

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION WITH INDIA

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 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. 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,<sup>1</sup> 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."

<sup>1</sup> See Annex

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 Developmental Plans 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 materials, 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 has 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 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 and 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 from abroad, 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. These 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. Strenuous efforts towards agricultural development leading to a progressively larger measure of self-sufficiency would of course continue and the 17 million tons of grains would be used partly for consumption and partly for building up buffer stocks to help maintain price stability when the country was in the process of massive development. India was 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. The Indian representative appealed to the CONTRACTING PARTIES to use their influence also to eliminate as much as possible the close tying of loans to purchases.

10. In concluding 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. A principal objective, 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 would soon be able to export a larger share of her products, but this depended both on continuing increases in production of goods for export and on other countries reducing barriers to Indian exports, barriers which frequently contravened the General Agreement.

12. Concerning external development assistance some 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 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. Another member of the Committee, while not disagreeing that the provision of tied financial assistance would create problems in some cases, pointed out that it did not necessarily result in a reduction in the total amount of financial assistance made available to the recipient country. Some countries, particularly those with young and growing manufacturing industries, might well feel able to give considerably more financial aid in tied form than they could afford to provide in untied form, since the latter caused a much greater burden on the balance of payments of the lending country.

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.1,870 million at the end of April 1960, and enquired about the reasons for this decline and about future prospects. The representative of India replied that the whole of this decline could be attributed to the re-purchase of the equivalent of \$50 million made from the International Monetary Fund in February 1960. There was no reason to regard the observed decline as a signal of a renewed downward trend. On the other hand, the servicing and amortization of loans, and the continuing need for heavy imports of capital equipment and industrial raw materials involved in the process of development would continue to impose heavy demands on reserves which would need to be met by an expansion in exports and the grant of long-term loans and credits. In the view of the Indian representative it was difficult to forecast how long the present balance-of-payments situation would last, but it was likely to remain under pressure for the next fifteen to twenty years.

14. The representative of India noted that the export promotion measures being undertaken by the Government, although on a substantial 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 and jute 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 the Federal Republic of 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 important steps taken to eliminate discrimination in the administration of the Indian import controls, and considered that this progress 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 explained that it was the belief of his Government that long-term interests of the country lay in adherence to the principles of multilateral trade. In dealing with east European countries, however, the trend towards bilateral payment arrangements stemmed from the original arrangements under which the rupee earnings of these countries were convertible. The change was brought about by the realization that some of these countries while making exports to India did not show enough awareness of the possibility of meeting part of their own requirements of raw materials and consumer goods from India. 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 both raw materials and manufactured goods, 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, newsprint and photographic paper, etc., and these fell in the category of essential maintenance goods or goods included in the hard core of the development programmes. 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 countries.

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 could therefore well be in a country's own interest not to expand trade on a bilateral basis, 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. A representative pointed out that, as a result of the bilateral arrangements made between India and certain countries in the Middle East - Egypt and Iraq - his country 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 India had entered into bilateral payment arrangements with a view to limiting the expenditure of foreign exchange and having regard to the special structure of trade of some countries or as a means of finding access to new markets. It was further stated that, with a few minor exceptions, there were no commodity quotas in India's bilateral agreements and development of trade was determined by commercial considerations of quality, price, etc. Referring to the point regarding reduction of exports of goat skins to one of India's traditional markets, the Indian representative explained that, even though diversification of export trade was desirable, India was anxious not to allow its traditional markets to be impaired. However, the larger exports to certain eastern European countries had taken place because the prices offered were more

attractive and short of imposing destinational restrictions - which were undesirable - the Government of India could not interfere with the right of the trade to sell in the best market. With regard to the difficulties met by a contracting party in maintaining its exports of tea in certain Middle East countries, the representative of India explained that trade arrangements with Egypt stemmed from the special situation that arose as a result of the Suez crisis, when payments from sterling sources were blocked. In fact, the contracting party concerned had itself extended a line of credit to Egypt and its tripartite arrangements for exports to that country preceded in point of time the present arrangement between India and Egypt. No single-country licences were issued by India under this arrangement and the importers were free to purchase their requirements anywhere. The trade agreement with Iraq did not provide for any exchange of quotas.

#### 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 liberal approach 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 procedures relating to approval of 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 procedures. Controls on the establishment of new enterprises had been introduced to channel industrial development consistently with the availability of natural resources, the needs of the economy and the established priorities in the use of foreign exchange. In the interest of small investors the authorization requirement had recently been relinquished for enterprises requiring an investment of less than Rs.1 million and employing not more than 100 workers. 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, new enterprises were exempted for a period of five years from income tax on returns up to 6 per cent per annum of invested capital; in a number of industries foreign companies receiving dividends from firms established after 1952 were exempt from super tax, and development rebates and liberal depreciation and research allowances had also been granted.

19. Some members of the Committee enquired as to what specific measures had been taken to encourage agricultural production. 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 fertilizers 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. In response to a question regarding the impact of the investments made with the assistance of foreign loans and credits on production, the representative of India 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.

#### System and Methods of the Restrictions

21. A member of the Committee noted that under the present Indian import control system applications for imports of capital goods 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 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 over the period for which the foreign supplier's credit was available. With respect to capital goods financed under tied or multilateral credit 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 the licensing of imports of such goods, account was taken of special credit facilities and facilities under bilateral arrangements.

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 uneconomic. The representative of India said that in view of the very tight foreign exchange position, the Government could not allow scarce resources to be taken up by the establishment of uneconomic industries, and that the regulations on investment in new industries or for expansion of existing industries took this factor fully into account. The availability of internal resources was also an important consideration. The Government's policy was to encourage industries which were based on the utilization of domestic raw materials and energy sources and which met essential consumer needs and the requirements of the economy or helped to add to export earnings.

General

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. Members of the Committee noted with sympathy the broad scope of the social and economic problems faced by India and the efforts of the Government of India to deal with them. They drew the attention of the delegation of India to the possible effects on India's economic development of the severe restrictions now in force, particularly if long maintained. Members of the Committee expressed gratification for the progress made in reducing discrimination. While fully appreciating the present difficulties faced by India and the efforts made by the Indian Government to reduce discrimination, they expressed the hope that India would find it possible to make further progress in eliminating any remaining discriminatory elements in the restrictions, including those arising from bilateral arrangements.

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.

ANNEX

Results of the 1959 Consultation between the IMF and  
India concluded on 13 April 1960

1. The Government of India has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.
2. Agricultural output, which suffered a serious setback in 1957-58, recovered in 1958-59, and was higher than in 1956-57. The 1959-60 crops are expected to be at about the same level as in the previous year. Industrial production, which rose only slightly in 1958, resumed a satisfactory rate of growth in 1959. Several industries recorded important gains. There appears to be a suitable climate in India for private foreign investment.
3. Over a period of years, the increase in money supply has been moderate relative to the rise in real production. But, during 1956-57 to 1958-59, the rise in money supply has been somewhat larger than the rate of growth in real national income. Budgetary deficits, met by recourse to bank credit, have been the chief expansionary factor. While deficit financing has been reduced from the high level of 1957-58, it remains substantial. In contrast to 1958, bank credit to the private sector increased in 1959 but there has been no undue expansion. The rise in prices noted after March 1958 continued during the greater part of 1959.
4. In November 1958, total Plan outlay in the public sector for the five years of the Second Plan (April 1956 - March 1961) was reduced from the original estimate of Rs 48 billion to Rs 45 billion; in real terms, the reduction was larger. There has been a steady step-up in development outlays, and it seems likely the revised Plan will be more or less fully implemented. There will be need both for augmenting domestic resources and for substantial external assistance.
5. India's balance-of-payments position continues to be difficult although in 1958-59 there was some improvement. The current account deficit was smaller than in the previous year, primarily due to lower imports. With larger external assistance, the draft on foreign exchange reserves was much less than in 1957-58. Export earnings continued to decline in 1958-59. On the basis of the trends in the fiscal year 1959-60, it seems likely that exports will show some rise during the year, and it is expected that there will be little further reduction in reserves. Continued efforts to expand export earnings are appropriate.

6. Restrictions on imports and import payments continue to be severe. Discrimination against dollar transactions has been completely eliminated in the licensing of imports and with respect to payments for invisibles. The Fund welcomes this action. The tendency to use bilateral payments arrangements has been on the increase. The Fund believes that the use of such arrangements should be reduced to the fullest extent possible.

7. In concluding the 1959 consultations, the Fund has no other comments to make on the transitional arrangements maintained by India.