Committee on Balance-of-Payments Restrictions

DRAFT REPORT ON THE CONSULTATION WITH INDIA

1. In accordance with its terms of reference the Committee has conducted a consultation with India under Article XVIII:12(b). The Committee noted that the previous consultation with India under the same provisions had been held in July 1967 (Cf. BOP/R/13 and BOP/69). In conducting the present consultation the Committee had before it a basic document transmitted by the Government of India (BOP/99), a decision of the Executive Board of the International Monetary Fund dated 17 February 1969 (Annex I) and two papers dated 28 January and 22 October 1969 respectively containing background material supplied by the Fund.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation took place on 20 November 1969. The present report summarizes the main points of discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with India. In accordance with the agreed procedures 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 February 17, 1969 taken at the conclusion of its most recent Article XIV consultation with India and particularly to paragraphs 4 and 5 which read as follows:
4. The sharp rise in exports and the reduction in imports that occurred in 1968 have done much to ease pressures on the balance of payments. It is essential, however, that continued emphasis be placed on export promotion. A rapid growth in exports will contribute to efficiency in the economy and permit the increased imports that a growing economy will need. The Fund believes that the liberalization of the restrictive system introduced in 1966 has benefited the economy and should be continued.

5. The Fund notes that India continues to maintain bilateral payments arrangements and believes that steps should be taken to reduce or eliminate the arrangements with member countries at an early date. 'At the present time the general level of restrictions of India which are under reference does not go beyond the extent necessary to achieve a reasonable rate of increase in its reserves.'

Opening statement by the representative of India

4. In his opening statement, the full text of which is reproduced in Annex II, the representative of India outlined the present balance-of-payments situation, the prospects for the near future, the current import control policy and relevant developments in the internal economic situation. It was stated that in the past year there had been a substantial improvement in the balance of payments. Exports had increased by a comfortable margin and imports had been reduced mainly owing to increased domestic production. The price rises which had beset the Indian economy in recent years had definitely abated, thanks to increased food production and increases in industrial output, and a better balance between overall supply and demand. Fiscal policy had also helped to keep inflationary pressures under check when the overall budgetary deficit was greatly reduced partly through increases in taxation. The rise in agricultural output was attributable to technical innovations such as the introduction of high yield seeds, greater use of fertilizers and pesticides, and better irrigation. The improvement in industrial production was reflected both in substantially increased output and in a more diversified and better balanced composition. Industrial production has raised from the previous stagnation. Output of newer industries, particularly base metals and engineering goods, had considerably increased, although there was a decline in cotton textiles and jute manufactures. The improvements in agriculture as well as in industrial production had been greatly
helped also by monetary policy, involving the provision of preferential credit treatment for priority sectors. All these developments had made possible a reduction in imports of foodstuffs and non-development goods, so as to enable greater import facilities to be provided for the purchase of essential inputs for development, the highest priority being given to capital equipment. A new feature in the current import policy was to require certain industries to export a specified proportion of their output and this had helped to bring about increased cost consciousness in industry as well as improved efficiency of labour and of management, and greater care in making purchases in the light of economy and efficiency.

6. The representative of India, in conclusion, observed that, while the overall trade and payments outlook was encouraging, careful use of the existing foreign exchange resources was still called for and the need for external financial help was still urgent, especially having regard to the mounting debt servicing obligations. There was need for increasing amounts of untied aid, untied both with regard to the types of imports that might be financed and the sources from which imports might be made. Furthermore, in spite of the results of the Kennedy Round, some of the major items of India's exports continued to face high tariffs in the major developed countries, as well as quantitative restrictions and other non-tariff barriers. In short, the situation called for a combination of appropriate trade and aid policies in developed countries without which India would find it difficult to attain the export targets which it had set for itself, and to obtain the increased imports necessary for the sustained development of the Indian economy.

Balance-of-payments position and prospects

7. Members of the Committee expressed appreciation for the very comprehensive and lucid statement by the Indian representative and expressed satisfaction over the remarkable progress that India had made in regaining stability and accelerating economic growth. It was observed that the Indian economic situation was better than it had been at any time in recent years. The fundamental change that had been brought about in agriculture had largely removed the severe strain on the economy, and had made self-sufficiency in food an objective attainable in
a few years. Some members added that the Indian achievement provided a
heartening example for other developing countries grappling with the same kind
of problems faced by India which until now had been considered insoluble.

8. Invited to comment on the prospects of India's balance of payments in the
current and coming years, the representative of India stated that India's total
official gold and foreign exchange reserves amounted to $672 million at the end
of October 1968. While this might appear comforting, account must be taken of
the very sizable debt servicing payments that were due shortly, notably
$127 million of repayment to the IMF. During 1970/71 while exports were
expected to rise by $100 million and food grain imports might decline by another
$100 million, the overall surplus would again be marginal if account was taken
of debt servicing which in that fiscal year would amount to $754 million,
including a repayment to the IMF of $205 million. The change in input control
policy which as applied to essential materials and components needed by the
priority industries, permitted imports according to need and thus lessening the
desire to maintain high inventories, might have the effect of reducing somewhat
the import bill. Basically substantial amounts of foreign aid would continue to
be needed to fill a foreign exchange gap.

9. In a discussion of India's recent success in expanding and diversifying
exports, it was pointed out that the traditional items of Indian exports had
generally not shared in the increase, and that the rise had occurred mainly in
new lines such as iron and steel, machinery, transport equipment. The
suggestion was put forward that the expansion of exports might not be sustained
as economic growth proceeded and domestic demand rose. Invited to assess India's
export earning prospects the representative of India first commented on the
factors responsible for the decline or stagnating state of some of the country's
traditional exports. Tea, in spite of efforts at innovation in further
processing and energetic marketing, had lost ground owing to a decline in
demand in the major consuming countries with the result that the price had fallen
markedly in recent years. Owing to changed methods of transport and packing of
bulk commodities, demand for sacking and hessian had reached the vanishing
point and efforts at changing to new jute products such as carpet backing sometimes faced impediments in importing countries bent on protecting competing domestic products. Constant endeavours were made by the Indian authorities to improve the quality of Indian exports. Pre-shipment inspection had been introduced for a large variety of goods which showed a salutory effect on the confidence of foreign buyers in Indian goods. Sustained efforts were made to make certain other products (such as iron ore, leather goods, handicraft products, etc.) more competitive, attractive and marketable. Jute manufactures situation would improve this year as raw jute had again become available after a serious shortage and high prices had deprived the industry of its raw material during the past two years. As regard future trends, the 13.5 per cent growth of exports in 1968/69 would surely not be repeated this year, the present rate being even lower than the 7 per cent planned for the current and coming years.

10. Noting that there had been a decline in new foreign investment in India which appeared to have been partly caused by government policy, a member asked whether there might be any change in that policy and whether any incentives might be provided to attract more foreign capital to meet the investment goals of the Fourth Five-Year Plan. In posing this question the member remarked that whereas a preliminary version of the Plan seemed to have overestimated available investment resources from both domestic and foreign sources, the revised Plan's targets and resource estimates were much more realistic. The question would seem to be one of whether the planned investment outlay was sufficient to achieve the planned growth rate. The representative of India replied that the Indian Government had taken various steps to streamline decision-taking in dealing with investment projects involving foreign capital and had recently decided to set up a Foreign Investment Board on which were represented all ministries concerned so that decisions could be taken instantly as all delays caused by inter-ministerial communications would be eliminated. In fact the Indian Government has been actively campaigning to get foreign investors to make direct investment in particular industrial sectors, (such as fertilizers,
tractors) to take part in the Indian economic growth, and the efforts had been fairly successful as might be seen from the number of foreign enterprises establishing in the country. An Indian Investment Centre had been opened up in New York and a branch office had been set up in Düsseldorf. Similar branches at other foreign financial centres were not precluded.

11. In answer to a question on the recent nationalization of banks and any possible ramifications that this might have on capital inflow, the representative of India explained that the action had been taken for purely domestic reasons, and did not apply to foreign banking establishments in India. The main purposes of this action were to ensure that bank credit was available for investment in the priority sectors in accordance with the basic Plan objectives, to ensure availability of working capital funds for the important sectors and to avoid the misuse of funds for purposes contrary to public interest, such as the use of bank resources for improper speculation in the equity market. There was no intention to affect the availability of capital for the private sector, or otherwise to alter the basic nature and functions of the banks.

12. Some members of the Committee stressed the importance of monetary and fiscal policies in regulating the rhythm of growth, with reference to the greater degree of fiscal restraint that the Indian authorities seemed to have been exercising than in the past and to their success in keeping monetary expansion within the limits of increased output, they asked in what fiscal and monetary policies were intended to be applied in the coming years. The Indian representative stated that the budgetary provisions for this and coming years included a slight increase in outlays and a total deficit somewhat below the increase in national output. Such policies had indeed been successful in the past two years as might be witnessed by the stability of prices; the whole price index had fallen by a small margin and only in isolated cases had there been an increase in price. Monetary policy had been oriented to assisting the priority industries, providing capital for agriculture and small-scale industries. To meet increasing investment needs, steps were taken to stimulate saving.
13. In confirming that the planned budgetary deficit for 1969/70 and 1970/71 were both about $300 million the Indian representative pointed out that these figures, though slightly higher than the 1968/69 level were considered lower than those in the preceding years. The Indian authorities considered that deficits of this magnitude would not be inconsistent with price stability, having regard to the increase in total national output. In fact, a judicious expansion of money supply was necessary in present circumstances when increased output was generating sufficient savings for investment; an inadequate money supply could exert an undesirably restrictive effect on industrial expansion and bring on a recession.

14. Noting that State Governments in India could have recourse to deficit financing to the detriment of the resources available to the Central Government, a member of the Committee asked what measures were available to limit the State Governments' access to the resources of the Centre for the financing of their deficits. The representative of India stated that the Central Government, as well as the Reserve Bank of India, had over the years been using their persuasive powers to discourage the State authorities from having undue recourse to deficit financing, and they had met with a certain measure of success, and such deficit financing had diminished. The States had been resorting to new ways of raising funds and it had recently been agreed that the States should have a greater share in the tax revenues of the Central Government, and the Bank would also provide overdraft facilities for the State Governments. These ameliorations should help to solve this thorny problem to some extent.

15. In answer to questions concerning measures to stimulate investment the Indian representative referred to various tax exemptions applying to reinvested revenue, generous depreciation allowance, etc., the tax policy being generally geared to encourage corporate reinvestment and self-sustained industrial expansion. The equity market in India was somewhat stagnant and less active than desired, partly owing to the lingering apathy of investors generated by the memories of the recession years and the present high cost of money and these special encouragements had to be resorted to in order to mobilize private capital. The means relied upon to activate personal savings included higher interest rates for fixed-term savings accounts, which had lead to a marked rise in time deposits.
16. The material before the Committee showed that Indian public revenue had not been responsive to the rise in national income in recent years, and that, in striking contrast to the highly taxed industrial sector, agriculture seemed to be virtually exempt from taxation. Interest was shown in the Committee in any measures, apart from the recently proposed wealth tax on agricultural assets, that the Indian authorities might have contemplated adopting to ensure that the agricultural sector, which accounted for an increasing proportion of Gross National Product, make a fuller contribution to revenue. In reply the Indian representative explained that one of the Government's basic policies being to encourage agricultural investment, the Government was reluctant to place any new tax burden on this rising rural income as it might reduce the resources now devoted to the purchase of new farm implements, tractors, irrigation equipment and fertilizers. Furthermore, under the Indian constitution, the Central Government had no power to tax agricultural income. If it were decided that agricultural earnings must be made to bear part of the burden of Central Government finance, reliance would have to be placed on indirect taxes which could be so structured as to place an appropriate level of tax incidence on consumers and end-users in the agricultural sectors.

17. A member of the Committee observed that while industrial output had also shown a significant growth (by 6.4 per cent) and contributed substantially to the rise in exports in 1968/69, under-utilization of industrial capacity seemed to have persisted (the rate of utilization being: finished steel 66 per cent, aluminium 57 per cent, nitrogenous fertilizers 57 per cent and steel castings 37 per cent), and asked what the current situation was and whether special steps could be taken to raise the level of utilization of existing capacity. The representative of India explained that this "under-utilization" of industrial capacity reflected a number of situations. There had been, for example, a shift in the pattern of demand for various types of steel and some steel mills had met with certain technical difficulties in adjusting to new demand. Stoppage necessary for the relining of furnaces, for example, might be counted as idle time, as could also be the time elapsing between the setting-up of plant and its effective operation. Some steel casting mills had been idle during periods of
falling demand, but had recently been working to capacity as the country was now faced with a steel shortage. The Government had been endeavouring to ensure fuller utilization of industrial capacity and one of the solutions lay with the expansion of exports.

18. In response to a question concerning surplus manpower and unemployment, the Indian representative recalled that the problem of unemployment had been one of the main concerns of the Government ever since planning began in early 1951. The problem of late becomes more acute owing to the pause in industrial growth which had lasted for several years until recently during which the growing labour force outnumbered the increase in employment opportunities. The problem had to some extent been attenuated by recent developments in agriculture, as a result of which there had even been occasional labour shortages in rural areas during the sowing and harvest seasons, which had caused increased interest in the modernization of agriculture. Policy measures included the promotion of small-scale industries and labour intensive industries such as hand-loom textile production which was particularly useful in solving the problems of under-employment in the countryside. (Small-scale local industries, incidentally, also served the useful purpose of mopping up surplus capital, especially in rural areas, which was likely to be squandered on consumption if productive outlets were not found to absorb accumulated savings.)

System and methods of the restrictions

19. Members of the Committee presented questions on various aspects of the Indian import controls and restrictions. In the course of the discussion, they reviewed the evolution of the system especially since the new departure made at the time of the Indian devaluation in June 1966, in the direction of seeking external stability and increases in exchange reserve through export expansion and import liberalization. Since then India had taken several steps in the direction of liberalizing administrative controls on imports of industrial inputs, the most significant one being the designation of fifty-nine "priority industries" entitled to import licences to meet their total needs, irrespective of previous base year imports. In the view of members of the Committee this progress towards simplification of the administrative controls were praiseworthy and should be welcomed by the contracting parties.
20. On the other hand, the Open General Licence was still confined to a limited number of raw materials; new items had recently been added to the already lengthy prohibited list, now including not only luxuries and non-essential consumer goods but chemicals, insecticides, pharmaceuticals, and even machine tools, on account of their being also available from domestic production.

21. Members of the Committee said that they recognized that India was entitled to maintain the import restrictions at a level necessary to safeguard its balance of payments and monetary reserves as provided for in Article XVIII:B. Some of the members wished to know, however, India's outlook for further liberalization, especially with respect to the underlying policy of maximizing import substitution through prohibiting imports; how India viewed the effects of past liberalization of administrative controls; what were the prospects of enlarging the Open General Licensing and shortening or abolishing the Prohibited List. Some members wished to know whether India would at least shorten the Prohibited List as soon as its balance-of-payments situation permitted such a move. Other members merely urged that India simplify its import control procedures and documentary requirements, in having regard to the complexity of the present procedures which sometimes involved long delays in the issue of licences, required calls and waiting by applicants at a multitude of ministries and regulatory agencies or entailed prolonged withholding of foreign exchange transfers.

22. In discussing the State-trading operations of India and their possible discriminatory effects on imports from different sources members of the Committee noted that the list of commodities which must be imported through State-trading corporations had recently been lengthened by the addition of seven industrial raw materials while four other products would henceforth "normally be arranged under the auspices of the State-trading corporation". This seemed to indicate that increasing reliance was being placed on this device. While they felt reassured by the Indian Government's statement that "an entirely non-discriminatory policy is followed, subject to the constraints imposed by the exchange availability and the conditions attached to external assistance" (BOP/99, paragraph 22), they were nevertheless anxious to be assured that the State-trading arrangement would not
interrupt the traditional contact between foreign exporters and Indian end-users, and that exporters in Western countries would continue to have equal opportunities to compete with the State-trading countries on the Indian market for the products in question.

23. The representative of India stated that the State-trading agencies of India had been set up primarily because of the economic and practical advantages that could be derived from bulk buying, particularly for the small industrial end-users of imported raw materials, most of whom had neither the administrative set-up nor the necessary demand volume to be able economically to engage in direct importation. For such end-users the economy to be derived from bulk buying and bulk transportation could be considerable, and the multitude of small industrial producers in India had gratefully welcomed the establishment of the Metals and Minerals Trading Corporation. Recently even large-scale industrial firms in the priority sectors had shown a willingness and pleaded for the privilege, to entrust their requirements to the corporation and to surrender their own import licences. The attitude of the end-users had conclusively proved that the rôle of the State-trading corporations in India was that of an expert agency, competently performing an essential service to the industrial community on the basis of commercial considerations at a minimum cost and not a State monopoly bent on maximizing mark-up profits and indulging in discriminatory manipulation. Certain products had recently been placed under the auspices of the State-trading corporations in order to ensure their proper utilization; that is, to ensure that the imported goods were used for the purpose for which their import had been facilitated and paid for with scarce foreign exchange. In short, the State-trading agencies' operation involved no discrimination against any particular countries, or in favour of any specific countries.
24. Some members of the Committee recalled that in the sixteen years since 1953 an increasing portion of India's trade had been carried out under bilateral trade agreements. They noted that while in the earlier years these agreements had been designed to help India to trade traditional exports for capital equipment and manufactured goods, they had increasingly served to market India's industrial products against imports of raw materials. Some of the members expressed the view that some of these agreements were not in India's best interest in so far as they obliged India to purchase inferior products at excessively high prices or to supply Indian products at low prices which the bilateral partner could re-export to third markets at a profit—thereby depriving India of her traditional outlet. Apart from the damage that might be caused to the trading interest of other contracting parties by the discriminatory features of these agreements, India was likely to have suffered sizable loss from this rupee trade with the few bilateral trading countries. Recalling the advice repeatedly given by the IMF and the CONTRACTING PARTIES that India reduce her reliance on bilateral agreements, these members of the Committee wished to know whether India had any plans to give effect to that entreatment by terminating or reducing the scope of its bilateral agreements. They would also like to be assured that the existing agreements were operated in such a way as to involve no discrimination against the exports of the contracting parties. In this connexion they noted that whereas an Indian statement asserted that most of India's bilateral agreements did not involve any obligation to import any goods (BOP/99, paragraph 17) it had been reported officially elsewhere that its agreements with certain trading partners entailed the purchase and sale of specified commodities.

25. The representative of India in reply to these questions, stated that the trade agreement with Fund members merely served the useful purpose of ensuring supplies of certain products and that the proportion of trade covered by them was an insignificant portion of India's total trade. The change in the composition of products covered by India's agreements merely reflected the general change in India's industrial horizon and the widening of the range of her production. The agreements with non-members of the Fund had been entered into often in order to ensure continued supplies of components and spare parts for equipment originally
bought from the partner country. The Indian authorities were not aware of any cases in which inferior goods were forced on India at prices higher than world market prices. India's bilateral agreements generally contained a provision forbidding the diversion to third markets of goods traded under the agreement. If, on rare occasions such goods of Indian origin were come across in third markets a representation would be made to the bilateral partner and an appropriate adjustment might be made in the value of the products to be supplied to that country in the following year.

26. Some members of the Committee mentioned in context the question of preferential and discriminatory effects of the Tripartite Agreement between India, the United Arab Republic and Yugoslavia. It was generally agreed that this subject could more appropriately and effectively be dealt with in the Working Party on the Tripartite Agreement which was going to meet shortly to review the operation of that Agreement.

27. The representative of India reiterated his conviction that India's balance-of-payments position, in spite of the apparent increase in reserves in the past year, remained precarious; especially having regard to the debt repayments falling due in the near future and called for vigilant husbandry of the limited resources. It would not be prudent for India to take any precipitate action now and court the danger of having to take retrogressive steps at a later stage. Within permissible limits, however, the Government of India would be willing, as it had always been, to explore all the possibilities of simplifying the procedures. The need-based licensing of essential supplies for priority industries had been evolved precisely to that end. As a large part of India's foreign exchange resources consisted of non-convertible currencies, the uncertainty about the availability of individual currencies entailed the scrutiny of various bilateral accounts when applications for licences were examined and this might cause some delay in licensing. Slowness of exchange transfer might similarly be caused by the laborious task of weighing the relative abundance of, and estimating the likely calls on individual currencies. The clerical work involved in the handling of the thousands of applications received each day could be another explanation of any tardiness in their processing.
28. The Indian representative pointed out the enlargement of the prohibited list partly reflected the increased sophistication of industrial production; the number of individually identifiable products was growing daily, as a result of new designs and inventions, as well as the even more precise specification of products and the multiplication of appellations, especially in such sectors as electronics and chemicals. It should be noted that not all products on the so-called prohibited list were really banned from importation; most of them were importable under licence if they were needed by a priority industry. This control was applied with due regard to prices and maximum import substitution was sought consistently with cost. Many items had been taken off the list when justified by local shortage and the list was constantly previewed and was applied with flexibility. Although the Indian authorities had every intention to enlarge the Open General Licensing, they were not at present in a position to indicate any definite date for this action. As for admitting taken imports in order to provide local producers with stimulative competition, the Indian representative pointed out that the present import system provided ample opportunities, in various forms, for individual products to enter the country in substantive quantities, including products on the prohibited list.

29. In general the Indian policy was oriented towards export expansion and import substitution was necessitated only by currency consideration. It should be noted that if the import of some items were severely restricted it simply meant that the foreign currency exchange saved was being devoted to the import of other, more urgently needed, products.

30. In reply to a question, the representative of India stated that imports of spare parts generally enjoyed high priority and, in so far as they were needed for a priority industry, were licensed up to the full requirement expressed as a percentage of that capital equipment to which they were destined. For small end-users, such as contractors, they were licensed freely.
31. In reply to a question concerning the nature of the "Compensatory Financial Support" the Indian representative described the taxation system of India under which most products were subject to a variety of levies and taxes at various stages of production and whenever they were transported across communal frontiers. As the tax was levied by sundry State and local authorities there was no way for the Central authorities to grant any exemptions. The burdening of the tax was usually more than sufficient to price the products out of foreign markets and the Compensatory Financial Support was intended to be a rebate to the exporters to compensate for the taxes that he had borne as the final possessor of the products; it was in the nature of a border tax adjustment.

32. In response to a representation on transit through India the representative of India explained that transit traffic through India to Pakistan had been interrupted owing to the absence of official contact and proper arrangements for trade and economic changes between the two countries. He stated that India was ready, and earnestly wished, to enter into negotiations with Pakistan to normalize their relations. As to transit traffic to Nepal, India had been obliged to control goods entering Nepal since, in the absence of customs checking points on the border between the two countries, there was always the possibility and likelihood of goods the import of which was restricted in India entering India from Nepal shortly or immediately after their "importation" into that country. Nepal had been asked to undertake to refrain from such illicit trade and had been asked to limit its imports of certain products to the amount needed to meet estimated domestic demand.

Conclusions

33. Members of the Committee commended the Government of India for the substantial improvement in the balance of payments, and especially for the increase in exports and the rise in food production which contributed substantially to the progress towards solution of the most fundamental problem of the country. They expressed appreciation for the prudent yet flexible fiscal and monetary policies which India had relied upon for restoring the balance between supply and demand.
They recognized that under the present circumstances India needed to maintain its restrictions on imports the general level of which had been referred to in paragraph 3 of this report. They expressed the hope that further improvements in the balance of payments would be made in the near future so as to enable India to take new steps of import liberalization. In the meantime, they urged that India examine the possibility, within the limits set by the balance-of-payments considerations, of simplifying its import control procedures.

34. The representative of India expressed appreciation for the sympathetic attitude of the members of the Committee in considering the problems faced by his country, and assured the Committee that he would take up with the other competent authorities in New Delhi the various questions and representations put forward by members of the Committee during this consultation.