Committee on Balance-of-Payments Restrictions

DRAFT REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XVIII:12(b) WITH INDIA

1. In accordance with its terms of reference, the Committee has conducted the consultation with India. The Committee had before it a basic document for the consultation supplied by the Government of India (BOP/69), a Decision by the Executive Board of the International Monetary Fund dated 3 March 1967 (see Annex II) and background material supplied by the Fund.

2. In conducting the consultation the Committee followed the Plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 25 July 1967. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with India. 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 Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of March 3, 1967, and particularly to paragraphs 2 and 4 which read as follows:

'The Fund welcomes the major changes in India's economic policies that have occurred since the last consultation. The change in the value of the rupee and the substantial liberalization of import restrictions together with the new priorities in the Fourth Plan should do much to increase the rate of economic growth."
'A policy of financial restraint coupled with active efforts to expand exports should do much to ensure the success of the exchange rate change and the import liberalization program introduced in 1966. If such measures are supported by an adequate inflow of foreign assistance, the Government should be able to make substantial further progress in removing restrictions on external trade and payments.'

"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."

Opening statement by the representative of India

4. The representative of India presented a detailed review of recent developments in the Indian economic situation, dealing in particular with the effects of two successive droughts on India's internal economy and with the repercussions of the shortages on the external trade and payments situation of India. He stressed the need for an improvement in the amount, terms and forms of aid and for India's exports to have freer access to world markets. The complete text of this statement appears in Annex I.

5. Members of the Committee expressed their particular thanks to the representative of India for his very thorough, cogent and perceptive statement which not only made clear that the Indian economy is beset with grave problems of food shortage and famine, inflation and industrial stagnation but also discussed in detail India's many-sided effort to deal with these difficulties.
Balance-of-payments position and prospects

6. Members of the Committee praised the Government of India for the measures which it had taken and planned to take and they reviewed with the representative of India the rather sharp swings of the Indian balance-of-payments position from one of deficit at mid-1965 to surplus a year later and more recently into renewed acute deficit. They noted that the devaluation of 1966 had undoubtedly been adopted as a means of effecting some correction in the external trade balance and they welcomed the measures of trade liberalization taken at about that time. But in the face of a new drought, continuing inflation and industrial stagnation it was now clear that still further measures were needed and in the new budget there was evidence of intensified efforts on many fronts.

7. For one thing, it was felt that India still had a long way to go in order to compete successfully on world markets. On the one hand, the domestic market seemed to be more attractive than the export market for many industries, reflecting the inflationary tendencies still not under control, and suggesting also that Indian costs and prices were moving out of line with world levels. Export promotion efforts had obviously not yet overcome these difficulties, as the declining overall export returns showed. To some, the very multiplicity of urgent problems and priorities raised a question whether India could successfully carry the various programmes through to the point at which significant improvement in the balance-of-payments position would be effected.

8. The representative of India confirmed that agriculture, family planning, anti-inflationary measures and expansion of export earnings were all objectives of highest importance and that India was confident of improving her balance of payments through persevering in all of these programmes. The agricultural shortages had had very adverse effects on exports since India's exports consist to a large degree of certain agricultural raw materials and also of manufactures based on agricultural materials. The shortages had forced cutbacks in production of numerous such export items at the same time that foodgrain
shortages had increased the amount of foreign exchange that had to be spent to feed India's population. Higher agricultural production would thus help in two directions simultaneously, by reducing foreign-exchange requirements for food imports and by helping to overcome industrial stagnation and to stimulate exports.

9. Another somewhat related point was brought out concerning the need to keep domestic costs competitive even in items not exported as such. Where exports are mainly primary products, it was noted, it is arguably feasible to let consumers within the developing countries bear the costs arising from manufactured imports for consumption being excluded or made more expensive through import restrictions, without direct adverse effect upon export trade. But as the economy develops to the point which India's has now reached, the export trade consists to a growing extent of complex manufactures which themselves are manufactured of components of domestic origin. In that situation, high-cost domestic production becomes a positive deterrent to export, as some more highly developed countries have found.

10. The representative of India agreed that it was important to keep working toward lower industrial costs, and he pointed out that in India increased attention is being given to feasibility studies and project reports of proposed new industries. He added that one difficulty facing Indian producers had fortunately become less serious, namely the small size of the units, for as the market grew, many producing units also grew to an economic size. Industrialists had themselves become more conscious of the need for efficiency, and they were being encouraged to keep efficiency in mind by such policies as the relaxations of industrial licensing and the priority in licensing of imports of capital goods, components and materials which was given to good export performance. It was necessary in this connexion that more aid be given in an untied form so that it would not be necessary for India to ask her producers to take on the added costs sometimes involved in purchasing from a specified country source.
11. One member asked whether India's export taxation on certain commodities was compatible with the objective of export promotion. It appeared that this form of tax might work against export promotion and the question was asked whether consideration had been given to replacing such levies by some equivalent revenue-raising measure. He added that such export taxes could hardly improve India's terms of trade significantly. The representative of India assured the Committee that the taxes in question were not regarded primarily as revenue measures and were not levied in a situation where exports were being impeded. The export levy was used on certain products of which India is a major supplier mainly to keep unit values up and to keep the terms of trade favourable. Every such levy was carefully watched and adjusted so far as possible to avoid interference with growth of exports. It was of course a delicate matter to manage these duties, as too frequent or too ready change would encourage buyers to hold off in an effort to bring about a reduction in the levy, but within this limitation India did attempt to manage the levies so as to avoid conflict with growth of export earnings.

12. Interest was also expressed in what India might be doing to promote private foreign investment, which could make a contribution to overcoming India's balance of payments in a way that would also foster development. The longer-term outlook would be of interest in this connexion. The representative of India replied that private foreign investment was welcome in India in the many industries open to the private sector. Such investment was especially welcome in fertilizers and other high priority sectors. Projects for investment were initially screened for essentiality, but once approved, remittance of current and accumulated profits and of the initial investment was allowed freely. The recent capital inflow had been somewhat slower than earlier, but some important negotiations were in progress even now, especially in regard to fertilizer manufacturing facilities. He felt that the best guarantee of a revival of foreign investment would be a healthy, expanding economy.
Alternative measures to restore equilibrium

13. From the outset of the consultation it was recognized that putting a stop to inflation was one of the primary objectives which India was seeking to attain and that this was an area in which fiscal and monetary policies played a major rôle. India was commended for its courage in adopting the devaluation of last year and representatives hoped that it would produce additional beneficial results for India's balance of payments. The careful balanced budget was also praised, as were the new measures to raise and collect taxes. For good results to be realized, however, it was also recognized that sustained budgetary prudence and restraint would be required. Members asked whether the Five-Year Plan was considered to place enough restraint on governmental spending, and whether it was really believed that it would be possible to avoid deficit financing and still attain the planned growth rate of $5\%$ per cent per year.

14. The representative of India replied that his Government was fully determined to avoid inflationary financing, as it was well recognized that that could only lead to further price increases and to still greater balance-of-payments difficulties. The objectives of fiscal and monetary policy would be to secure growth with stability. He believed that the conflict between the growth objective and the need to overcome inflation could be exaggerated since the principal area in which investment and increased production would be needed was agriculture, where there was much need, and room, for increased productivity. In response to a related question, the representative of India added that along with pursuit of fiscal stability, India would certainly keep constantly in mind the possibility of further relaxation in direct controls; he cited as recent instances some easing in restrictions on coal and steel.
15. Another aspect of India's plans which had already been touched upon was noted again at this point - the importance of export promotion. It was noted that India had adopted a variety of measures ranging from exhortation to higher internal taxes on export goods, cash rebates for exports and other measures of like nature. Special interest was expressed in learning whether India felt, for example, that exports of jute goods could be made more competitive. The representative of India again drew attention to the central importance of higher agricultural production not only as a means of enhancing the domestically available food supply but as a source of materials for export products. As exports usually absorbed only a relatively small part of the output, there would be a multiple effect upon exports, as a result of higher production. As regards the jute industry, the export levy on jute had been adjusted downward recently, but beyond a certain point, further downward adjustment would simply lower the export price without adding to the total earnings from exports. To have gone further in this case would also have hurt Pakistan. Outside the agricultural sector, iron ore and fish exports seemed to be increasing rather well and hides and leather goods had benefited from the devaluation. Producers of engineering goods had been optimistic regarding export possibilities; it would not be surprising if the difficulty there were simply that an unusually long time was required for a given stimulus to work its way back into deliveries, so that improvement might show up soon now.

16. A further question sought to explore whether credit might not be made somewhat dearer to good effect, judging by indications that interest rates in the so-called "unorganized" market (rural moneylenders) were considerably higher than rates in the official "organized" market. It appeared that if official rates were in fact too low this might be tending to lead to a less than ideal resource allocation. The importance of this consideration might depend to a considerable extent on the relative importance of the "unorganized" market in supplying credit needs or, stated the other way around, the extent to which
official rates are available to potential borrowers. The representative of India stated that it was generally believed that interest rates in the organized sector were not unreasonably low; they have been raised steadily over the years, and assuming as one must that the effort to achieve price stability would succeed, it was felt that the rate structure was adequate to ensure a proper allocation of resources. It would be difficult to say what proportion of total needs was supplied through unorganized channels, but the Government had been trying to extend the availability of organized credit especially in crucial sectors which had relied in the past on the unorganized sector. In particular, the Central Bank had been financing co-operatives to lend to farmers and efforts were being made to interest commercial banks in this project as it had an important bearing on success in introducing new techniques in agriculture.

System and methods of the restrictions

17. Members of the Committee again welcomed warmly the important steps toward liberalization taken by India after devaluation and appreciated the courage involved in that decision. They expressed the hope that more liberalization action would be taken whenever feasible.

18. A problem of concern to several members was, however, the apparently growing tendency to specify that imports must come from a particular country source, sometimes pursuant to aid agreements and sometimes pursuant to bilateral trade and payments agreements. They felt that this trend prejudiced effective use of scarce foreign exchange by India, and it did undoubtedly place at a disadvantage suppliers in countries not partners to such agreements with India, even though some of those excluded might in certain cases offer the best prices and even though some had by patient effort built Up trade ties of long standing. One might reply that countries which felt they were losing out in this process had only to offer more aid, but some of those who felt discriminated against had
in fact supplied as much aid as they could afford on terms that were acknowledged to be liberal. These countries noted the statement by the representative of India that the effect of aid-tying was to reduce the extent to which Indian importers could be given flexibility in taking decisions regarding imports on purely commercial grounds and agreed with the Indian view that relaxation of restrictions on use of assistance would promote the emergence of competitive conditions in India's industrial structure.

19. The representative of India gave some examples of the different degrees of tying which were encountered and of their effects on the administrative procedures involved in operating India's licensing system. When free foreign exchange or aid equivalent to cash was available, a licence to import components and materials up to a certain value for use on a stated project could be issued and the importer left to select his own sources and obtain the best terms available. When he had utilized a certain percentage of the value of his licence he had only to come back for a repeat licence with evidence that the goods had been ordered or imported. But if one or more tied sources were involved, the licensing authorities would have to specify separately ceilings on permissible imports from the different country sources. If it happened, as it sometimes did, that the importer could not combine his arrangements so as to satisfy utilization conditions with regard to imports from each source, the licensing authorities were obliged to examine the matter with him to determine whether failure to arrange imports from certain sources was unavoidable. A still more undesirable situation arose when it became necessary to tell an importer that he must try to negotiate terms with a foreign supplier who might have to be asked to help finance the transaction and who therefore might or might not finally agree to supply the importer's full requirements. It could happen that after a good deal of time and money had been spent in trying to negotiate such contracts, importers would find themselves unable to conclude a deal. Further, there were even on occasion commodity specifications which meant that there would be ceilings on total amounts of the various commodities which could be obtained from a specified country under the particular credit. The net result was obviously extensive administrative supervision of importers' activities and efforts.
20. On commercial sales under free foreign exchange India tried to do its best and such licences carried freedom to select goods from any country source, but free exchange was in very short supply and to obtain the largest total import of needed goods, including food, it was necessary to use all the credits available and to save free exchange for goods that could not be obtained otherwise. Diverting free exchange to purchase of things which might be had otherwise would further reduce total imports. In short, India had very little room in which to manoeuvre.

21. A specific inquiry was made as to what products were on the open general licence list and whether the list did not include additional items not listed in the basic document supplied by the Government of India. The representative of India replied that the list in the basic document was complete. Open general licence meant use of free foreign exchange and it would be difficult to extend use of that technique now. There was a special general licence list for imports from one country. When a licence was issued for import without country tying of components and spares for a given project, for the holder of such a licence a longer open general licence list could give no additional freedom, but in any event India could not afford to extend the system at this time.

22. On further questions regarding the prohibited list, the Indian representative said that some of the goods involved were non-essentials which India could not afford to import, while others were produced in adequate quantity in India. These lists were reviewed and gradually adjusted. New industries were sometimes given temporary protection to stimulate investment. The Finance Minister had spoken to that point recently. He specifically called for an import policy neither attempting to justify all restrictions for all time nor looking toward abolition of all restrictions on a particular date; instead, he envisaged a deliberate selective policy in which "the frontiers of protection keep on moving from time to time and from commodity to commodity so that, by progressive stages, protection is removed from some commodities while it is introduced in the case
of other commodities which begin to be produced in the country". It was pointed out to the representative of India that token licence systems were envisaged by GATT for countries invoking Article XVIII:B. The representative of India said that it would be impossible for the Government to let in even small quantities of low-priority goods at a time when even food could not be imported in adequate quantities because of shortage of foreign exchange.

23. A question was also asked about what was understood to be a relatively new system under which small firms might apply and obtain free-exchange licences from local controllers of imports located in ports of entry. Members expressed interest specifically in learning what proportion of available free licences were being distributed by this method and on what basis a firm might choose to approach either a local or the central licensing authority. The representative of India replied that the authority to which any firm applied for licence was prescribed by regulation and that it was not within the discretion of the individual firm, large or small, to decide which authority it would apply to. Generally speaking, large firms were required to go to the central licensing authority and smaller ones to local authorities. Until recently small firms were required to go to local licensing authorities through State directors of industry, but a recent change enabled them to go direct to local authorities for licences. In 1966, immediately after the liberalization measures, it was at first arranged, for obvious practical reasons, to grant all licences to small firms out of free foreign exchange. But it had now been seen that India could not afford that practice, so that even though it involved much additional administrative work, an effort was being made to use funds obtained under assistance arrangements even for these small licences accorded to small firms. The representative of India stated that he would supply some information on this point at a later stage.
24. Members of the Committee also reverted to the question of India's bilateral trade and payments agreements, some with other contracting parties to GATT. They recalled their view that such agreements, in some cases providing for bilateral settlement of accounts in inconvertible rupees, have an inherently discriminatory effect and reduce the freedom of Indian industry to buy in the most advantageous markets. The subject was not a new one, in consultations with India, and the question was asked what consideration had been given in India to past Committee views on the bilaterals. More particularly, members were interested to know whether experience really buttressed the theoretical rationale to the effect that bilaterals helped promote new exports to new markets or helped dispose of stocks that had been difficult to sell on the world market. Were such benefits really sufficient to outweigh the disadvantages? Finally, a plea was made that effective traditional suppliers be given more consideration especially where a relatively recent bilateral agreement disturbed traditional commercial links.

25. The representative of India pointed out that most of the agreements in question were in fact with countries having centrally-planned economies, where the bilateral agreement constituted the only basis on which India could develop trade. In those cases there could be no doubt that the agreements made possible access to additional markets and led to development of a significant volume of trade appropriate to the trade pattern one might expect, given the relative stages of development of the countries involved. The partner countries had also, as a result of the agreements, taken a real interest in developing trade with India; as India applied to such imports the same criteria of essentiality as those applied to other imports, there seemed to be no reason to think in terms other than of sustaining and developing the trade on a long-term basis. Generally speaking, India's attitude towards trade with other countries was to develop trade on a multilateral basis. Naturally, India was doing it best, in its own interest, to ensure that imports were obtained from the most effective sources, subject only to the limitations inherent in the fact that some foreign exchange resources were not freely convertible, yet had to be used fully. In this connexion he again stressed the need for an improvement in the amount, terms and forms of aid, and for India's exports to have freer access to world markets.
26. Members also noted that State trading and Government monopolies were used to handle a considerable volume of India's import trade. Although they understood that there was no intent to restrict imports on balance-of-payments grounds through the operation of these agencies, they would be interested to have confirmation that such operations were not being extended and that the Government of India intended to give up, when possible, remaining monopoly functions and phase out remaining bulk-buying practices so that trade might return to private hands for such items as food grains, fertilizers and petroleum products.

27. The representative of India said that his Government actually found that State import of bulk items, with purchasing often on the basis of tenders, was a good system; for India's purposes it was in fact probably better and more advantageous than a system of all-private import would be likely to be. Often there were economies that could be realized by purchasing on a bulk basis, as for example in shipping. Then too, bulk-buying avoided the risk that Indian buyers might be competing with one another to bid up the price of scarce goods, as once happened in sulphur. For small users, there were obvious advantages to bulk Government import. Actually his Government's view was a pragmatic one: where there seemed to be advantage in bulk-purchasing only a part of the supply, private importers were allowed to trade alongside the State agency, and where it seemed more advantageous for the State agency to handle the entire supply, that was done.

Effects of the restrictions

28. Members recalled that a good deal had already been said in earlier parts of the consultation concerning effects of the restrictions. In summary, they felt that India's import restrictions had had a good many of the unfortunate effects common to such systems, especially in sheltering some infant industries with poor prospects of ever developing into vigorous viable enterprises. High protection had without doubt led to some imprudent resource allocation, and as long as the weak industries struggled on they would penalize the Indian consumer, and to some extent would also hamper the export drive to the extent that their
products entered into and made India's exports dearer than otherwise. They expressed the hope that increasingly India would intensify efforts to concentrate industrial investment resources in sectors with the best prospects of attaining a fully competitive position. The representative of India assured the Committee again that this matter was receiving continuous and increasing attention and that new investments proposed were being closely scrutinized.

29. In reply to a question about the conditions under which new and expanded industries might be established, he added that the Industries Act was the main instrument for channelling investment toward the targets of the development plans and that until recently every new producing unit and the production of every new line of goods required an advance licence. More recently the regulations had been relaxed somewhat to permit some established industries to diversify within limits without special permission and some industries had been exempted from licensing requirements. All that the basic document intended to convey was the logical consequence of the requirement that new industries be duly licensed, that is that firms could in general not obtain licences for importing materials with which to carry out operations which themselves had not been approved.

Conclusion

30. The Committee thanked the representative of India for his very comprehensive opening statement and for the frank and well-informed replies he had given to their questions. He in turn thanked the Committee and promised to convey to his Government the views that had been expressed.