GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/W/128

5 October 1989

Limited Distribution

Committee on Balance-of-Payments Restrictions

1989 CONSULTATION WITH INDIA UNDER ARTICLE XVIII:12(b)

Background paper by the Secretariat

I. Introduction

1. India has consulted regularly with the CONTRACTING PARTIES on its balance-of-payments restrictions, initially under Article XII, and, since 1960, under Article XVIII, section B (see BISD 8S, page 74, paragraph 3). Full consultations have been held in 1960, 1962, 1964, 1967, 1969, 1973, 1978 and 1987; simplified consultations under the procedures introduced in 1972 (BISD 20S/47) have been held in 1975, 1977, 1980, 1982, 1984 and 1986.

2. At the full consultation held in 1987, it was felt that, in the light of the in-depth discussions which had taken place and in view of the expected announcement regarding India's import-export policy, the next consultation with India should be a full consultation.[1] India took note of this feeling (BOP/R/168, paragraph 43).

II. India's trade régime: developments since the last full consultation

3. India has regularly replied to the Questionnaire on Import Licensing (most recently in L/5640/Add.7/Rev.3 of January 1989). As a signatory to the Agreement on Import Licensing Procedures, India has made copies of Import and Export Policy documents available for consultation in the Secretariat. A list of the CCCN headings covered by import licensing in India is contained in the Secretariat's analyses in 1987 and 1989 of the documentation supplied to the Technical Group on Quantitative Restrictions and Non-Tariff Measures (NTM/(TG)/W/3 and W/5). Because India's most recent Import Policy document is not classified by CCCN or HS, it has not been possible for the Secretariat to bring up to date this analysis (see NTM/W/6/Rev.5, page 26).

4. Since the last consultation, although a strong and complex structure of regulation remains in place, the process of easing and liberalizing import controls has continued. India's import control structure is of long standing and reflects many historical and economic factors, including the structure of industrial licensing which was created to promote domestic development on a basis of import substitution combined with export

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[1] The full text of the summary and conclusions of the 1987 meeting is reproduced in Annex 1.

promotion. The objectives of the current Five-year Plan, 1985/86-1989/90, implied a higher growth rate of exports and a reorientation of imports. Exports of industrial products, including engineering goods, clothing, gems and jewellery products were planned to grow most rapidly. The transformation of India's industrial structure towards greater export orientation which this was intended to encourage required an easing of supply constraints through greater liberalization of imports of capital goods and industrial materials, as well as easier access to markets both in developed and other developing countries.

5. The three-year import policy structure introduced in 1985 to provide greater stability in policies was continued with a second three-year import programme for the period April 1988-March 1991. Within the programme, modifications have been made from time to time to correct anomalies and in response to the changing economic situation; the movement has generally been in the direction of easing trading conditions. The period of validity of individual import licences remains at twelve months. Import licence availability remains in many cases linked either to the non-availability of competing domestically produced goods, or to export performance. The evolution of the system is described in paragraphs 7 to 20 below.

6. India's balance-of-payments policy has generally continued to be cautious and prudent. So far, India has managed to avoid the serious debt problems facing many developing countries. However, a combination of rapid economic growth, problems related to drought in 1987/88, higher commercial borrowing, bunching of repayments of earlier loans, and higher levels of imports has led to a considerable drawing down of reserves since the last consultation, as shown in the "Economic and Trade Developments" section below.

The import licensing system

7. The statutory authority for import licensing in India is contained in the Imports and Exports (Controls) Act 1947 and the Imports (Controls) Order 1955, as amended up to date. Under the latter, all goods, classified by CCCN, are covered by import controls; imports are prohibited unless they are made under specific licence, customs clearance permit, Open General Licence, or under particular exceptions ("savings") laid down in Clause 11 of the Order. (These cover such things as central government imports, diplomatic and United Nations agency goods, duty-free shop supplies, goods in transit, passengers' baggage, personal or institutional imports for their own use (with specified exceptions), Indian goods for repair and re-export, certain temporary imports, and foodgrains imported by the Food Corporation of India.)

8. Import licensing policy was determined annually up to 1985, when for the first time a three-year Import and Export Policy document was issued covering 1985-88. A further three-year policy document was introduced in 1988 covering the period April 1988-March 1991.[2] The stated objective of

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[2]Annex 2 gives a summary of the items subject to import licensing in the current Import Policy Document, April 1988-March 1991.

the triennial policy has been to bring in continuity and stability of Import and Export Promotion policies. The Government, however, reserved the right to make any necessary amendments to the policy. Reports suggest that the movement towards greater liberalization has continued in 1988 and 1989.

9. Importers are classified as "Actual Users" (industrial or non-industrial), "Registered Exporters" and others. Importers must obtain code numbers from regional import licensing authorities; however, individuals importing goods for their own use, and central or State government departments, are exempt from this requirement. Applications for import licences must also be certified by the relevant sponsoring authorities (sectoral Ministries or the Ministry of Industry). These agencies certify the "essential" nature of the imports and give "indigenous angle" clearance where it can be shown that no adequate domestic substitute can be supplied in reasonable time. If these conditions are satisfied, the goods may be imported. Imports under OGL do not need to be cleared by the relevant sponsoring authorities, except where the industry concerned is subject to a programme of "Phased and Progressive Indigenization". The list of imports allowed under OGL has increased steadily over time. After 1987, the additional products added to this list include capital goods (136 items), raw materials components and consumables (more than 340 items), life saving equipment (209 items) and life saving drugs (108 items).

10. Raw materials, components, and consumables are classified as "Banned", "Restricted", "Limited Permissible", "Canalized" or "Open General Licence" products. The banned list is very short and contains animal fats and rennet banned for religious reasons. The two restricted lists contain chemical items, including some pharmaceuticals, insecticides and pesticides, engineering items, including some electronics products, some iron and steel products and certain categories of scientific and measuring instruments. The list of "limited permissible" items (Appendix 3 of the Import Policy Document) contains 667 defined products, some of which are extensively subdivided, comprising chemical and allied products, engineering and allied items, tools, and raw materials of iron, steel and ferro-alloys.

11. A number of bulk commodities and other goods remain "canalized" through specified governmental or semi-governmental agencies. The products currently canalized include paraffin wax, raw silk, silk worms, cotton, jute and sisal, various metals including copper, lead, nickel, platinum, palladium, zinc, pig iron, non-alloy and alloy steel items, certain chemicals, natural rubber, petroleum products, fertilizers, certain drugs, oilseeds and vegetable oils, newsprint, cereals and fatty acids and oils as well as cinema films and floppy disks. A large number of items have been de-canalized in the current Import Policy 1988-91.

12. The Import Policy Document states that "import [of raw materials, components and consumables appearing in the Restricted, Limited Permissible or Canalized lists] is sought to be made only to bridge the gap between demand and supply keeping in mind the external resources position".

13. The Open General Licence list of raw materials, components and consumables has been considerably expanded in the last few years. The categories of goods and eligible importers are set out in Appendix 6 to the Import Policy Document. As well as a general list of OGL items covering 40 broadly-defined categories (including all raw materials, components and consumables, personal computers, iron and steel items, and permissible spares not included in the restricted lists mentioned above), it includes gem and jewellers' machinery, equipment, testing apparatus, tools and implements; a wide range of medical, surgical, ophthalmic and dental equipment and drugs; books on educational, scientific and technical subjects; chemical, engineering, tools and allied products; iron, steel and ferro-alloys; products required for the manufacture of electronic items; and diving equipment.

14. Spares classified as "permissible" may be imported by actual users under OGL. "Restricted" spares may be imported by actual users at a rate of up to two per cent of the c.i.f. value of all imported plant, machinery or equipment and/or one per cent of the purchase price of any indigenous plant, machinery or equipment having imported components, installed as on 1 April of the licensing year, subject to individual product limits. "Emergency" spares (urgently needed in the case of actual or imminent breakdown of production equipment) may be imported whether or not local substitutes are available. Various special provisions also exist for import of motor vehicle spares, import of spares by Indian agents of foreign machinery or instrument manufacturers, computer spares, import of spares against capital goods licences, shipping companies, airlines, vehicle manufacturers, vehicle repair shops, consumer electronics service centres and consultancy, design and engineering firms.

15. Two lists of capital goods are established: those which may be imported under Open General Licence and those classed as restricted items. OGL capital goods can be imported freely, provided that the importing firm can certify that it is the "Actual User" of the equipment, and subject to domestic industrial licensing criteria relating, inter alia, to technology requirements, size of firm and anti-monopoly controls. For restricted items, individual import licences are required. Imports of other capital goods not appearing in either list are considered on their merits and require certification of "essentiality" by the sponsoring authority, indigenous clearance by the technical authority and approval by the relevant Capital Goods Committee. In addition, importers are required to put any purchases of capital goods valued over Rs.25 lakhs up for advertisement in specified trade journals: 45 days is given to indigenous manufacturers to make offers and only after that period may an import licence be applied for. However, imports of capital goods for use in the sectors of fertilizers, newsprint and paper basic drugs, basic technical material for pesticides and weedkillers, power generation and transmission, mining, petroleum, petrochemicals, professional grade electronic components, waste disposal and ecological engineering, ports materials handling, sugar, cement and asbestos, and integrated steel plant modernization, are open to global tenders by foreign and Indian bidders equally: successful Indian tenderers are allowed unrestricted import of raw materials and components for manufacture of the capital goods in question. Special procedures exist for import of agricultural and food processing machinery, diesel generating sets, printing machinery, sports

goods equipment and secondhand machinery. There has been a steady increase in the number of goods which can be imported under OGL, from 79 in 1976 when the OGL list was first introduced to 987 in late 1986 and 1,159 when the current policy was initiated. Some more were subsequently added to the list, raising the number of these items which can be imported under OGL to 1,280. Capital items remaining restricted in the 1988/91 policy include certain types of cinema machinery, jute mill machinery, printing, textile and textile testing equipment, and a variety of miscellaneous items ranging from air pollution equipment to staplers.

16. Particular provisions exist for imports of items for stock and sale, including dried fruits (excluding cashew nuts and dates), photographic films, ammunition, weedkillers and a list of miscellaneous products. Some of the items (e.g. photographic films and the goods in the miscellaneous list) can be imported under OGL by any person: others (e.g. dried fruits) are allocated to dealers on the basis of quotas related to past performance: still others (e.g. ammunition, pesticides) are allowed to licensed dealers or imported through a designated public sector agency.

17. Special facilities have been established in the 1988-91 import policy for imports by non-resident Indians or persons of Indian origin, including imports of capital goods, computer systems, raw materials or inputs for the establishment of new industries, and goods for the establishment of amusement parks. However, neither capital nor the profits from the operation of such enterprises may be repatriated.

18. As regards technologies, import and foreign investment are permitted where need has been established, technology does not exist within India, and the time taken to create it locally would delay the achievement of development targets. The Government may identify areas of high national priority where import or investment procedures would be simplified to ensure "timely acquisition" of the required technology. A Technical Development Fund, equivalent to the US$ equivalent of Rs.1.25 crores/year, has been established to cover the foreign exchange requirements for small scale but high-impact equipment imports, imported technical know-how, foreign consultancies, imports of drawings and designs and other inputs needed by industries for encouraging modernization and upgrading of existing technology with a view to facilitating output expansion and improving export capacity.

19. Imports of consumer goods by private individuals or companies are not generally permitted. However, substantial exceptions to this general rule exist for imports under passengers' baggage rules, for imports by Indian nationals returning or residing abroad, for imports of cars and other vehicles, and for imports of goods as gifts.

20. Foreign exchange for import payments is released automatically by an authorised bank on presentation of the exchange control copy of an import licence and the appropriate shipping documents. Licence holders may make payments either through letters of credit or through sight drafts; use of suppliers' credits and other long-term import credits is subject to prior approval by the Reserve Bank. Advance remittances of funds before shipping documents are submitted is only allowed in certain special cases such as deposits with foreign manufacturers for imports of machinery and equipment.

Export policy

21. The 1988-1991 Import and Export Policy sought to reduce the number and complexity of schemes for the encouragement of exports and to increase the effectiveness of existing schemes. In general, various provisions were been introduced aimed at giving export-oriented firms easier access to imported supplies; cash compensatory support schemes were extended, and tax reliefs provided, including duty drawbacks on imported products contributed significantly to alleviating the effect of high tariffs on export profitability. Export duties have also been eliminated for the majority of products and now remain in force only on [coffee, manufactured tobacco and hides and skins].

22. "Registered exporters" are defined as merchant exporters, manufacturer exporters and export or trading houses. Such enterprises are permitted to import, under the "Import Replenishment" scheme, specified amounts of particular goods which are regarded as essential imports required in the manufacture of the exported products or which can assist diversification. An extra 10 per cent is allowed if goods are exported on Indian vessels. Replenishment (REP) licences may be transferred by their holders to any other person. Moreover, they are now automatically endorsed for a certain degree of flexibility permitting import of limited permissible and canalized items with an extended range of export products qualifying for import replenishment. Domestic producers may also supply goods to purchasers against REP licences, in which case the sale is counted as an export by the supplier.

23. A number of domestic sales (e.g. sales of locally produced goods against "Duty free licences" issued under the Import-Export Passbook scheme, sales to international aid projects under competitive bidding or limited tender, supplies to units in free-trade zones, sales of certain items to foreign tourists)are counted as "Deemed Exports" and can count towards the grant of REP licences as well as other export performance benefits.

24. Firms registered as "Export Houses" or "Trading Houses" (determined on the basis of net foreign exchange earnings in a three-year base period) are eligible for "Additional" licences for restricted capital goods and for raw materials, components, consumables and tools otherwise available only to actual users under OGL, as well as other favourable import conditions. Additional licences issued to Export Houses and Trading Houses for the period prior to 1988/89 have been made freely transferable without actual user conditions.

25. Facilities for duty-free imports of inputs for goods to be exported by manufacturer-exporters, export houses, trading houses and (since 1988) by manufacturers having a three-year average turnover of Rs.15 crores or over, are available through the Import-Export Pass Book Scheme. Firms benefiting from this have to fulfil certain export obligations; on the other hand, they are eligible for extra "REP" import licences to the extent these obligations are fulfilled.

26. Special conditions exist for the establishment of 100 per cent export oriented industrial units in free trade zones and export processing zones:

goods supplied by firms in the domestic tariff area to firms in the zones are eligible for "REP" licences provided certain conditions are fulfilled. Goods manufactured in the zones may be sold in the domestic tariff area against valid import licences or OGL. Firms operating in the domestic tariff area, recognised as "100 per cent Export-Oriented Units", are entitled to import on duty-free terms many types of capital and intermediate goods. Such firms may also sell their goods within India against valid import licences or OGL.

III. Economic and trade developments

27. During the period 1986/87-1987/88, the Indian economy continued to grow steadily despite the severe drought of 1987/88[3] (Graph 1). The poor agricultural performance since 1983/84, due to unfavourable monsoons, was reversed in the last fiscal year when there was a record foodgrain production of 172 million tonnes. After its drought-related drop in 1987/88, industrial production is believed to have recovered last year to its growth rate of 1986/87, about 9.3 per cent. The annual inflation rate, as measured by wholesale prices (end of period), dropped to 6.8 per cent as of March 1989, following a 10 per cent rise the previous year (Graph 2). However, the consolidated budget of the Central and States Governments and Union Territories continued to show an estimated deficit of 10.8 per cent of GDP in 1988/89. Thus, there was some fiscal stimulus to domestic demand last year. In 1988/89, a sharp recovery in domestic demand from the low level of the previous year combined with the short-term effects of the ongoing trade liberalization programme undertaken by the government to bring about a further deterioration in India's trade balance. During the first three quarters of 1988/89, the trade deficit is estimated to have widened by nearly 40 per cent, compared to the same period of the previous year. Total reserves (excluding gold) dropped by 22 per cent during the last fiscal year (Graph 3).

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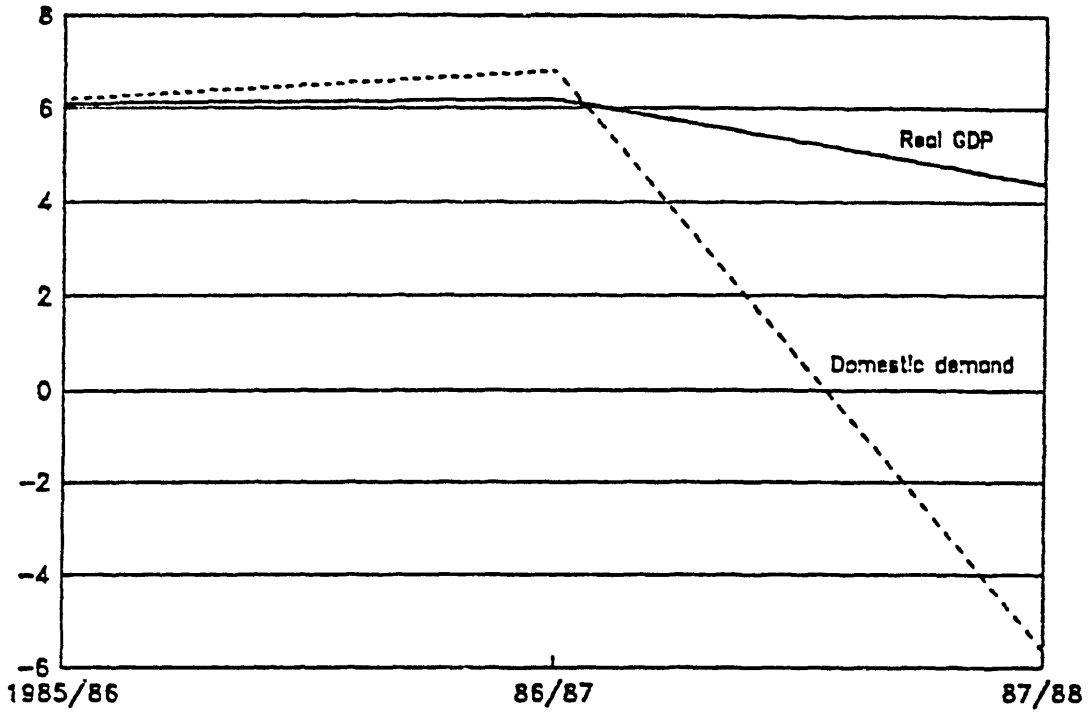
[3]The fiscal year is April 1-March 31.

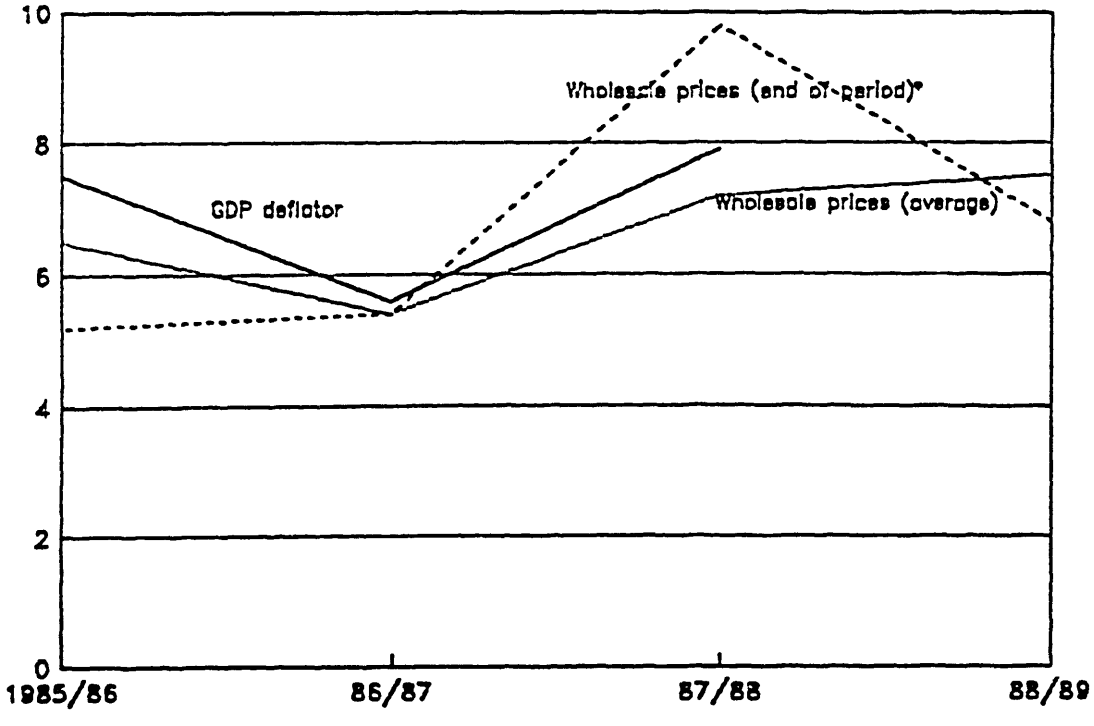
Graph 1

REAL GDP AND DOMESTIC DEMAND
(Annual percentage change)



Graph 2

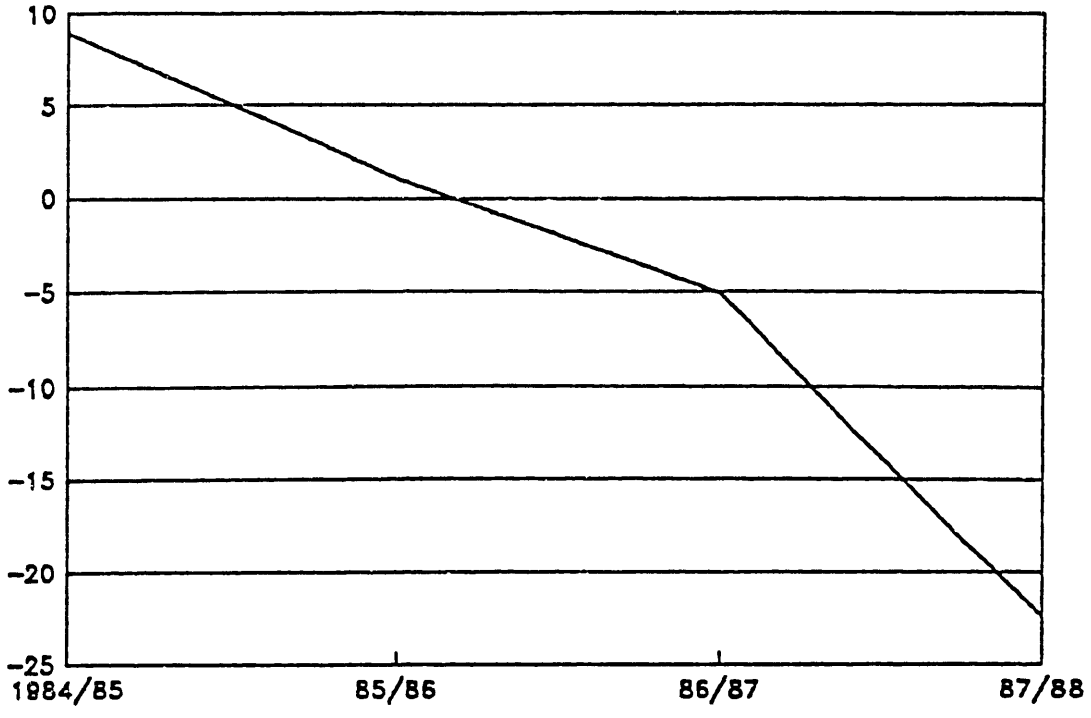
PRICE INDEXES
(Annual percentage change)



*Index 1980=100

Graph 3

INTERNATIONAL RESERVES
(Annual percentage change)



Source: IFS

Production, investment and savings

28. In 1987/88, the growth rate of GDP at market prices fell to 4.4 per cent after growth of 6.6 and 4.6 per cent in the previous two years. This was largely the result of the worst drought in recent Indian history. Despite the seriousness of the drought, the overall performance of the economy was better than in previous droughts. In the last fiscal year, output of goods and services recovered significantly and grew at an estimated 9.8 per cent. In 1988/89, agricultural production is expected to show a large recovery with a growth of some 20 per cent, while industrial production is expected to grow by over 9 per cent.

29. Gross fixed capital formation fell slightly dropped from 21.6 per cent of GDP in 1986/87 to 21.3 per cent in 1987/88. Although both private and public sector domestic capital formation showed the consequences of the drought, the major reduction came from the public sector, in an effort to keep overall outlays within budgeted limits in face of a rise in current expenditure. According to national sources, gross domestic savings declined from 21.6 to 20.2 per cent of GDP, primarily reflecting increased Central Government current expenditure. A reversal of this situation is expected for 1988/89, as the weather returned to normal. It is expected

that in 1988/89, the continuation of the financial liberalization programme will again help to raise the private sector savings rate by drawing resources into new assets offering a higher real return.

30. The agricultural sector of India contributes about 30 per cent of GDP. This sector showed a decline of 2.3 per cent in 1986/87, basically as a result of a poor monsoon. In 1987/88, rainfall was less than 80 per cent of normal levels in 60 per cent of the country. Despite the gravity of the drought, the fall in agricultural output was less than in previous droughts. Foodgrain production fell by 3½ per cent. Rice production declined by around 7 per cent while production of wheat was almost unchanged. Other crops affected by the drought were pulses, oilseeds, cotton, jute and sugar cane. The Government intervened to reduce the consequences of the drought on prices by drawing down foodgrain stocks by more than 50 per cent and raising procurement prices of wheat and rice by between 2 and 3 per cent, and minimum support prices for other agricultural commodities by 1 to 5 per cent. In 1988/89, the good rains along with the price changes, produced a strong recovery of agricultural production. Foodgrain production is estimated to have reached a record 172 million tonnes. This will enable India to add an estimated 20 million tonnes to its grain stocks. All crops but summer rice and coarse grains broke production records in 1988/89. There is, however, some stagnation in the production of most pulses. Production prospects for 1989/90 are good because of expectations of a second favourable monsoon year.

31. Indian industry has traditionally been regulated in an effort to promote the objectives of import substitution, a dominant rôle for the public sector in selective core industries, employment preservation and promotion of small-scale industry. However, since the mid-80's, the Government has aimed at increasing efficiency with a series of measures, including partial relaxation of import licensing; reduction in the coverage of monopoly legislation; simplification of administrative procedures for capacity expansion; increased export incentives; and new measures intended to attract foreign investment. After some slowdown in the pace of liberalization in 1987/88, significant changes have been made in 1988/89. These include: the halving of the number of industries requiring licenses to expand capacity; a further rise in the threshold for investment and foreign exchange outlays requiring a license; a further relaxation of government controls of the market activities of dominant companies; and steps to simplify the administration of industrial policy.

32. Industrial production grew by an estimated 9.1 per cent in 1986/87. The growth of the manufacturing sector was slightly larger. Despite the effects of the drought, industrial output grew by a robust 7.3 per cent in 1987/88, while the manufacturing sector grew by 7.9 per cent. Industrial output again grew by 8.8 per cent in 1988/89 aided by 9.4 per cent in electricity sector. During these two years fast growing industries were chemical and chemical products (15.1 per cent and 15.5 per cent respectively), other manufacturing industries (15.6 per cent and 11.1 per cent respectively), basic metals (6.9 per cent in both years), transport equipment (5.1 per cent and 12.8 per cent respectively) and rubber, plastic, petroleum and coal products (3.7 per cent and 8.9 per cent respectively). Output of cotton textiles was appreciably higher in 1988/89 by 46.2 per cent as against 5.3 per cent in 1987/88. The overall good

performance of industrial production is explained by the continuing reduction of the share of agro-based industries in total output, maintaining the availability of power to industry by augmenting thermal generation to make up the short-fall in hydro-electric generation and other government measures which have helped to maintain aggregate demand. Prospects for industrial sectors during 1989/90 are expected to be encouraging.

33. Despite these positive developments, there has been an increase in the number of firms which the Indian government has placed on its official sick firm list. The total bank credit to these units was about Rs.5,738 crores at the end of June 1987 with a growth rate of more than 16 per cent per annum between December 1983 and December 1986. In the six months to June 1987, the expansion was of 17.7 per cent.

34. In 1987/88, a continued rise in the consumption of petroleum products was offset by a rise in domestic production with almost no change in net exports. The growth of natural gas production slowed to 16.4 per cent in 1987/88 against a 21.2 per cent increase in the previous year, and preliminary figures for 1988/89 show growth of over 15 per cent. Coal production increased by 8.4 per cent in 1987/88, almost one percentage point more than in 1986/87; in the year 1988/89, production is estimated to have gone up by over 8 per cent. Electric power generation rose by almost 8 per cent in 1987/88 after a strong increase of more than 10 per cent the previous year, and the estimated growth for 1988/89 is some 9½ per cent.

Public finance

35. India's consolidated public sector deficit increased in the first part of the 80's, peaking in 1986/87 and 1987/88 at 10.5 per cent of GDP, largely due to the rising Central Government deficit (Table 1). Despite measures taken to increase revenue and reduce expenditure, the consolidated deficit for 1988/89 is reported to have increased to 10.8 per cent of GDP. The budgeted deficit for 1989/90 is marginally lower. Traditionally, the public deficit has been financed by the banking system, household savings deposited at financial institutions and other nonbank borrowing (Graph 4).

Table 1 - Summary of consolidated public finances, 1985/86-1988/89
(Billion rupees and percentages)

	1985/86	1986/87	1987/88	1988/89 Budget	1988/89 Est.
			(Billion rupees)		
Total revenue and grants	587.3	676.5	761.4	878.8	861.6
Tax revenue	(432.7)	(495.4)	(569.5)	(641.5)	(649.3)
Nontax revenue	(149.8)	(176.7)	(186.3)	(231.4)	(205.9)
Foreign grants	(4.8)	(4.4)	(5.6)	(5.9)	(6.4)
Total expenditure and net lending[1]	820.2	986.0	1 107.8	1 253.6	1 278.6
Development	534.0	637.8	699.5	781.1	...
Nondevelopment	305.6	370.1	436.9	496.7	...
Less: Loan repayments	-19.4	-21.9	-28.6	-24.2	...
Overall deficit (-)	-232.9	-309.5	-346.4	-374.8	-417.0
External financing (net)	13.7	19.4	25.5	31.5	24.1
Domestic financing (net)	219.2	290.1	320.9	343.3	392.9
Banking system[2]	(80.9)	(137.0)	(123.5)	(...)	(127.4)
Small savings[3]	(42.9)	(32.8)	(33.0)	(37.0)	(46.0)
Other[4]	(95.4)	(120.3)	(164.4)	(...)	(219.5)
			(Percent of GDP)		
Total revenue and grants	22.3	23.1	23.0	22.5	22.3
Total expenditure and net lending	31.2	33.6	33.5	32.5	33.1
Overall deficit (-)	-8.9	-10.5	-10.5	-10.0	-10.8

Source: IMF.

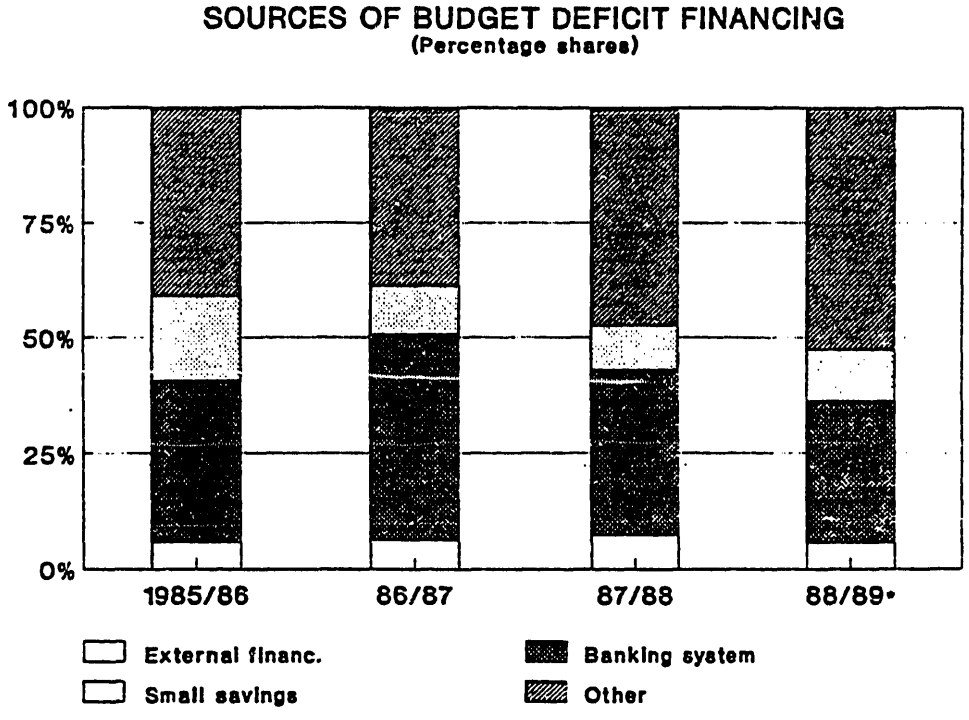
[1] Includes Plan expenditure by Central and State public enterprises financed from internal and extrabudgetary resources.

[2] Change in net credit to Central and State Governments.

[3] Includes post office deposits, national savings, and social security certificates.

[4] Market borrowing, provident fund deposits, and other miscellaneous capital receipts.

Graph 4



*Estimates

36. The Central Government budget deficit increased during the 80's peaking at 8.4 per cent in 1985/86. While in the year 1986/87 the deficit was reduced to 8.1 per cent, the revenue deficit (the excess of current expenditure over revenue excluding grants) widened to 2 per cent from 1.7 per cent the previous year. In 1986/87, the rise in the Central Government deficit despite higher than expected revenues, was due to increases in current and capital expenditures, notably on defence, interest payments and subsidies. In 1987/88, the deficit was reduced to 7.8 per cent of GDP, as the share of tax revenue in GDP grew moderately, while the share of government expenditure in GDP remained at the levels of the previous year. The share of interest payments in total government expenditure continued to grow, reaching 3.4 per cent against 3.2 in the previous year. To cope with the effects of the drought on the Central Government accounts, the authorities took additional emergency revenue and expenditure measures (i.e. increases in taxes, surcharges and fares, and cuts in fuel consumption, bonuses, and travel). Government capital expenditure relative to GDP fell from its 1986/87. level. Interest payments and subsidies accounted for more than half of the budget overruns.

37. The 1988/89 Central Government budget aimed to eliminate the effects of the drought and to develop agriculture to meet the targets of production

of the Seventh Plan. The budget deficit was to be slightly below the level of the previous fiscal year. This was to be obtained through reductions in both current expenditure and revenue. Interest payments were the only expenditures item expected to grow. The 1988/89 budget introduced important changes in tax collection and expenditure. The Modified Valued Added Tax base was enlarged. Customs duties on textile machinery and on some raw materials for the production of machinery, capital goods and electronic products were reduced. Income tax deductions and ceilings were raised. Exports profits were exempted from income tax. Sectoral tax exemptions were provided. Revenue measures included a tax on wealth transfers, rises in indirect taxes on "luxury" items and the conversion of selected ad valorem customs tariff rates to specific tariffs.

38. Provisional data on 1988/89, show that revenues were slightly higher than expected despite much faster GDP growth than anticipated. Expenditure is reported to have been 3.5 per cent higher than budgeted. This was largely accounted for by expenditure on fertilizer subsidies and in the export subsidy. The overall deficit for 1988/89 grew to 8 per cent and the revenue deficit further rose to 2.7 per cent from 2.5 in 1987/88.

39. The 1989/90 budget of the central government seeks a reduction in the overall deficit to 7.3 per cent of GDP. It is expected a 14.5 per cent rise in revenue and grants, while expenditure and net lending is budgeted to increase by 9 per cent. The budget proposes a series of changes to direct and indirect taxes including the reduction in the starting rate of income tax for low level income and a surcharge on incomes above Rupees 50,000, the removal of the wealth and income tax surcharges introduced in 1988/89, and increases in taxes on many commodities and services. On the expenditure side, interest payments are expected to rise by 20 per cent and subsidies by 8.5 per cent. Total defence expenditure is cut by 1.5 per cent. As a result, the revenue deficit is expected to fall to 2.2 per cent of GDP.

40. The State Governments' budgetary position (according to IMF data) worsened in 1986/87 despite a substantial increase in grants received from the Central Government. Their share in income tax and excise tax was increased, but expenditure on interest payments, administrative costs, relief operations, education, public health and agriculture increased rapidly. In 1987/88, the budgetary position of the States again worsened, with a further rise in non-development expenditure and interest payments. The budget for 1988/89, called for the deficit to be reduced to 3.8 per cent of GDP from 4.3 the previous year. However, as Central Government grants and loans were higher than anticipated, the consolidated deficit is expected to be of about 4 per cent of GDP in 1988/89.

41. The Central Government dominates the coal, steel, petroleum, chemical, and fertilizer sectors. The railways, postal services, and telecommunications are Government departmental companies. State Government companies produce and distribute electricity and provide road transport services. State Government departmental companies deal with forestry, mining, irrigation and river projects. The number of Central Public Enterprises has risen by 36 per cent since 1980/81. Their net profits after tax have been growing since the mid-80's, but are still well below 1 per cent of GDP. In 1986/87, two-thirds of the increase in pre-tax

profits came from petroleum and petrochemical companies. However, the number of loss-making public sector companies increased from 90 to 100. Preliminary data for the first half of 1988/89 show that the number of profit making companies grew by 14 per cent over to the same period of the previous fiscal year. Recently, the Government has taken steps to increase the autonomy of the public sector companies including their investment decisions, personnel management and capital market borrowing. State Government public companies, have been traditionally unprofitable with losses of the order of 0.7 to 0.9 per cent of GDP. The 1989/90 budget estimates that the Central Government enterprises' deficit is to fall to 3.2 per cent of GDP.

Money and Credit

42. The Indian financial system comprises the Reserve Bank of India (RBI), commercial banks, specialized lending institutions and other nonbank institutions. The Government, in consultation with the RBI, determines annual targets for aggregate and sectoral credit expansion, although there has recently been some interest in targeting monetary aggregates. The instruments of monetary policy are the cash reserve ratio and an additional statutory liquidity ratio (SLR); the refinance policy by the Reserve Bank and bank lending guidelines; selective credit controls; and interest rate policy. Following the report by the Committee to Review the Working of the Monetary System (the Chakravarty Report) in 1985, measures have been taken to strengthen and liberalize monetary and financial markets.

43. Between 1983/84 and 1985/86, the annual rate of growth of the broadly defined money supply (M_3) fluctuated within a range of 16 to 19 per cent. In 1986/87, M_3 grew at 18.6 per cent against 15.9 per cent in the previous year (Table 2). The acceleration in the growth of demand deposits from a growth rate of 12.6 to 21.7 per cent was the result of buy-back operations initiated by public companies to finance investments. Net bank credit to Government was the main contributory factor, growing by 23.5 per cent. The relative higher yield on Government securities and stricter enforcement of the SLR accounted for the sharp rise in banks' holdings of Government securities. The net reserve bank credit to the Central Government (2.4 per cent of GDP) mainly reflected the Central Government deficit of 1986/87 according to Indian budgetary practices. The growth rate of bank credit to the commercial sector decelerated by more than two percentage points, to 14.4 per cent.

Table 2 - Selected factors affecting changes in money and quasi-money
(Percentage change)

	1985/86	1986/87	1987/88	1988/89*
Broad money (M3)	15.9	18.6	15.9	15.0
Selected sources of change in M3				
- Net bank credit to government	16.1	23.5	17.1	17.7
- Bank credit to commercial sector	16.7	14.4	13.5	10.7
- Banking sector's net non-monetary liabilities other than time deposits	19.9	17.6	11.4	5.2

*March 31 to January 13 1989.

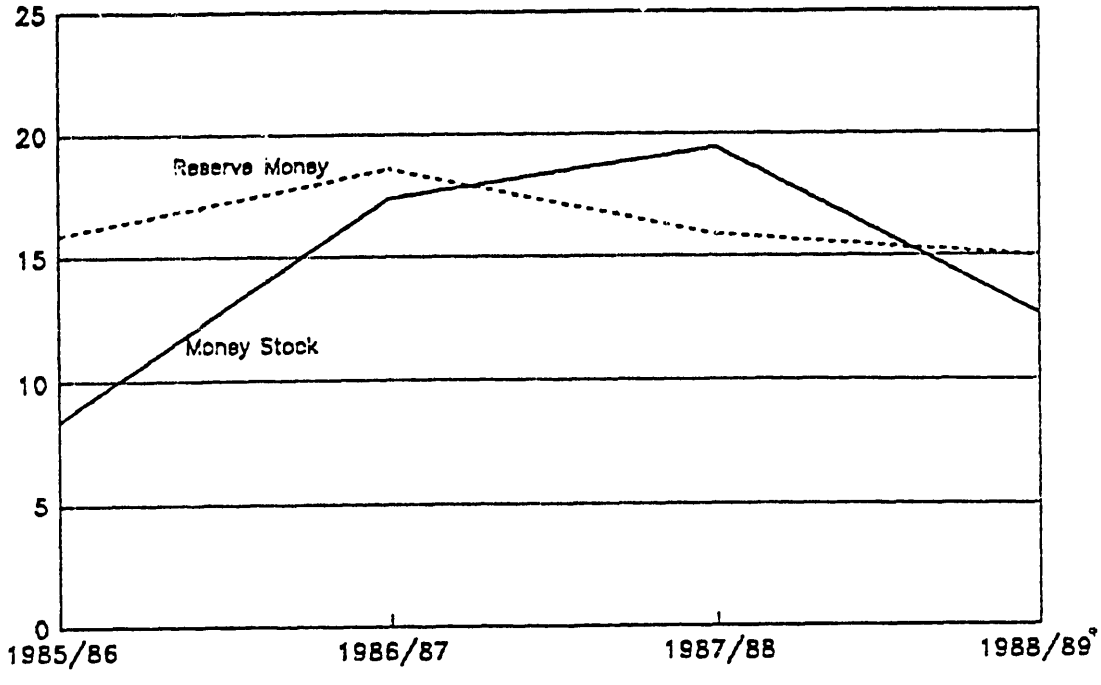
44. In 1987/88, monetary policy was used to reduce the growth of broad money to 15.9 per cent in order to prevent a worsening of inflationary pressures. The major factor behind this reduction was a decline in the growth rate of net bank credit to government, to 17.1 per cent from 23.5 per cent the previous year, reflecting a lower Central Government deficit. Bank credit to the commercial sector decelerated again to a rate of 13.5 per cent. The fastest growing component of M_3 was currency with the public (18.2 per cent against 13.3 per cent the previous year).

45. As of January 1989, the rate of growth of M_3 has been 15 per cent against 14.5 per cent during the same nine-month period of 1987/88. There was a significant acceleration of growth demand deposits (12.7 per cent against 6 per cent the previous corresponding period) and a reduction of growth in currency in the hands of the public. The modest increase in liquidity between April 1988 and January 1989 resulted from growth both in net bank credit to government and bank credit to the commercial sector (17.7 and 10.7 per cent, respectively, as against 16.6 and 7.1 per cent in the corresponding previous period). The Reserve Bank of India's credit to the Central Government was more than 28 per cent higher than the same period of the previous fiscal year, showing substantial fiscal strains on Government finances during 1988/89. Data provided by the Indian authorities indicate that in the full fiscal year 1988/89 broad money grew by over 17 per cent, with net bank credit to the government increasing by some 14 per cent and to the commercial sector by almost 18 per cent. In the current year i.e. 1989/90, M_3 has (also according to national sources) registered a growth of 6-7 per cent up to August 25, 1989 against a growth of 6.8 per cent in the corresponding period of 1988/89. Deposits with banks have risen by 7.3 per cent in this period compared with a slightly higher rise of 8.2 per cent in the similar period last year. Net bank credit to Government have grown by 12.3 per cent and bank credit to commercial sector by 3.1 per cent against somewhat lower growth of

11.2 per cent and 2.5 per cent respectively in the similar period of 1988/89. Net Reserve Bank credit to Central Government had also recorded a higher growth rate of 17.1 per cent as against 13.6 per cent in the corresponding period last year.

46. Traditionally, the growth of reserve money has been closely linked to the budget deficit. A large expansion of reserve money of the order of 19.4 per cent took place in 1987/88 as against an expansion of 17.4 per cent in 1986/87 (Graph 5). Net RBI credit to the Government accounted for about two-thirds of the growth in reserve money, as against 81 per cent the previous year. In 1988/89, the growth of reserve money is estimated to have been lower than in the previous year. However, showing again a deterioration in Government finances, net RBI credit to the Government accounted for the total growth of reserve money excluding non-monetary liabilities of the RBI.

Graph 5
CHANGES IN MONEY STOCK AND
IN RESERVE MONEY
(Annual percentage change)



*Up to January 1989.

47. The RBI influences the allocation of credit by commercial banks. Since the beginning of the decade it has instructed banks to allocate a larger share of credit to agriculture and small businesses. Bank lending to the food sector, which had grown up to 1986/87, has declined since then (attributed by the authorities to drawing down of foodgrains stocks by the public distribution system in 1987/88). Export credit has, by contrast,

grown steadily. Reserve Bank prior authorization is no longer needed before banks can release more credit to large industrial borrowers.

48. In 1986/87 and in 1987/88, outstanding commercial credit grew by 13.3 and 12.4 per cent respectively. In both years, food credit dropped by almost 8 and 56 per cent due to a drought-induced decline in the public foodgrain stocks in 1987/88. Credit to the priority sectors (including agriculture and small businesses) grew about 16 per cent per annum in 1986/87 and in 1987/88. The share of this sector rose to more than 41 per cent in 1987/88. Credit to medium- and large-sized industries (Credit Authorization Scheme) grew briskly by 14.7 and 15.9 per cent respectively in fiscal years 1986/87 and 1987/88. The Credit Authorization Scheme was considerably liberalized in July 1987. Credit guidelines up to September 1989, advised commercial banks to give food credit the highest priority. However, food credit declined by 14 per cent during the first quarter of 1988/89. In October 1988 the requirement of prior RBI approval of term loans and working capital credit was replaced by a Credit Monetary Arrangement under which proposals for large term loans and working capital credit over Rs.50 million are scrutinized export by the RBI; a system which appears to have eased loan approvals somewhat.

49. One key objective of monetary and credit policies has been to maintain a reasonably stable level of prices. The Government succeeded in reducing the rate of inflation, as measured by the wholesale price index (end of period), to 3.8 in 1985/86 (Graph 2). However, inflation increased again to 5.3 per cent in 1986 and doubled in 1987/88 to 10.6 per cent. However, substantially as a result of the drought-related policies, the inflation rate in 1987/88 was only half the inflation rate registered in the previous major drought. Administered prices of drugs, telephone and selective postal services, and railways fares were raised in early 1988/89. Nevertheless, the annual rate of inflation was brought down to 6.8 per cent during 1988/89.

50. Bank interest rates, which in India are set administratively, have remained relatively stable in recent years (Table 3). In 1987/88, rates on 5-15 year bonds were raised to 10-11 per cent. However, the Government continues to obtain a large part of its finance requirements through issues of 3-month treasury bills, which the banking sector purchases at the below-market rate of 4.6 per cent (unchanged since 1974).

51. Since 1987/88, the Government of India has undertaken a series of reforms of the financial sector following some of the recommendations of the Chakravarty Report and the Working Group on the Money Market. Some measures include the adoption of monetary targeting; the rising of the yield on longer-term government securities toward market levels; the auctioning of 6-month treasury bills and the rise in their yield since April 1988; and broader autonomy for commercial banks in lending operations. In addition, the Discount and Finance House of India was set up and mandated to deal in 6-month treasury and commercial bills in order to provide greater flexibility to companies and banks. In July 1988, it was authorized to participate in the interbank call money market. Also in July 1988, the National Housing Bank was created to promote specialized housing finance institutions. During 1988, new money market instruments were created in order to increase financing possibilities of banks and

companies. In May 1989, interest rate ceilings for call money, interbank term money, and discounting of commercial bills, were removed.

52. The administered interest rate structure, the high reserve requirements and the directives of the Government on lending to priority sectors, have resulted in low bank profitability. The Government has taken measures to reverse this trend, including an increase in the rates of returns on some assets, limiting the growth of bank staff, and increasing the capital base of public sector banks. Other institutional changes have reinforced the role of development finance institutions in export assistance, technology upgradation and rehabilitation of sick small-scale companies.

Table 3 - Selected interest rates, 1986/87-1988/89
(End of period; per cent per annum)

	1986/87	1987/88	1988/89
Reserve Bank of India			
Bank rate	10.0	10.0	10.0
Export refinance	9.0	9.0	9.0
Food refinance	11.5	11.5	11.5
Stand-by refinance	12.5	12.5	12.5
Discretionary	14.0	14.0	16.0
Commercial bank deposits[1]			
3-6 months	6.5	6.5	8.0
6-9 months	8.0	8.0	8.0
9-12 months	8.0	8.0	8.0
1-2 years	8.5	8.5	9.0
2-3 years	9.0	10.0	10.0
3-5 years	10.0	10.0	10.0
Over 5 years	11.0	10.0	10.0
Commercial bank loans			
Exports	9.5	9.5	9.5
Food	14.0	14.0	14.0
General	17.5	17.5	16.0[2]
Government obligations			
3-month treasury bills	4.6	4.6	4.6
Bonds-maximum yield	11.5	11.5	11.5
Private sector obligations			
Call money rate	10.0	10.0	10.0
Debentures-ceiling rate	15.0	14.0	14.0
Deposits-ceiling rate	15.0	14.0	14.0

[1]Deposits of 1-45 days currently yield no interest; deposits of 46-90 days yield 6 per cent interest as at September 1989.

[2]Floor rate.

Balance of payments

53. During the first half of the 1980's, India's current account deficit averaged 1.6 per cent of GDP. The trade deficit remained stable up to 1984/85 and the invisibles account recorded a sustained surplus. However, the external debt-to-GNP ratio (on a calendar year basis) rose from 11.1 per cent in 1980 to 16.3 per cent in 1984. As a result of current and past import substitution measures, there was reduced growth of import volume during this period. The Government took advantage of these developments to begin liberalizing the import regime. Nevertheless, export performance remained sluggish, as commercial policy continued to make the domestic market more profitable.

54. IMF data show that in 1985/86, the current account deficit widened to 2.8 per cent of GDP, declining again to 2.5 per cent in 1986/87 (Graph 6 and Table 4). Factors behind this development include the short-term impact of the import liberalization measures; a reduction in workers' remittances from abroad; and a further rise in interest payments on foreign debt. On a more basic level, attention should also be drawn to the drop in excess of private savings over private investment in 1985/86 and the widening of the excess of investment over savings in the public sector in the period 1985/86-1986/87. India's increasing financing needs were satisfied to a large extent by aid disbursements and inflows into nonresident bank accounts. The overall balance-of-payments surplus increased from some US$200 million in 1984/85 to almost US$850 million in 1985/86 and US$650 million in 1986/87. Gross reserves (excluding gold) grew to $6.7 billion in 1985/86 and remained at that level in 1986/87 (about 5.3 months of imports for each year). The total external debt was US$36.6 billion in 1985 and grew to US$41.3 billion in 1986, increasing the total external debt to GNP ratio from 17.2 per cent to 18.1 per cent (Graph 7). The ratio of total debt servicing to exports of goods and services jumped from 8.3 per cent in 1984 to 11.6 per cent in 1985 and to 15.2 per cent in 1986.[4]

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[4]Source: World Debt Tables, World Bank, 1988. According to IMF's accounting procedures, the ratio was 17.9 in 1984/85 and 30.6 in 1986/87.

Graph 6

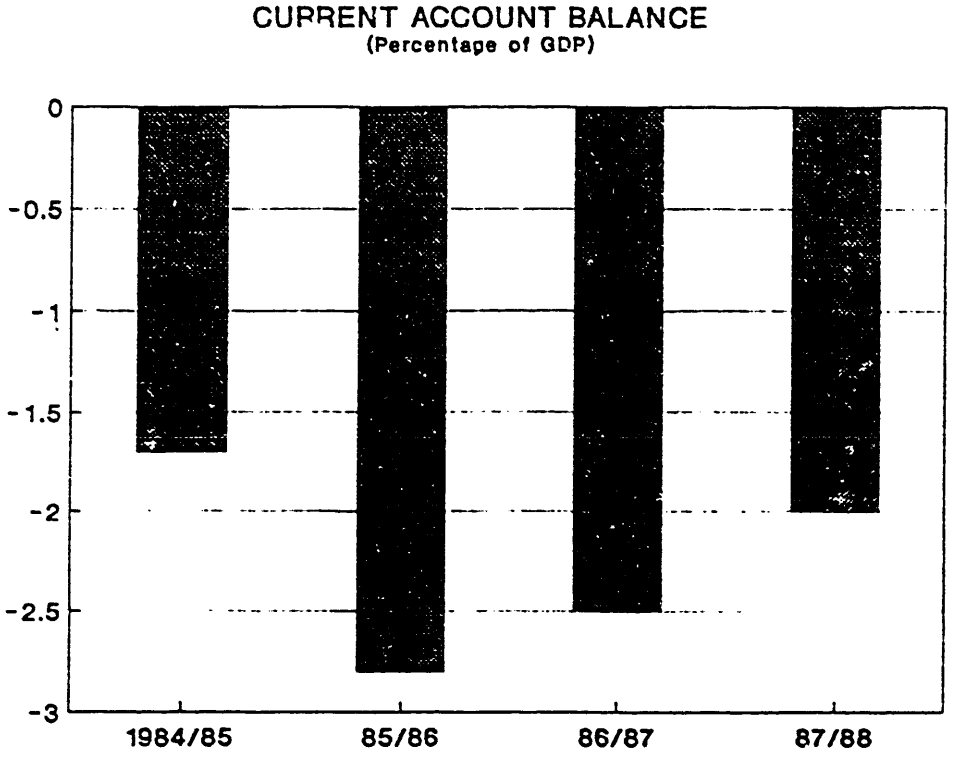

CURRENT ACCOUNT BALANCE
(Percentage of GDP)
0
-0.5
-1
-1.5
-2
-2.5
-3
1984/85
85/86
86/87
87/88

Table 4 - Balance of Payments, 1984/85-1987/88
(In millions of US dollars)

	1984/85	1985/86	1986/87	1987/88
Trade balance	-5,652	-7,838	-7,316	-6,847
Exports (f.o.b.)[1]	9,770	9,460	10,414	12,833
Imports (c.i.f.)[2]	15,422	17,298	17,730	19,680
of which: oil	(3,183)	(3,944)	(2,169)	(3,114)
Invisibles balance	2,372	1,935	1,571	1,785
- Nonfactor services	1,098	1,187	995	1,150
- Net investment income[3]	-1,251	-1,449	-1,779	-2,173
- Transfers	2,525	2,197	2,355	2,808
Current account	-3,280	-5,903	-5,745	-5,062
Capital account	3,481	6,751	6,392	5,691
Direct investment	62	160	208	251
Net aid	1,637	1,728	1,841	2,590
Loans	1,184	1,369	1,459	2,150
Disbursements	(1,643)	(2,027)	(2,390)	(3,351)
Amortization	(459)	(658)	(931)	(1,201)
Grants	453	359	382	440
Commercial borrowing	1,099	781	2,099	923
Disbursements	1,429	1,243	2,722	1,623
Medium- and long-term	(1,259)	(1,470)	(1,935)	(1,976)
Short-term (net)	(170)	(-227)	(787)	(-353)
Amortization	330	462	623	700
Private nonguaranteed borrowing	530	482	76	169
Bilateral arrangements	164	-136	-334	127
Nonresident deposits	747	1,434	1,607	1,742
Other capital (including errors and omissions)[4]	-759	2,301	895	-111
Overall balance	201	847	648	629

Source: IMF.

[1] Excluding crude oil exports.

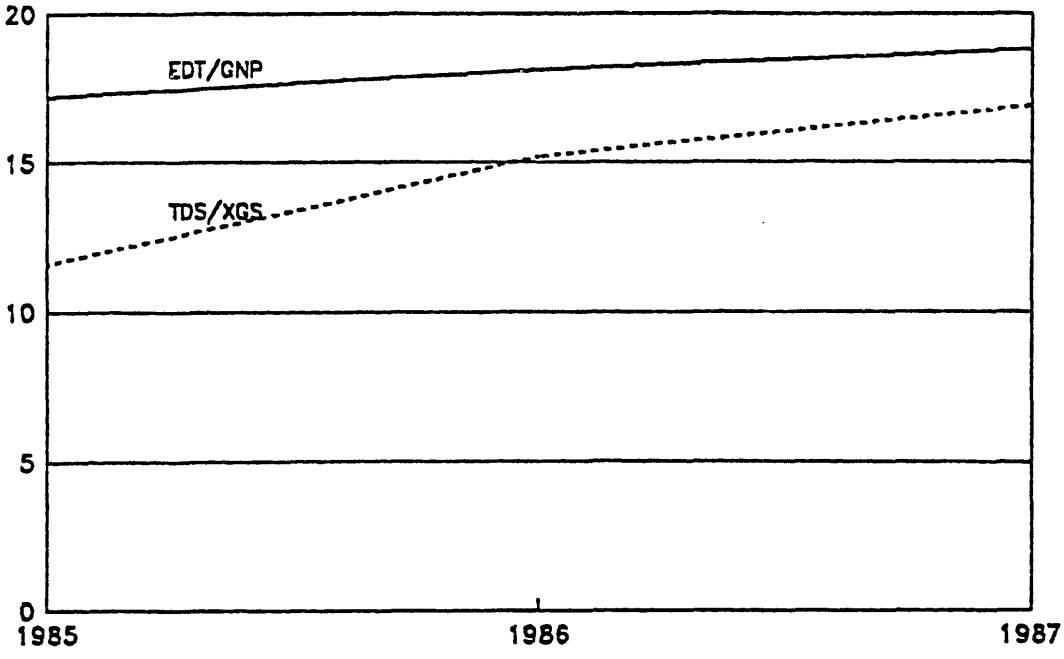
[2] Including net crude oil imports.

[3] Includes accrued interest on nonresident deposits.

[4] Also includes valuation adjustment on non-US dollar reserves.

Graph 7

EXTERNAL DEBT INDICATORS
(Percentage)



Note: EDT refers to total external debt; TDS refers to total debt service; XGS refers to exports of goods and services.

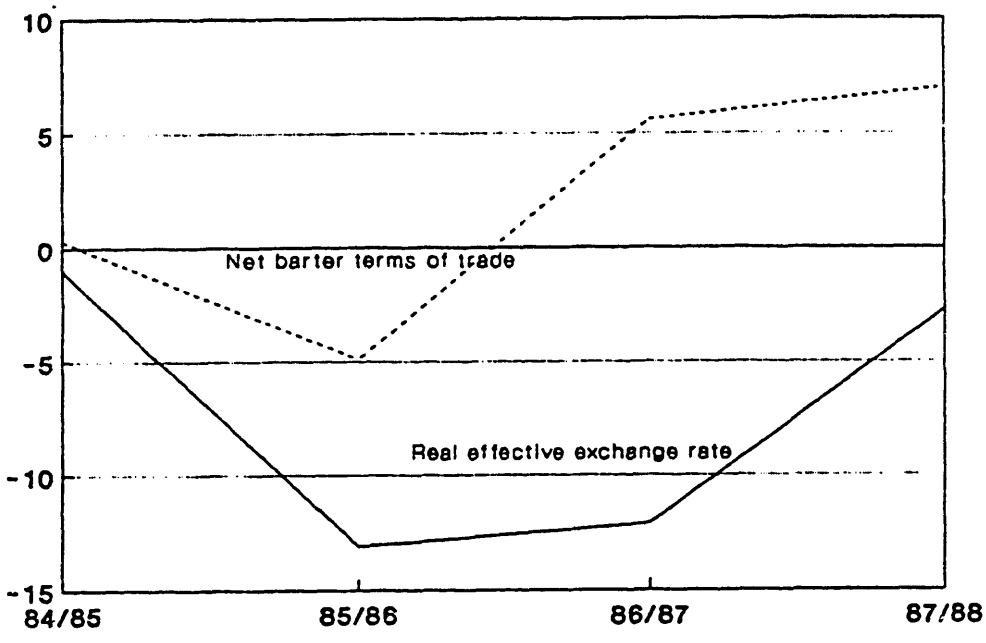
55. As a result of favourable developments in the terms of trade and in competitiveness during 1986/87 and 1987/88 (Graph 8), the trade deficit (on a customs basis) was reduced by 15 per cent in 1987/88. The current account deficit dropped to 1.8 per cent of GDP, according to IMF estimates. During 1987/88 tourist receipts and transfers offset interest payments, improving the invisibles balance. Disbursement of external aid rose by an estimated 40 per cent and nonresident deposits rose by about 8 per cent. The overall balance remained around the previous year's level. Reserves (excluding gold) slightly declined to US$6.4 billion (4.5 months of imports). The value of reserves is reported to have decreased further at the end of last fiscal year to around US$5 billion (just three months of imports).

56. IMF estimates show that India's total external debt, which stood at $52 billion at the end of the fiscal year 1987/88, increased further to $58.6 billion, or some 22 per cent of GDP, by the end of 1988/89. A

notable factor in the recent period has been the rapid growth in borrowing on commercial terms, which can be expected to affect India's debt servicing burden further in the future.

Graph 8

NET BARTER TERMS OF TRADE AND
REAL EFFECTIVE EXCHANGE RATE
(Annual perc.change;end period)



a. The merchandise trade account

57. Merchandise exports (on a BOP basis) grew more than 10 per cent in dollar value in 1986/87 after having declined by 3.2 per cent in the previous year; in 1987/88 they increased by 23.5 per cent. According to provisional national data available for 1988/89, export value rose by 25 per cent over the level for the corresponding period of 1987/88. On a customs basis, exports reached US$12,140 million in 1987/88 (Graph 9). The growth of export volume rose from 4.2 per cent in 1985/86 to 9.3 and 10.6 per cent in years 1986/87 and 1987/88 (Graph 10).

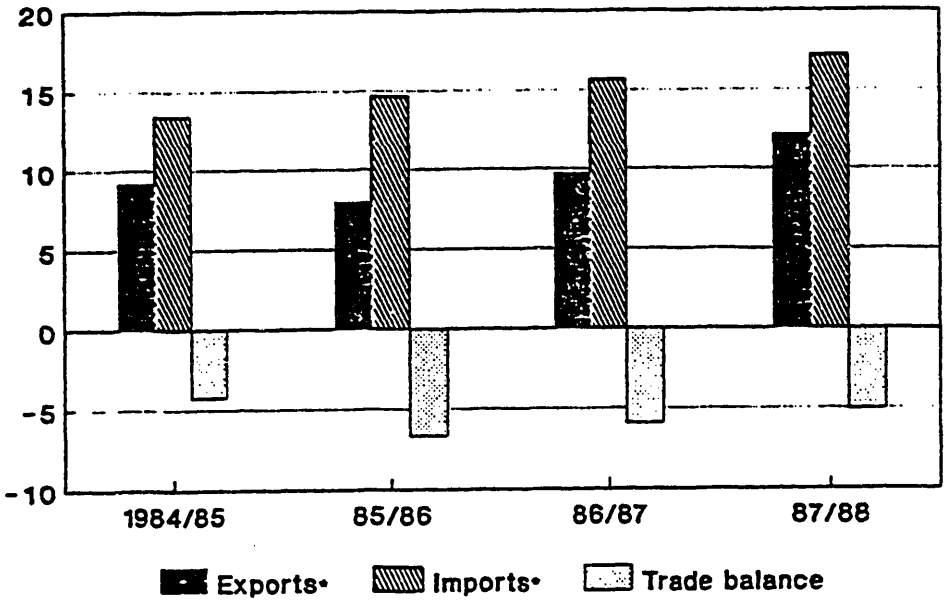
58. The value of imports grew by 2.5 per cent in 1986/87 and almost 11 per cent in 1987/88 (on a BOP basis). However, the drought led to an increase of almost 17 per cent in non-oil imports in 1986/87. According to national sources, preliminary figures for the period April-September 1988 show an increase in import value of 18 per cent compared to the same period of the previous year. The volume growth of Indian imports has consistently

declined from a peak of 14 per cent in the year 1985/86 to 7.5 per cent in 1986/87 and 6.6 per cent in 1987/88 (Graph 10).

59. The reduction in the trade deficit between 1985/86 and 1987/88 results from various internal and external causes, including a significant rise in India's terms of trade and a substantial gain in price competitiveness during the years 1986/87 and 1987/88 (Graph 8); and the payoff of incentives for exporters (i.e more generous drawback and cash compensatory arrangements; lower interest rates on export credit and more competitive access to raw materials and capital equipment because of lower tariffs). Preliminary national data up to September 1988 show an increase of 30 per cent in the merchandise trade deficit over the corresponding period of the previous year, due to a surge in imports (despite falling oil prices and reduced imports of fertilizers and vegetable oil).

Graph 9

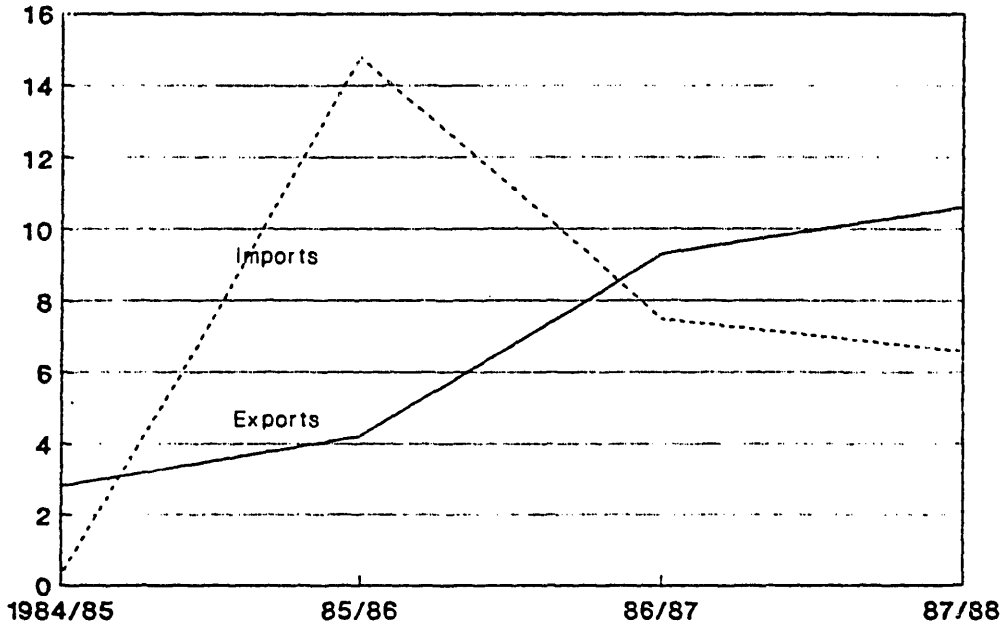
VALUE OF MERCHANDISE TRADE,
1984/85-1987/88
(Billion US dollars)



*Customs basis

Graph 10

VOLUME OF MERCHANDISE
IMPORTS AND EXPORTS, 1984/85-1987/88
(Annual percentage change)



60. In 1988/89, manufactures represented more than two-thirds of Indian merchandise exports (see Table 5, where the product categories are ranked in descending order of their growth rates in 1988/89). According to preliminary data the fastest growing sectors in 1988/89 were chemicals, spices, gems and jewelry, engineering goods, oil cakes and leather goods. Chemicals, gems and jewelry, and engineering goods accounted for 97 per cent of the growth of exports in that year. Agricultural exports declined in recent years as a result of bad weather conditions and growing internal demand. High quality rice is the only agricultural product showing a significant growth rate, except last year, following the impact of the drought on output.

Table 5 - Principal exports, 1985/86-1988/89
(Million US dollars)

	1985/86	1986/87	1987/88	1988/89 Est.	% change 1988/89 over 1987/88
Chemicals	406	456	635	1,059	66.8
Spices	227	218	238	359	50.8
Gems and jewelry	1,228	1,622	2,015	2,984	48.1
Engineering goods[1]	734	886	1,105	1,556	40.8
Oil cakes	110	148	134	169	26.1
Leather and leather goods	629	721	886	1,079	21.8
Iron ore	473	427	419	468	11.7
Fish and fish preparations	334	422	405	434	7.2
Textiles and manufactures	872	1,041	1,382	1,410	2.0
Rice	160	154	250	235	-6.0
Jute goods	214	191	187	170	-9.1
Tea and mate	512	451	457	389	-14.9
Coffee	217	232	203	166	-18.2
Tobacco	112	113	84	66	-21.4
Cashew kernels	184	256	236	176	-25.4
Other goods	2,492	2,400	3,502	3,311	-5.5
TOTAL	8,903	9,738	12,138	14,031	15.6

[1]Including iron and steel.

61. According to preliminary data, imports of foodgrains, fertilizers, chemicals and gems were the fastest growing categories of imports in 1988/89 (see Table 6, where the product categories are ranked in descending order of their growth rates in 1988/89). Foodgrains' imports rose significantly in 1988/89 due to shortages caused by the drought and restocking. The recovery of the economy and further import liberalization mesures, were reflected in a rise in machinery and transport equipment and iron and steel (this effect was also evident in fertilizers). Imports of edible oils dropped in 1988/89, once the shortages of domestic production of the previous were reduced. Imports of petroleum and petroleum products also fell due to the drop in world market prices (import volume rose by 9 per cent). However, they still represented the second longest item in the import bill.

62. The direction of merchandise trade shows that between 1984/85 and 1987/88 there has been a shift towards trading with the European

Communities and Japan as against North America (imports) and Eastern Europe and the USSR (Table 7 and Graph 11). Merchandise exports to the European Communities represented 25 per cent of Indian exports in 1987/88, as against 17 per cent in 1984/85. The share of merchandise exports to North America grew from 16 per cent to 20 per cent during the same period. A similar change but in the opposite direction affected merchandise exports to Eastern Europe and the USSR. With respect to merchandise imports, the share of the European Communities increased from a quarter to almost a third (Table 7 and Graph 12). The share in merchandise imports of Eastern Europe and the USSR dropped by almost 40 per cent between 1984/85 and 1987/88.

Table 6 - Principal imports, 1985/86-1988/89
(Million US dollars)

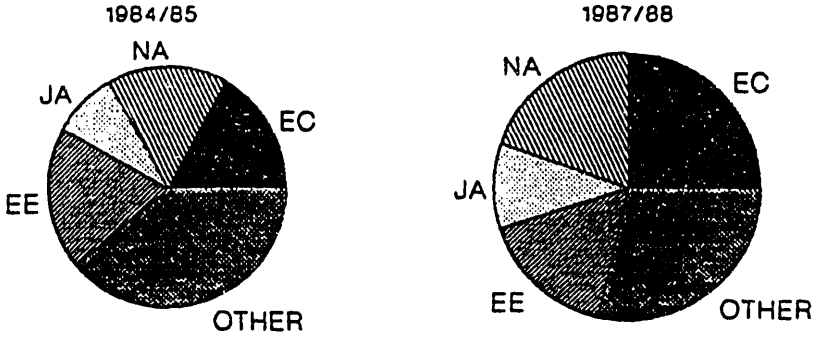
	1985/86	1986/87	1987/88	1988/89 Est.	% change 1988/89 over 1987/88
Foodgrains	90	37	25	410	1540.0
Fertilizers	994	490	239	522	118.1
Chemicals	890	810	810	1,556	92.1
Gems	899	1,170	1,538	2,266	47.3
Non-ferrous metals	443	325	444	561	26.4
Machinery and transport equipment	3,337	4,120	4,731	5,921	25.2
Iron and steel	1,140	1,134	982	1,217	23.9
Petroleum and petroleum products	4,054	2,169	3,114	2,921	-6.2
Edible oils	601	479	709	660	-6.9
Other goods	3,616	5,064	4,679	3,828	-18.2
TOTAL	16,064	15,798	17,271	19,862	15.0

Table 7 - Direction of merchandise trade
(Million US dollars)

Countries/Regions	1984/85		1985/86		1986/87		1987/88	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
European Communities	1,684.3	3,551.3	1,576.0	4,276.8	2,139.5	5,115.9	3,051.5	5,737.6
North America	1,595.8	1,850.7	1,720.9	2,055.0	1,930.5	1,831.2	2,373.4	1,797.1
Japan	866.0	1,043.2	951.5	1,449.6	1,043.2	2,001.2	1,245.2	1,634.4
Eastern Europe and the USSR	1,886.0	1,810.7	1,874.2	1,772.7	1,868.5	1,214.0	1,999.8	1,384.7
Rest of the World	3,847.5	6,158.6	2,780.1	6,509.5	2,756.9	5,636.0	3,468.0	7,489.1
TOTAL	9,879.6	14,414.5	8,902.7	16,063.6	9,738.7	15,798.5	12,138.0	18,042.9

Graph 11

REGIONAL PATTERN OF MERCHANDISE EXPORTS
(Percentage share)



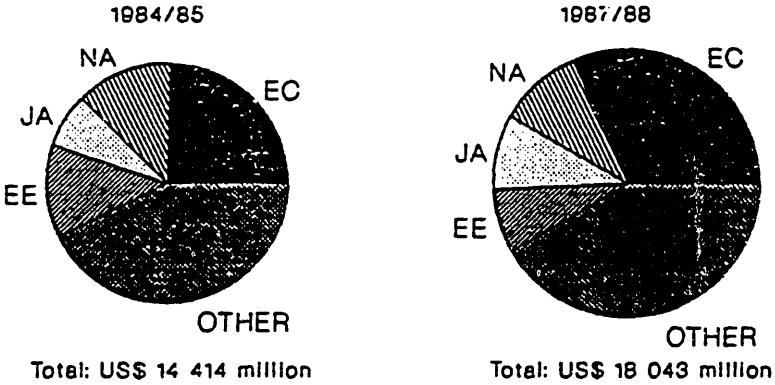
Total: US$ 9 880 million

Total: US$ 12 138 million

Note: NA refers to North America; EC refers to the European Communities; JA refers to Japan; EE refers to Eastern Europe and the USSR.

Graph 12

REGIONAL PATTERN OF MERCHANDISE IMPORTS
(Percentage share)



Total: US$ 14 414 million

Total: US$ 18 043 million

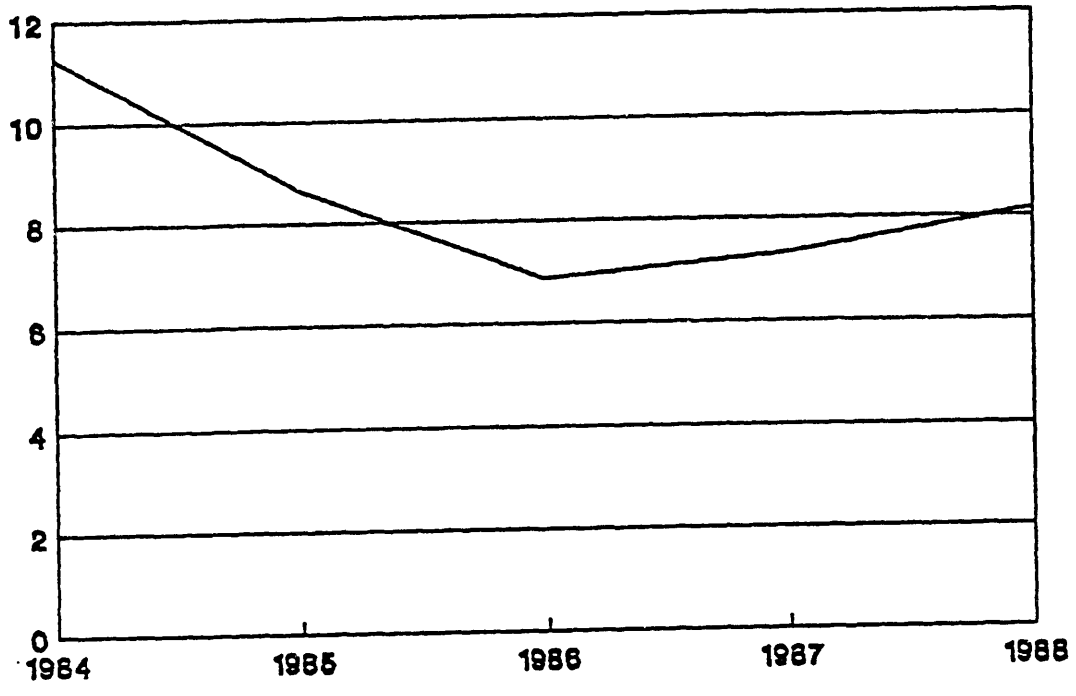
Note: See note to Graph 11.

b. The invisibles account

63. In 1987/88, net receipts from non-factor services increased by 15.6 per cent, resulting from a rise of 24.3 per cent in tourism credits which more than offset an increase in the transportation services deficit. The growth of the external debt and the rise in interest rates pushed up the net debit of investment income by 22.1 per cent (Graph 13). Private transfers - an estimated 50 per cent of which is composed of Indian workers' transfers - increased by 19.2 per cent. Overall, the net invisibles recorded a rise of 13.6 per cent.

Graph 13

LIBOR ON US DOLLAR DEPOSITS
6 months
(Percentage per annum; period average)



c. The capital account

64. Traditionally, India has received most of its financing in the form of official external assistance. However, the concessional component of foreign loans has been declining consistently (with the exception of 1987 inflows related to the drought). About half of external financing in 1987/88 was on commercial terms. These factors, together with large IMF repurchases, have increased debt service payments in recent years.

65. Net external aid grew by almost 41 per cent in 1987/88. Almost half of this growth was drought related. Another important component were disbursements from World Bank projects. At the same time, commercial

borrowing dropped by 5 per cent in 1987/88 after a rise of almost 170 per cent the previous fiscal year; amortization increased by about 12 per cent while disbursements dropped by 40 per cent.

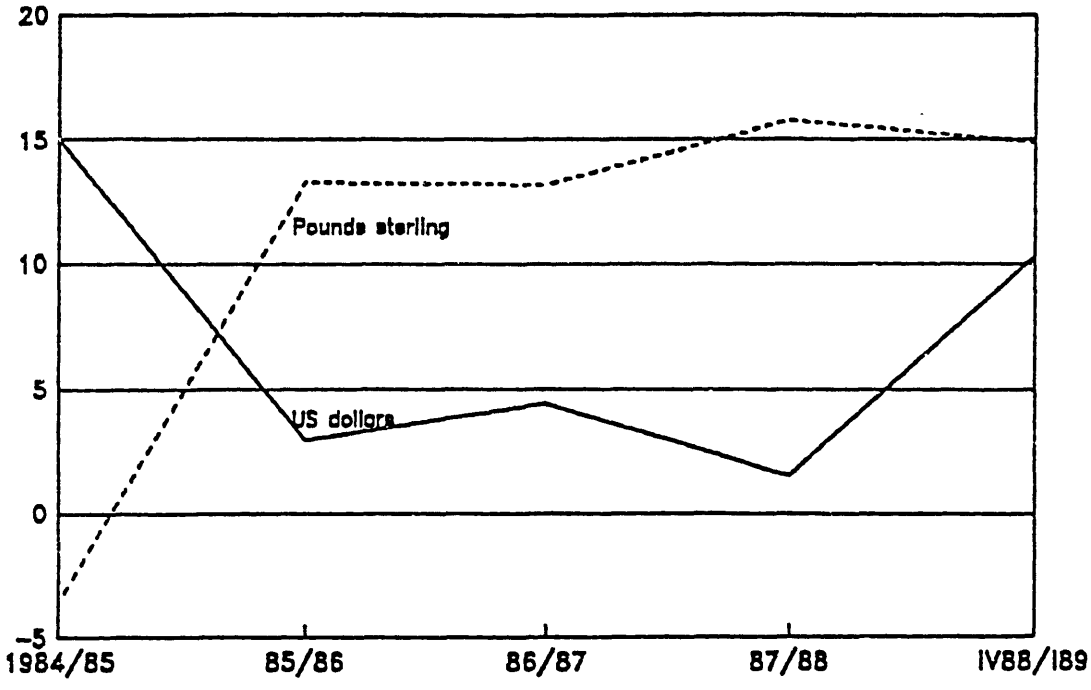
66. Inflows of nonresident deposits increased 8.4 per cent over the previous year. This was stimulated by the upward adjustment of interest rates on nonresident accounts in foreign currency with a view to maintaining a premium over the yield on international deposit rates. Those rates were increased twice since April 1987 to a range between 5.25 for the Japanese yen 6-12 months' account and 12 per cent for the pound sterling 2-3 years' account. Less frequent adjustment of interest rates on rupee accounts explains the steady decline of their share from 79 per cent in 1983/84 to 51 per cent in 1987/88.

d. The exchange rate system

67. India maintains a complex exchange rate system that affects notably direct foreign investment, nonresident deposits and payments for invisibles. There is a ceiling for foreign investment of 40 per cent of the equity of any company, with some exceptions for priority industries or export oriented industries. With respect to Foreign Resident Accounts, commercial banks are requested to clear all transactions through the Reserve Bank at predetermined spreads. Payments for invisibles require the Reserve Bank's approval.

68. The exchange rate of the rupee is fixed by the Reserve Bank of India in relation to a weighted basket of currencies of major trading partners within a margin of 10 per cent. The intervention currency is the pound sterling. After 1985/86, the rupee depreciated slightly against the weakening US dollar (Graph 14). Between April 1988 and January 1989 the rupee further depreciated on average by more than 10 percent against the US dollar while that currency depreciated against other major currencies. Between 1985/86 and January 1989 the rupee depreciated more than 57 per cent against the pound sterling. The real effective exchange rate of the rupee depreciated almost 30 per cent between April 1985 and March 1988.

Graph 14
RUPEES PER UNIT OF FOREIGN CURRENCY
(Percentage change; period average)



Note: an increase between two years indicates a depreciation of the rupee.

Annex 1
(BOP/R/168, paragraphs 36-43)

The Committee noted with appreciation that since the last full consultation, and particularly in the last few years, the direction of India's domestic and external policies had been towards greater liberalization of the economy. The introduction of a three-year framework for trade policies had brought about greater predictability and stability for economic operators. Both imports and exports had increased in dollar terms as a result of these policies. The Committee looked forward to the expected announcement of a new multi-year import and export policy in April 1988.

A number of Committee members expressed the view that the reserve position in relation to imports was relatively comfortable. Prospects for the evolution of the current account balance, taking into account such factors as the potential contribution of exports and of other elements such as remittances and tourism, were less clear, particularly in the light of the effects on the current account of the present drought and floods. The partial removal of policy-related disincentives to exports, as well as the exchange rate policies followed by India in recent years, had contributed to the growth of exports. Some members also stressed the need for continuing liberalization and removal of remaining disincentives to trade. India noted that reserves had declined over the last 2½ years, both in terms of SDR's and months of import cover. Further it noted that the rise in international oil prices, the continued decline in net invisible earnings, the progressive hardening in the terms of its external financing, the cumulation of debt service on past obligations and the substantial adverse consequences of the recent unprecedented drought and floods would continue to exert severe pressure on the balance-of-payments situation.

In view of the documentation placed before the Committee and the discussion which had taken place, some members did not accept the justification of India's trade restrictions on balance-of-payments grounds. Some members also suggested that Article XVIII:C might provide a more appropriate justification for the measures. Other members did not question the balance-of-payments justification for trade restrictions in present circumstances. One view expressed in this context was that the restrictions applied were greater than those necessary to restore the situation. India, recalling the reasons why its balance-of-payments position continued to be under severe strain, maintained that import restrictions were fully justified under Article XVIII, section B.

The Committee welcomed the reaffirmation by the representatives of India of their authorities' commitment towards internal and external liberalization. While stressing the need to monitor internal and external balances carefully, the Committee took note of India's assessment that fiscal and other domestic policies would maintain control of the internal balance. They drew attention to the combined effects of the existing adjustment policies and changes in exchange rates on India's export performance.

In discussion of the import measures applied by India, it was felt that there was a need for fuller and more up-to-date information, and some members requested India to notify complete lists of restrictions and quantification of the measures. Concerns were expressed regarding the complexity of administration of the Indian import system, simultaneous application of different measures, and a lack of proportion between the measures applied and India's balance-of-payments requirements. Members welcomed the market-opening measures already taken by India. There was also a general feeling that there was scope for further opening and greater transparency of India's import system. Further liberalization, as well as the maintenance of an appropriate exchange rate and balanced macro-economic policies, would contribute to the continuing competitiveness of India's trade. A further phased liberalization of imports thus appeared to some members both desirable and feasible.

It was noted that improvements in terms of access for Indian exports to world markets would also make an important contribution to improving the situation. Four sets of restrictions were cited by India as particular obstacles to export growth: bilateral agreements under the Multi-fibre Arrangement, anti-dumping and countervailing proceedings, taxes on coffee and tea, and competitive subsidization of foodgrain exports. The Committee noted that the CONTRACTING PARTIES had committed themselves to progress in these as well as other areas in the framework of the Uruguay Round and that negotiations to these ends offered the most promising means of facilitating the expansion of India's export earnings.

The Committee noted that a new import-export policy would be announced by India in April 1988, which it expected would be consistent with India's past efforts towards import liberalization and the progressive removal of restrictive measures. India was requested, in announcing the policy, to take full account of the provisions of paragraph 1 of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes, in particular sub-paragraph (c).

In the light of the in-depth discussions which had taken place and in view of the expected announcement regarding India's import-export policy, it was felt that the next consultation with India should be a full consultation. India took note of this feeling.

Annex 2
Items subject to import licensing in India, 1988-1991
(Source: India, Import and Export Policy, April 1988-March 1991)

Appendix	Category/Licensing classification		Product grouping	Number of items (1)
1	Capital Goods			
	Part A:	Restricted	Cinema Machinery	9
			Machinery for jute industry	24
			Mach. & equip. for printing presses	26
			Textile mach. other than silk/jute	63
			Textile testing equipment	7
			Misc. items	25
			Total	154
	Part B:	Open General Licence	Machinery for jute industry	24
			Mach. & equip. for printing presses	22
			Machine tools	151
			Machine tools for mfr. of ball & roller bearings	10
			Metrology & measuring instruments	17
			Testing machines	5
			Instrument testing & electronic equip.	11
			Mach. for mfr. garments/hosiery/made-ups	118
			Mach. for leather processing etc	224
			Dental equipment	4
			Cinema studio & film lab. equip.	50
			Tea industry machinery	9
			Mach. for mfr. electronic components	239
			Food processing machines	5
			Meat processing machinery	9
			Textile machinery	20
			Silk machinery	32
			Mach. for sea-food industry	23
			Packaging mat. mfr/ packaging mach.	23
			Transportation of frozen foods	2
			Dairy industry equip.	5
			Mach. for chemical industry	11
			Mach. for woollen industry	29
			Mach. for mfr. jewels incl. watch	18
			Mach. for mfr. spectacle frames	15
			Mach. for mfr. electric lamps	29
			Equip. for oil field services sector	48
			Mach. for writing instruments	10
			Mach. for mfr. electrical equip.	2
			Mach. for mfr. sports goods	28
			Mach. for mfr. bicycles & comp.	27
			Mach. for mfr. forged hand tools	10
			Misc. items	14
			Total	1244

(1) Where several codes are shown for one item, the number of codes has been used.

Appendix		Category/Licensing classification	Product grouping	Number of items
2		Raw Materials, Components, Consumables, Tools & Spares		
	Part A:	Banned	Tallow fats and oils	5
			Animal rennet	1
			Total	6
	Part B:	Restricted		
			Chemicals and allied items	158
			Engineering items	14
			Non-alloy steel	4
			Alloy steel	4
			Misc.	6
			Total	186
3		Raw Materials, Components, Consumables, Tools & Spares		
	Part A:	Limited permissible (other than iron and steel and ferro-alloys)	Chemical and allied items	697
			Engineering and allied items	200
			Tools	200
			Total	1097
	Part B:	Limited permissible (iron and steel and ferro alloys)	Non-alloy steel	11
			Alloy steel	14
			Ferro alloys	2
			Total	27
4		Capital goods Special Import Facility for manufacturers	Pressure vessels	Unspecified
			Heat exchangers	Unspecified
			Centrifuges and industrial separators	Unspecified
			Mixers	Unspecified
			Reactors	Unspecified
			Distillation columns	Unspecified
			Kilns and mills	Unspecified
			Misc.	Unspecified
5		Public sector agency canalization		
	Part A		Paraffin wax	1
			Silk	2
			Floppy disks	1
			Cinema film	1
			Jute, etc	4
			Chemical products	5
			Metal, scrap and waste	5
			Minerals and metals	14
			Non-alloy steel	6
			Alloy steel	8
			Steel	1
			Total	48

Appendix		Category/Licensing classification	Product grouping	Number of items
5		Public sector agency canalization		
	Part B		Petroleum products	28
			Fertilizers	18
			Drugs	3
			Films, feature and video	1
			Oils/seeds	9
			Newsprint	1
			Cereals	1
			Fatty acids and oils	14
			Total	75
6		Open General Licence		
	List 1		Gem & jewellery machines	131
	List 2		Life saving equipment	253
	List 3		Finished drug preparations	244
	List 4		Crude drugs	63
	List 5		Surgical instruments	8
	List 6		Dental equipment	428
	List 7		Books, educational scientific technical	160
	List 8	Part 1 Industrial	Chemical and allied items	651
			Engineering and allied items	449
			Non-alloy steel items	25
			Cladded and composite steel	19
			Ferro-alloy items	1
		Part 2 General	Items for use, stock and sale	105
	List 9		Ophthalmic equipment	45
	List 10		Materials etc for mfr electronic items	31
	List 11		Diving equipment	18
			Total	2631
7		Products under OGL No. 4/88		Unspecifi
8		Scientific and measuring instruments Restricted		36
9		Spares for after-sales service imported by eligible manufacturers		25
10		Spares Restricted		9
11		Sports goods and equipment		20
12		Exports Ineligible for REP licences etc		9
13		Conditions for duty exemption for products imported for use in export production or for aid-related projects		
			Engineering products	70
			Chemicals and allied products	221
			Plastics	3
			Leather, leather goods & other animal	7
			Sports goods	2
			Fish and fish products	3
			Foods	2
			Handicrafts	2
			Textiles, hosiery & knitwear	48
			Gem & jewellery	2
			Total	360

Appendix		Category/Licensing classification	Product grouping	Number of items
14A		Import-export pass-book scheme		
	Part A:	Engineering goods:	Ferrous manufactures	24
			Aluminium semis	1
			Non-ferrous semis	5
			Electrical mach & equip	20
			Electronic & telecom equip.	2
			Machine tools	1
			Hand tools	6
			Int combustion engines, pumps etc	3
			Industrial machinery	4
			Motor vehicles	4
			Railway equipment	2
			Water transport equipment	3
			Misc. engineering goods	22
	Part B:	Chemical and allied products:	Chemicals and chemical products	28
			Drugs	17
			Dyes	3
			Pesticides	3
			Toiletries	16
			Paints	22
			Matches, fireworks, and explosives	4
			Ceramic products	7
			Glass and glasswear	8
			Asbestos and cement products	2
			Wood products	3
			Rubber manufactures	12
			Paper, paper products and stationery	12
	Part C:	Plastics:	Raw materials	2
			Manufactures	28
	Part D:		Leather and other animal products	13
	Part E:		Sports goods	8
	Part F:		Fish and fish products	7
	Part G:		Foods	51
	Part H:		Handicrafts	10
	Part I:		Cashew kernels	2
	Part J:		Tobacco and tobacco products	6
	Part K:	Textiles:	Cotton textiles	1
			Woollen textiles	8
			Natural silk	6
			Mixed/blended textiles	13
	Part M:		Coir products	3
	Part N:		Natural fibre products	2
	Part O:		Readymade garments	14
	Part Q:		Stainless steel products	3
			Total	411
14B		Conditions for use of import-export pass-book scheme		
14C		Sensitive items for purposes of pass-book scheme		15
15		Products under OGL Nos. 19/88 to 22/88		Unspecified
16		Products under OGL Nos. 23/88 to 26/88		Unspecified

Appendix		Category/Licensing classification	Product grouping	Number of items
17		Import replenishment for registered exporters		
	Part A:	Engineering goods:	Ferrous manufactures	23
			Aluinium semis & manufactures	1
			Non-ferrous semis & manufactures	6
			Electrical machinery & equipment	16
			Electronic & telecom. equipment	2
			Machine tools	1
			Hand & small tools	6
			Int. comb. engines, pumps & compressors	1
			Industrial machinery	3
			Motor vehicles	5
			Railway equipment	2
			Water transport equipment	2
			Light eng. goods & all other eng. mfrs.	20
			Miscellaneous	1
	Part B:	Chemicals and allied products:	Chemicals and chemical products	28
			Drugs	18
			Dyes	3
			Pesticides	3
			Toiletries	16
			Paints	22
			Matches, fireworks, and explosives	4
			Ceramic products	7
			Glass and glasswear	8
			Asbestos and cement products	2
			Wood products	3
			Rubber manufactures	13
			Paper, paper products and stationery	12
			Miscellaneous	1
	Part C:	Plastics:	Raw materials	2
			Manufactures	26
	Part D:		Leather and other animal products	11
	Part E:		Sports goods	12
	Part F:		Fish and fish products	7
	Part G:		Foods	51
	Part H:		Handicrafts	9
	Part I:		Cashew kernels	2
	Part J:		Tobacco and tobacco products	6
	Part K:	Textiles:	Cotton textiles	1
			Woollen textiles	7
			Natural silk	6
			Mixed/blended textiles	7
	Part L:		Cinema films	5
	Part M:		Coir products	3
	Part N:		Natural fibre products	2
	Part O:		Readymade garments	14
	Part P:		Gem & jewellery	26
	Part Q:		Stainless steel products	3
	Part S:		Misellaneous	5
			Total	434
		Total for all appendices		6787