the number of auxiliary duty rates was reduced from 11 to 3 (zero, 25 per cent and 40 per cent). In this context it should be noted that, as announced by India in the March 1986 GATT Council, auxiliary duties no longer apply to any bound items.

9. As regards export policies, the 1984/85 budget had contained a number of measures intended to give extra impetus to export efforts. The most general was a provision to allow amounts of up to 50 per cent of profits derived from export sales to be placed in special funds for export development and exempted from tax. Similar provisions were extended to the tea industry, linked to modernization programmes. Export duties were removed from most products in 1984 and remained in force only on coffee, unmanufactured tobacco, hides and skins, and certain types of mica.

10. The 1985-88 export policy contains a number of measures intended to increase export incentives, while tightening up on other aspects of export policy. For established export manufacturers, a new Import-Export Passbook scheme was introduced in order to simplify procedures for, and expand the product coverage of, importing supplies under duty free concessions in connection with export production. Improvements were also made in the capital goods import allowances for raw materials and components for registered exporters under "advance" and "replenishment" licence schemes. At the same time, however, the minimum value-added criterion in the Advance Licensing Scheme was set at 33 per cent, compared to 25 per cent previously.

11. The 1985/86 budget provided for further fiscal incentives to promote exports, including the reduction of import duties on a large number of machinery items and inputs to particular industries. The foreign exchange forward cover facilities provided by the Reserve Bank have been improved, and concessional pre-shipment credit periods have been extended.

12. Alongside these measures directly affecting trade, a number of new provisions were introduced in 1985/86 which represent a degree of loosening of controls over industry. A number of industries were freed from industrial licensing requirements, policy on monopolies and restrictive trade practices
was modified to allow a larger asset limit for defining "large houses" for monopoly purposes, which should permit greater expansion of production, and a number of industries defined as of national importance, including energy exploration, light commercial vehicles and electronic components, were freed from monopolies controls. Greater encouragement was given to new or modernizing domestic industries such as energy exploration, computers, motor vehicles, telecommunications and general electronics, through a more flexible application of licensing provisions and significant reductions in duty rates for capital goods and intermediate inputs. Sales of firms in the energy exploration equipment industry were henceforth counted as "deemed exports", giving various tax advantages.

13. A new long-term policy for the textile industry, announced in 1985, aims to remove long-standing limitations on textile mill capacity, to liberalize restrictions on production and use of synthetic fibres and yarns, and both to reduce the level of and to alter the basis for excise duty on textiles in order to put the mill and powerloom sectors on a more equal footing. The government has also begun a new attempt to revitalize ailing industries in a number of sectors including engineering and electrical, chemical and iron and steel, including measures to allow greater acceptance of takeovers and mergers under monopolies legislations, and tax relief and price control exemptions.

III Economic and trade developments

14. The attitude of policymakers in India towards foreign trade, and in particular exports, has changed significantly since the export pessimism of the 1950s. The current Five Year Plan (1985/86 to 1989/90) envisages an annual growth rate of about 7 per cent for exports in order to earn the foreign exchange required to achieve the target 5 per cent annual growth rate of the economy. The government has taken several liberalizing measures and also provided the other incentives mentioned in this paper, in order to encourage exports. However, the experience during the fiscal year 1985/86 suggests that the target export growth rate may be difficult to achieve.

15. Recent estimates indicate that the rupee value of exports fell by about 8 per cent in 1985/86 (some 11 per cent in US dollar value). This contrasts with an average annual growth rate of 10 per cent for the dollar value of exports during the period 1974/75-1984/85, with yearly growth rates varying between 4 and 20 per cent (Chart 1). These lower exports were mainly due to adverse movements of export unit values of some and/or reductions in export volume of some important items. The rupee value of exports of tea and jute manufactures fell by 22 per cent and 8 per cent, respectively, in the first half of 1985/86 (an estimated fall in dollar value of some 30 and 16 per cent respectively). The rupee value of crude oil exports, which accounted for 13½ per cent of total export receipts in 1984/85, also fell by about 75 per cent during this period compared to the first half of 1984/85, because a substantial volume was diverted from exports to domestic refining.

16. Excluding crude oil, the rupee value of other exports increased by 7½ per cent in this period. Exports of iron ore and marine products grew most rapidly, increasing by 55 per cent and 26 per cent respectively, while exports of pearls, precious and semi-precious stones, engineering goods and ready-made garments also increased, though at lower growth rates ranging from 7 to 12 per cent. The share of these products in total exports has grown rapidly since the 1960s, while those of traditional export items like tea, jute goods and cotton textiles has declined over time. A substantial change
has thus taken place in the pattern of Indian exports, especially in favour of machinery and transport equipment and other manufactures except textiles and clothing (See Table 1). The change in the pattern of exports was accompanied by a rise in the average share of exports in GNP during the Fifth Five Year Plan period (1974/75 to 1978/79) compared to the previous ten years. However, this share declined very slightly to 6 per cent during the Sixth Five Year Plan (1980/81 to 1984/85). The recent decline in exports implies a still smaller share since GNP is expected to have grown by about 5 per cent in 1985/86.

17. As against the performance of exports, the average share of imports in GNP increased to 10 per cent in the Sixth Five Year Plan period from about 7 per cent during the previous Plan. This tendency was reinforced in 1985/86 as the US dollar value of imports increased by about 9 per cent, primarily because of a sudden surge in the import of bulk items such as petroleum products, fertiliser raw materials, edible oils, iron and steel, sugar and capital goods. The growth in the dollar value of imports in 1985/86 contrasts with the negative growth rates for most of the period 1980/81-1984/85, and resembles more closely the increase in imports which took place between 1976 and 1980 (Chart 1). Over the last twenty years the pattern of imports has also changed substantially. For example, with a decline in the respective shares of food and machinery and transport equipment partly reflecting the increased domestic production capabilities for these items, while fuels and manufactures other than machinery and transport equipment have increased their share of total imports (Table 1).

18. Despite the large share of fuels in imports, the recent fall in the oil price is not an unmixed blessing for India because both exports of crude oil and worker remittances will be adversely affected, and the lower purchasing power of oil-exporters will imply lower exports from India to these countries. Crude oil exports and private transfer payments together accounted for about 24 per cent of the total receipts on the current account in 1983/84, the latest year for which this data is available. In 1984/85, OPEC countries purchased 8 per cent of India's total merchandise exports.

19. In dollar terms, the trade deficit decreased continuously from some US$7.5 billion in 1980/81 to some US$4.5 billion in 1984/85. However, in 1985/86 this deficit is estimated to have increased sharply to about US$6.2 billion (see Chart 1). The deficit on the current account increased to US$3.1 billion in 1981/82 and then decreased till 1984/85. The balance on the invisibles account in 1985/86 is estimated to have remained the same as the previous year since remittances from tourism and workers abroad appear to have risen to compensate for the decline in other net receipts. However, there is some uncertainty about the future evolution of the invisibles account because of the possibility of a renewed fall in tourist income and other remittances, and increasing debt services payments. External debt service as a percentage of current receipts has increased from 9 per cent in 1980/81 to 16 per cent in 1984/85, despite the fact that over half the cumulative current account deficit during the Sixth Five Year Plan was financed by official aid. Though gross foreign exchange reserves at the end of 1985/86 have increased since a year earlier, the rise in imports implies that they are equivalent to 4.7 months' import cover compared to 5 months in 1984/85. This contrasts with the exceptional four years between 1976/77 to 1979/80 when gross foreign exchange reserves were equivalent to between 7 and 10 months' import cover.
IV  Effects of the measures

20. The policies recently adopted by the government to liberalize both the domestic market and trade were expected to cause a surge in imports, but the poor export performance in 1985/86 has belied earlier hopes. Continued encouragement is being provided for imports of technology and components to modernize industry, though extra import duty has been imposed on the import of some capital goods. In addition, cuts in some customs duties have been made after discussion with businessmen. Nonetheless, the recent poor export performance and the rapid increase in imports would tend to dampen the earlier optimism regarding the foreign trade sector. In this situation, it would be important to avoid those measures to limit the deficit which adversely affect the incentives for promoting economic capability in the near and medium term.

21. The direction of policy in the Seventh Five-Year Plan is clearly, in intention at least, one of greater internal and external liberalization. The official committee reports referred to above recognize that heavy protection of import-competing industry has discriminated against export growth, and that trade policy should give greater incentives to export oriented production, including through liberalization of imports destined for export industry. The overall balance of payments has developed favourably by virtue of higher domestic output of basic foodstuffs and certain raw materials and intermediates, positive developments in the terms of trade and an inflow of service and transfer payments; while foreign borrowing and debt servicing has been kept low. However, the Plan targets call for rapid growth in industrial output and in exports, to finance imports needed for modernization, and the prospects for achieving this will depend both on the progress in liberalizing India's economic and trading structure and on the external trading factors affecting growth of India's main markets. The economy and the balance-of-payments situation are thus at a turning-point which could merit a closer review in the Committee.
CHART 1 - EXPORTS, IMPORTS AND END-YEAR GROSS FOREIGN EXCHANGE RESERVES OF INDIA, 1974-75 TO 1985-86

(Billion US dollars; fiscal year April to March)

### TABLE 1 - STRUCTURE OF INDIA'S MERCHANDISE EXPORTS AND IMPORTS

(Percentage share)

#### EXPORTS

<table>
<thead>
<tr>
<th>Fuels, Minerals and Metals</th>
<th>Other Primary Commodities</th>
<th>Textiles and Clothing</th>
<th>Machinery and Transport Equipment</th>
<th>Other Manufactures</th>
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</thead>
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<tr>
<td>1965</td>
<td>10</td>
<td>41</td>
<td>36</td>
<td>1.</td>
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<tr>
<td>1983</td>
<td>18</td>
<td>29</td>
<td>14</td>
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#### IMPORTS

<table>
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<th>Food</th>
<th>Fuels</th>
<th>Other Primary Commodities</th>
<th>Machinery and Transport Equipment</th>
<th>Other Manufactures</th>
</tr>
</thead>
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<tr>
<td>1965</td>
<td>22</td>
<td>5</td>
<td>14</td>
<td>37</td>
</tr>
<tr>
<td>1983</td>
<td>7</td>
<td>37</td>
<td>6</td>
<td>17</td>
</tr>
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</table>

TABLE 2 - SHARE OF SELECTED REGIONS AND COUNTRIES IN INDIA'S EXPORTS AND IMPORTS
(Percentage)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EEC</td>
<td>18.2</td>
<td>19.5</td>
<td>17</td>
<td>24.5</td>
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<td>United Kingdom</td>
<td>11</td>
<td>7.8</td>
<td>5.8</td>
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<td>Federal Republic of Germany</td>
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<td>4</td>
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<td>19.2</td>
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<td>Saudi Arabia</td>
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<td>1.5</td>
<td>2</td>
<td>7.3</td>
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<tr>
<td>Eastern Europe</td>
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<td>17.2</td>
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<td>Japan</td>
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<td>5</td>
<td>9.2</td>
<td>7.3</td>
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<tr>
<td>Developing countries in Asia</td>
<td>10.8</td>
<td>3.3</td>
<td>10</td>
<td>13.4</td>
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\(^p\) Provisional.