Committee on Balance-of-Payments Restrictions

1. In accordance with its terms of reference the Committee conducted the consultation with India under paragraph 12(b) of Article XVIII. The Committee had before it: (a) the "basic document" prepared by the secretariat; and (b) documents provided by the International Monetary Fund. In conducting the consultation the Committee followed the "plan" recommended by the CONTRACTING PARTIES. The discussion with the Committee was completed on 25 May 1960. The present report summarizes the main points discussed during the consultation.

Consultation with the International Monetary Fund

2. Pursuant to the provisions of Article XIV of the General Agreement the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with India. As a part of the consultation between the CONTRACTING PARTIES and the Fund, the latter transmitted the Executive Board decision taken at the conclusion of the 1959 consultation with India under Article XIV of the Fund Agreement, and the background material prepared in connexion with that consultation. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of India. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision taken at the conclusion of the 1959 consultation with India under Article XIV of the Fund Agreement, and the background material prepared in connection with that consultation. The consultation was concluded on April 13, 1960.

"With respect to Part I of the Plan for Consultations, relating to balance of payments position and prospects, the general level of restrictions of India which are under reference does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves."
"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, the Fund draws attention to the decision taken at the conclusion of its last consultation with India. The Fund has no additional alternative measures to suggest at this time."

Balance-of-Payments Position and Prospects

3. In his opening statement the representative of India explained that his Government's import policy continued to be determined by the low level of available foreign exchange reserves and their use consistent with the objective of rapidly developing the economy without causing undue strains in the system. The licensing policy and the import allocations made during each six-monthly period were determined by the requirements of the economy for imports of foodstuffs, raw materials and other commodities in accordance with priorities established under the Development Plan and by taking into account such other factors as the availability of credit facilities. As a result of the growing requirements of the economy for imported raw materials, an increasing demand for consumer goods and a heavy and increasing import demand for capital goods in connexion with the implementation of the Second Development Plan (1956-61), there had been an upsurge during 1956 and 1957 of raw material, capital goods and consumer goods imports. This increase in imports, together with a significant increase in the prices paid for many imports following the Suez crisis, had made it necessary to tighten import controls, particularly for consumer goods, to avoid a further deterioration in the balance of payments.

4. Since 1957 the licensing of raw materials had been liberalized in order to meet the requirements of existing and newly established industries. Following the restoration of external convertibility of currencies, India had abandoned the distinction in its licensing policy between imports from different currency areas except for capital goods imports. The distinction between currency areas for the licensing of capital goods imports was maintained because a large part of external assistance available to India continued to be in the form of tied loans. There had been a decline during the last two years of imports of "non-developmental" and other intermediate goods, and imports of capital goods had also registered a slight fall owing to the high tempo of imports in the first three years of the Second Five-Year Plan and the limitation of further developmental expenditure to a "core" of
basic industries. The decline in private imports of capital goods had partly been offset by an increase in such imports in the public sector, and a recent sharp decline in the latter had been compensated by an increase in imports of raw materials. Imports of food grains and of consumer goods had remained relatively stable since 1957.

5. The downward trend in exports had continued in 1958-59, but was reversed in the first half of 1959/60, when exports were Rs.190 million higher than in the corresponding period in 1958/59. While this increase reflected to some extent the upswing in business conditions in the United States and Western Europe, it also indicated that the investment which had been made in earlier years was beginning to make itself felt in larger aggregate output. In 1959 textile exports recovered from the set-back met in the previous year and exports of various types of manufactured goods, such as diesel engines, sewing machines and other light engineering goods increased encouragingly. The Government had devoted much attention to export promotion, through the reduction or elimination of export duties and restrictions and the use of various measures to improve the organization of the export trade and to develop new markets. It was expected that the present upward trend in exports would be maintained but it appeared unlikely that in the immediate future exports would provide any very considerable additional resources. The rather strict import restrictions, together with the larger receipts of external assistance had resulted over the last year in an easing of the pressure on India's foreign exchange reserves. The level of official foreign exchange reserves of Rs.1,870 thousand million, reached at the end of April 1960, was only slightly lower than that touched in October 1958.

6. The Indian Government had continued to use various internal measures to ensure that domestic inflationary pressures were held in check and would not exercise an unduly expansionary effect on external payments. For example, the volume and range of taxation had been considerably increased and efforts to mobilize savings had been stepped up. The Reserve Bank had also continued its policy of general restraint while permitting expansion of credit in keeping with the needs of expanding production. A requirement for commercial banks to deposit a proportion of all new liabilities had been instituted in March and the rate of deposit raised in May. Selective credit controls had been tightened and open market sales had been continued.
7. The representative of India considered that in view of the low level of external reserves and the continued large demands on foreign exchange resources for development financing there appeared to be little scope for a change in the immediate foreseeable future in the character and pattern of the import licensing policy. The Government would have to continue to allocate available resources in a manner which would enable the economy to move to higher levels of capital formation while at the same time trying to avoid undue pressure on the economy without neglecting the need for increased production in the short term. India was fully aware of the important role of external assistance and investment in the process of development. The availability of external assistance, amounting to Rs. 10,350 million, had been of considerable importance in financing development projects included in the second Five-Year Plan. The Government had continued its policy of encouraging private investment, and while such investment had remained small in comparison with external capital needs met at governmental levels and/or through international institutions, it had shown a welcome increase.

8. The second Five-Year Plan would come to a close by the end of March 1961 and, despite the foreign exchange difficulties, there had been a substantial record of achievement under that Plan. The progress achieved in basic industries and in mining, transport and power generation had laid the foundations for more rapid industrialization in the future. The third Five-Year Plan, which was being formulated, would aim at an increase in national income by at least 5 per cent per annum and at ensuring that at least this rate of growth would be maintained during subsequent years. Other important aims of the development policy included the progressive achievement of self-sufficiency in agricultural production and the expansion of machine-building and other basic industries in order to promote fuller utilization of domestic resources to meet domestic development requirements and those of other under-developed countries. In relation to the pressing need to raise the standard of living for a large and expanding population the targets were not over ambitious. However, the achievement of these aims would require continuing austerity in the utilization of savings and restraint of inflationary consumption as well as a vigorous effort to increase exports. There would also have to be a substantial increase in
external assistance. By the agreement signed by the Governments of the United States and India on 4 May 1960, the United States was to make available to India over a period of four years, 17 million metric tons of food grains. Those imports were to be paid for entirely in rupees much of which would be re-lent to the Government of India for development. This aid would contribute to the maintenance of reasonable standards of consumption, untroubled by the vagaries of the weather, and thus maintain social and political stability at this difficult phase in India's development when the people were being called upon voluntarily to make the sacrifices inherent in the high rate of saving which investment under the Plans involved. One might recall that this high rate of saving was being imposed on a people whose per capita income was of the order of $65 per year. India was most deeply grateful to the Government and people of the United States for this most imaginative act of assistance.

9. Commenting on other aspects of international assistance received by India, the representative of India observed that much of this assistance was tied to purchases in the lending countries. While all forms of assistance were welcome and the lending governments' inclination to this practice was understandable, it had two undesirable consequences. First, the limitation of import opportunities to specified markets which might happen to be high-cost suppliers, might considerably reduce the contribution to the real resources of the developing country. Secondly, the distortion of trade involved might be detrimental to the objective of multilateralizing the benefits accruing from growing international trade. In any case, against the background of the restoration of external convertibility and the general desire to restore complete convertibility, these distortions were obviously unnecessary and illogical. Indeed, the removal of the tight link between buying and lending would assist the process of distributing and increasing world liquidity.
10. In conclusion of his opening remarks the representative of India noted that foreign assistance to the development efforts of developing countries in the form of credits and grants, however welcome and beneficial, was no substitute for expanded and sustained earnings from exports. To this end contracting parties could play an important role by helping to create conditions under which India's exports, both of primary products and of the new and growing range of manufactures, could find easier access to external markets and thus add to the resources available for development.

11. The Committee thanked the representative of India for the clear and comprehensive account of the problems faced by his country. Members of the Committee commented on the fundamental nature and the immense scope of the problem of providing food and other basic needs of life for a very large and expanding population. The great human and social problems faced by the people of India and the great efforts being made by the Government to raise the standards of nutrition and living could only be regarded with sympathy. The main immediate objectives, it appeared, should be the expansion of agricultural production and of the production of exportable products in order to finance the necessary imports for development. It was to be hoped that India could soon be able to export a larger share of her products both as a result of increasing export goods production and as a result of the efforts being made by the CONTRACTING PARTIES to reduce barriers to the exports of less-developed countries.

12. Concerning external development assistance members of the Committee expressed agreement with the view stated by the Indian representative that as far as possible, loans should not be tied to purchases from particular sources of supply. The practice of tied loans introduced tended not only to reduce the overall benefit of a loan to the recipient country but also to discriminate against third countries, particularly smaller countries, which were not in a position to supply loan assistance. These views were subject only to the consideration that there might be cases where a financially weak country, while unable to provide external loans on a convertible basis, might conceivably be able to give assistance to another country by making a direct call on its own resources or surplus productive capacity; the assistance thus provided would be a benefit to the recipient country in addition to what it could expect to receive in untied loans and grants.
13. Members of the Committee noted that there had been a decline in the official foreign reserves from about Rs.2,000 million at the end of 1959 to Rs.1,700 million at the end of April 1960, and enquired about the reasons for this decline and future prospects. The representative of India replied that practically the whole amount of this decline could be attributed to the repurchase of the equivalent of $50 million made from the International Monetary Fund in February 1960, and that the remainder was probably due to a larger utilization of import licences during that period. So far there appeared to be no reason to regard the observed decline as a signal of a renewed downward trend. On the other hand, the demands on reserves arising from the servicing and amortization of loans, the continuing need for heavy imports of foodstuffs, capital equipment and industrial raw materials and any increase in reserves must depend largely on an expansion in exports. In the view of the Indian representative the Indian balance of payments would continue to be under pressure for the next fifteen to twenty years, although some levelling off of the pressure might be expected by, or possibly before, 1972.

14. The representative of India noted that the export promotion measures being undertaken by the Government, although on a massive scale, were not likely to lead to a large-scale increase in exports in the immediate future unless greater export opportunities were available in markets so far untapped by Indian exports. The prospects for an increase in such traditional exports as tea to traditional markets were limited because consumption was already at a high level. In other important markets where there might be scope for expansion, an increase in tea consumption was seriously impeded by high duties and internal taxes. Exports of cotton textiles continued to be faced by restrictions in many markets. Apart from these obstacles it was also difficult for a new supplier to enter a market in which his goods had not previously been traded on a significant scale because of the tendency of traders and users to favour traditional sources of supply and established trading channels. For example, it had been most difficult for India to persuade large tobacco users such as tobacco monopolies to consider meeting part of their requirements by importing tobacco from India on the basis of price and quality. On the other hand, some modest beginnings had been made in the export of durable consumer goods and other light engineering products to certain countries, including the United States, the United Kingdom and Germany.
Larger export opportunities for the growing range of such manufactured products, would, apart from contributing to foreign exchange earnings, also enable India to plan production on a larger scale, thus making possible more efficient production.

15. Members of the Committee noted with satisfaction the virtual elimination of discrimination in the administration of the Indian import controls, and considered that the absence of discrimination was bound to contribute to a better utilization of India's limited foreign exchange resources. On the other hand, some members of the Committee noted that there appeared to have been an increase in the use of bilateral clearing arrangements and they enquired about the reasons for this development and the proportion of total trade covered by such arrangements. The representative of India stated that when renewing expiring bilateral agreements with Eastern European and certain other countries in the past two years, India had taken the opportunity to revise the payments provisions so that balances were partly settled in non-convertible rupees instead of in transferable sterling or rupees. India's exports to these markets usually fell considerably short of its imports from them. The new Trade Development Accounts, providing for settlement in inconvertible rupees, were designed to limit the effects of such trade deficits on India's convertible currency reserves. Trade with these countries accounted, however, for only a small proportion of total trade. In response to questions the representative of India stated that exports from India to these countries comprised mainly traditional export items, such as vegetable oils, hides and skins, leather, tea, coffee, tobacco and jute manufactures, for some of which it had been difficult to find satisfactory markets. Imports into India from these countries consisted largely of machinery, transport equipment and equipment for hydro-electric projects, raw materials/etc. The representative of India considered that, on the whole, these bilateral arrangements had had the effect of creating and permitting additional trade which would otherwise not have taken place rather than of diverting trade from third channels.
16. Some members of the Committee pointed out that while India's desire to maximize foreign exchange earnings and to find markets for the country's exports was understandable, the reliance on bilateral arrangements to achieve these objectives was not without cost to India's long-term trade and development policies. Bilateral trade flows were often subject to considerable fluctuations. The dependence of certain industries on particular non-convertible currency markets might compel maintenance of expansion of imports from such countries, regardless of essentiality or price considerations. It would therefore be in a country's own interest not to expand bilateral trade more than necessary, especially if such expansion were achieved at the expense of normal trade. A member of the Committee pointed out in this connexion that, for example, as a result of a change in the direction of exports of goat skins towards a country with which India conducted its trade on a bilateral basis, supplies of goat skins in one of India's traditional markets had been reduced to such an extent that the long-established channel of profitable trade was being impaired. Another member pointed out that, as a result of the bilateral arrangements made between India and certain countries in that region, another had lost a substantial part of its previously important share of the Middle-East tea market and that owing to the difficulty of finding alternative markets for the special type of tea which was specially produced for that market a considerable loss had been caused to that relatively small, less-developed country.

17. The representative of India explained that his Government was, of course, endeavouring to conduct trade on a multilateral basis. India had entered into these arrangements only because of the special structure of trade of the particular countries or as a means of finding access to new markets. Even so, India had ceased to use single country licences and none of the agreements involved any import commitments on the part of India, except for a few imports from Burma and Pakistan. Being fully aware of the dangers inherent in bilateral trade practices, the Indian Government was endeavouring to avoid disrupting the flow of exports to traditional markets even though a diversification of export markets was evidently desirable. Nor had the Government considered it desirable to control exports or to allocate export products in short supply. The
exports of goat skins, for example, had shifted to the new export markets principally owing to the higher prices offered in those markets. The difficulties met by the other contracting party in maintaining its share in the Middle-East tea market was not the result of policies pursued by India; as had been pointed out, India did not use single country licences and had no import commitments or export arrangements providing for a particular share of Indian exports in trade agreement countries.
Alternative Measures to Restore Equilibrium

18. Members of the Committee complimented the Government of India on the circumspect and comprehensive manner in which it had followed internal policies of price stability while engaged in vast programmes of economic development. They expressed the hope that the Government would be able to control inflationary pressures which had lately again been noticeable and noted the recent tightening of credit controls as a significant sign of the Government's intention to continue its policy of monetary restraint.

Members of the Committee also welcomed the success of the Government of India in creating a favourable climate for foreign investment; references were made to the virtual absence of restrictions on foreign investment and on remittance facilities for profits and capital, and to the equal treatment accorded to domestic enterprises and foreign enterprises in tax or other matters. The only notable obstacle to foreign investments seemed to be the administrative regulations governing the establishment of enterprises in India, and perhaps also the high level of taxation which might well act as a disincentive to investment. The representative of India explained that his Government was aware of the great importance of attracting foreign investment and had given full consideration to the simplification of administrative regulations on enterprises. Such controls had been introduced to channel industrial development consistently with the availability of natural resource, the needs of the economy and the established priorities in the use of foreign exchange. The authorization requirement had recently been relinquished, however, for enterprises requiring an investment of less than Rs.1 million and employing not more than 100 workers in the interest of small investors. Furthermore, procedures for licensing of investment for expansion of existing enterprises had been simplified where the amount of foreign exchange required for such expansion did not exceed certain limits. Also the Government was trying to reduce procedural delays involved in the licensing process. In order to encourage investment liberal tax concessions continued to be available for new enterprises. For example, investors in new enterprises were exempted from income tax on returns up to 6 per cent per annum of invested capital; in a number of industries shareholders of firms established after 1952 were exempt from supertax, and development rebates and liberal depreciation and research allowances had also been granted.
19. Some members of the Committee enquired about the priorities in development planning and about any measures which might have been taken to encourage industries and branches of agriculture producing import substitutes. The representative of India explained that, although the specific development projects and production targets in the Third Development Plan had not finally been decided upon, the indications were that particular attention would continue to be paid to an increase in agricultural production. Import requirements for agricultural expansion and improvements were given high priority. As a result of this policy annual imports of fertilizers had almost doubled in recent years as compared with the first few years of the Second Development Plan and the domestic production of fertilizer was being increased. The Government had established seed farms; training and demonstration facilities to promote efficient farming methods were maintained and special credit facilities had been provided for farm improvement purposes.

20. The representative of India also noted that considerable advances had been made in recent years in the production of iron and steel, motor cars, coal, paper and paper board, various engineering goods, aluminium, chemicals and a number of other products. The index of industrial production (on the basis of 100 in 1951) had risen to 142 in 1958, and to 149 in 1959. The actual growth in output over this period had probably been somewhat larger, as industries established after 1951 were not covered by these indices. In relation to a question asked by a member of the Committee concerning the burden of debt servicing in coming years, the representative of India noted that although the expected increase in industrial and other production would reduce the burden of the repayment obligations relative to national income, the servicing and amortization of external loans would nevertheless continue to be an important item in India's balance of payments and called for intensified efforts to expand the country's export and other earnings if the other urgent calls on the external reserves were not to be ignored.

System and Methods of the Restrictions

21. A member of the Committee noted that under the present Indian import control system applications for capital goods imports were considered only when (a) the importer himself was able to put forward satisfactory proposals for financing the foreign exchange required for the import, or (b) the
import could be paid for under a loan or payment arrangement available to the Government. In discussing these requirements the representative of India stated that the financing of imports under (a) might take the form of sales credit extended by a foreign bank or the exporter, or in the form of equity investment made by the foreign supplier of the imported goods; alternatively, the requirement might be considered as having been met if the importer could show that the foreign exchange cost would be balanced by import savings or additional export earnings accruing from the use of the capital equipment imported. With respect to capital goods financed under external assistance programmes or under payments arrangements licences were granted for a particular category of imports up to a pre-determined ceiling. However, regardless of the method of financing these imports, licences were always granted strictly on the basis of essentiality, price and other commercial considerations. The Indian representative confirmed that in licensing imports account was taken of special credit facilities and bilateral balances with the result that imports from particular sources were at times more easily obtainable than others.

Effects of the Restrictions

22. Members of the Committee enquired about the effect of the import controls on the pattern of industrial development and production. They pointed out that as the process of industrialization progressed, and import restrictions were tightened on "non-essentials", production of the latter type of goods was increasingly likely to spring up or expand under the cover of protection, and many of such industries might prove to be uneconomical. The representative of India said that the Government was fully aware of the need to discourage the growth of uneconomic industries, and that the regulations on investment in new industries or for expansion of existing industries had been instituted principally with this in mind. The Government's policy was to encourage industries producing essential commodities, particularly those industries using domestic raw materials. Certain industries had indeed sprung up behind the shield of protection, but not all of these industries which had thus been established, sometimes with foreign capital or technical investment, could be considered as being uneconomic; some of these promised to be highly profitable and promising ventures.
23. The Committee expressed its appreciation for the spirit of co-operation and the frank manner with which the Indian delegation had engaged in this consultation. As noted in paragraph 11 above, Members of the Committee were deeply moved by the great human, economic and social problems faced by the Indian people and impressed by the great efforts made by the Government of India to improve their lot in the face of these difficulties. The present balance-of-payments position of India indicated little scope for a substantial relaxation of restrictions, and it was gratifying that India had been able to eliminate discrimination among the different currency areas in administration of the import controls on all but capital goods imports. It was hoped that India would soon find it possible to eliminate the remaining discriminatory element in the restrictions.

24. The representative of India thanked the Committee for the atmosphere of understanding and the friendly manner with which the consultation had been conducted. He assured the Committee that he would bring the many helpful comments and suggestions made during the course of the consultation to the attention of his Government.