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GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

1991 CONSULTATION WITH INDIA UNDER ARTICLE XVIII:12(a)

Background paper by the Secretariat

This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes, adopted by the CONTRACTING PARTIES on 28 November 1979 (BISD 26S/207).

I. Previous consultations with India

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, 1987 and 1989: 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 last full consultation under Article XVIII: 12(b), held in October 1989, the Committee noted that India's balance-of-payments and reserves position had deteriorated markedly since the last consultation, due to a number of factors including the effects of rapid economic growth on the demand for imports and a sharp rise in debt repayment obligations. It noted that future pursuit of more rapid growth in India's economy was likely to imply continuation of pressures on the balance of payments. It took note of the view expressed by the IMF that control of fiscal deficits, monetary restraint and a supportive exchange rate policy would be necessary to contain any further deterioration in the external position without intensifying import restrictions, and recognized that these efforts would need to be complemented by adequate aid flows and access to markets. The Committee welcomed the steps being taken by India, despite growing difficulties, to liberalize and expand trade, including the easing and rationalization of import and export regulations and procedures. It noted that the structure of restrictions remains broad and complex, and encouraged the Indian authorities to continue as vigorously as feasible the process of simplification and liberalization, bearing in mind the provisions of the 1979 Declaration.

3. The Committee also noted that the Indian authorities were in the process of improving the transparency of import policy by drawing up a

detailed schedule of import restrictions on a tariff line basis, according to the Harmonized System. The Committee, welcoming this development, invited India to notify such a list to GATT as soon as possible. The Committee took note of all the points made regarding elements relating to the need for access for India's exports, under paragraph 12 of the 1979 Declaration. It recognized that the Uruguay Round negotiations remained the most appropriate forum within which the problems raised by India should be resolved.

4. Subsequently, at a meeting in March 1991, some members of the Committee took note of new restrictions notified by India in L/6765. These restrictions had, in their view, intensified the overall level of India's import restrictions substantially and merited the holding of a consultation during 1991 pursuant to Article XVIII:12 (a).[1]

5. Following further informal discussion, it was agreed by the GATT Council that a consultation under Article XVIII:(a) would be held in November 1991 according to the normal procedures for full consultations.[2] (C/M/249). In November, however, the consultation was postponed to March 1992 due to the constraints of the Uruguay Round (BOP/R/196).

II. India's trade régime: General background and recent developments

Introduction

6. Trade policy in India has historically reflected its import substitution strategy, together with structural problems in the field of balance of payments. This has involved extensive protection of domestic industry complemented by export promotion.

7. Changes in trade policy since the mid-1980s have attempted to impart greater continuity and stability to trade policy by announcing it for three years; provide quicker and easier access to inputs by making more items available under Open General Licence; provide further incentives for exporting; encourage greater efficiency in import substitution; facilitate technological upgrading and modernisation; and gradually substitute tariffs for quantitative restrictions.

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[1]The note on the meeting is contained in BOP/R/192.

[2]BISD 18S/48.

8. In response to a balance of payments crisis, restrictions were re-introduced temporarily on imports of a number of capital goods, raw materials, components, spares etc., and some other items, from 20 July 1990. Some of these restrictions were eased in October 1990.[3] Between March and July 1991, exchange restrictions were generally tightened, while easing exchange regulations applying to exporters.[4] During the same period, a number of tariff changes were also made.

9. Since July 1991, the Indian Government has been easing import licensing conditions, particularly for exporters and export-oriented industries. Further plans include the liberalization of most import licensing for capital goods and raw materials, the introduction of more liberal foreign exchange conditions and the convertibility of the rupee within three to five years.

10. A new industrial licensing policy has also been announced which is in part aimed at facilitating foreign investment in India.

Import Policy

11. India's import policy divides imports into three categories: consumer goods, intermediate goods and capital goods. The policy does not permit imports of consumer goods, except for a limited range of essential commodities such as foodgrains, edible oils, medicines, books and specified fabrics.

12. The means of regulating permitted imports include both tariffs and quantitative restrictions, often used in conjunction. Importers are classified as "Actual Users", "Registered Exporters" and others (see Appendix 1). All imports require import licences or a customs clearance permit unless otherwise exempted. Goods can be imported under Open General Licence, or through Supplementary Licences, Automatic Licences, Capital Goods Licences, Import Replenishment (REP) Licences, Advance Licences, Import Licences and, until recently, Additional Licences (see Appendix 1 for a description of these licences).[5]

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[3]See L/6765, L/6846.

[4]See L/6839.

[5]Actual user licences are divided into two categories: General Currency Area Licences and Specific Licences, used for imports from specific countries.

13. The import régime for intermediate goods is based on the twin criteria of "essentiality" and "indigenous non-availability". The imports of these goods are classified as (i) Banned, (ii) Restricted, (iii) Limited Permissible, (iv) Canalised and (v) Open General Licence (OGL). The degree of restriction implicit in these categories depends on the proportion of domestic demand that can be met through domestic production (and is not a function of domestic prices of importable inputs - i.e. indigenous availability is defined in physical rather than economic terms). The Open General Licence (OGL), includes goods which are deemed to be essential but of which there is no domestic production; for goods in the Restricted List, Limited Permissible List and Canalised List, there is a varying degree of indigenous availability and imports may be allowed to meet shortages. Actual users (industrial) can usually import under OGL goods which do not appear on any of the lists. While import licences are used in each category, their allocation becomes increasingly stringent according to whether the goods are under OGL, in the Limited Permissible List, or on the Restricted List. Furthermore, the licences (with the exception of import replenishment licences issued to exporters) are non-transferable.

14. Most bulk imports of intermediate goods, including fertilisers, crude oil, petroleum products, iron and steel, non-ferrous metals, newsprint and cement (and some consumer goods, e.g. foodgrains and vegetable oils) are "canalised" - i.e. purchased by the Government or State-trading enterprises. The reasons for this include the expectation of obtaining more favourable prices through bulk purchases, realising economies of scale in trading operations and planning for the volume of imports to manage the supply of essential inputs and commodities.

15. The import régime for capital goods has a rationale similar to that for intermediate goods. Machinery and equipment imports are classified into those on the Restricted List, those on the OGL List (i.e. eligible for import by actual users subject to specified conditions), and those on neither list. In the last case applications for import by actual users are decided on individual merit with import allowed on the basis of a certificate of essentiality by the sponsoring authority, indigenous clearance by the technical authority and approval by the concerned Capital Goods Committee. The import of instruments is allowed under the same procedure as capital goods if imported as capital goods and under Supplementary Licensing if imported as components or spares.

Export Policy

16. The Exports (Control) Order, 1988, regulates the export of commodities. Most items can be exported freely, but the export of some

items is not allowed (e.g. beef, butter and certain chemicals, metals and minerals) and of some others is subject to ceilings which are determined by domestic requirements (e.g. grains and flour). Certain export items, such as coal and coke, are canalised. Goods imported under OGL cannot be exported without the permission of the Chief Controller of Imports and Exports, New Delhi.

17. Three kinds of incentives are provided to exporters:

(a) Fiscal incentives: These comprise a duty drawback system, reimbursing exporters for tariffs paid on the imported raw materials and intermediate goods, as well as central excise duties paid on domestically produced inputs entering into export production; market development assistance, until recently consisting principally of a cash compensatory scheme (CCS) designed to enable exporters to meet foreign competition, to develop marketing competence and to neutralise disadvantages inherent in the present stage of development of the economy; and partial exemption from income tax on export earnings.

(b) Import Entitlement Schemes: Under these, exporters receive import replenishment (REP) licences when domestic substitutes are inadequate in terms of price, quality or delivery dates. REP licences are freely transferable and normally trade at a premium. These licences are now issued at rates related to the value of exports, but until 4 July 1991 the rates used to be different for different categories of exports.

(c) Free Trade Zones (FTZs) and 100 per cent Export Oriented Units (EOUs): Their rationale is to provide duty free access to imports of intermediate goods and technology on OGL, without any significant licensing restrictions. Units in FTZs are allowed to sell 25 per cent of their output in the domestic market against valid import licences.

III. Changes since the last full consultation

18. The initial thrust of Government policy since 1989, was towards greater liberalization of the trade régime. The Import-Export Policy, 1988-91 was terminated a year earlier than scheduled and the new Import-Export Policy, 1990-93 was put in place from 1 April 1990. The policy moved towards reducing discretionary controls on exporters and actual users by allowing them to import a broad range of capital goods, instruments, raw materials and components against REP and Additional Licences granted on the basis of past exports.

19. Following severe balance-of-payments problems in late 1990 and early 1991, partly resulting from the Gulf crisis, trade and payments restrictions were tightened between July 1990 and July 1991.

20. Since 4 July 1991, the new Government has announced structural reforms in the area of trade policy, aimed at reducing and eliminating import licensing and at promoting exports. There have also been significant complementary changes in industrial policy, including measures relating to foreign direct investment.

The April 1990 Policy Changes

21. One of the main features of the Import-Export Policy 1990-93, introduced in April 1990, was a simplification of the Import Replenishment Licensing (REP) scheme, increasing the scope of the categories of items that could be imported. Under the scheme, exporters, except those in the gems and jewellery sector, could obtain REP licences to replenish raw materials, components, consumables and packing materials used in the manufacture of products exported, provided these inputs were classified as "Limited Permissible" or "Canalised". To encourage the export of electronic products, import of restricted items was permitted on REP licences earned against such exports made to General Currency Area (GCA) countries only. But the 1990 Policy still retained variable replenishment rates for different categories, with the intention of encouraging exports of higher value-added categories. The number of these rates was, however, reduced to four (i.e. 20 per cent, 15 per cent, 10 per cent and 5 per cent) with exceptions for handicrafts (40 per cent) and newspapers, journals and periodicals (50 per cent).

22. Flexibility was also introduced in Additional Licences, which could be used for the import of raw materials and components classified as Limited Permissible or Canalised. Exporters displaying high export performance, categorised as Export Houses and Trading Houses (see Appendix 1) were entitled to Additional Licences at the rate of 10 per cent of NFE, while the new category of Star Trading Houses (NFE of over Rs 750 million) were entitled to Special Additional Licences at the rate of 15 per cent.

23. A scheme for the import of capital goods by exporters at a concessional rate of customs duty of 25 per cent of c.i.f. value was introduced. Under this scheme, regular manufacturer-exporters became eligible to import capital goods up to a value of Rs 100 million (c.i.f.) with an obligation to undertake exports of a value equal to three times the value of the imported capital goods within a period of four years from the date of import, in addition to maintaining the past average performance of exports.

24. The 1990 Policy for the first time included service exports like software, computer consultancy and management-consultancy in the REP scheme, with entitlements at the rate of 10 per cent of the net foreign exchange earned. The Duty Exemption Scheme, under which imports of raw materials, components and spares meant for export production can take place free of tariffs, was also streamlined. To this end, a "Blanket Advance Licensing Scheme" was introduced to eliminate some of the existing procedural irritants. The Import-Export Pass Book Scheme (see Appendix 1) was abolished.

25. Several new elements were introduced in the policy regarding actual users. Industrial actual users were entitled to automatic Licences to import raw materials and components up to the value of 50 per cent of the Supplementary Licences issued to them in the preceding year to enable procurement of the necessary inputs without delay. To provide support to indigenous research and development institutions and facilitate technological upgrading, regular R&D Units were permitted to import their requirements of raw materials, components, capital goods, instruments and essential professional grade consumer durables, including those in the Restricted List, under OGL, on their own certification. The import of precision measuring instruments, process control instruments and quality control instruments was liberalized to upgrade the quality of industrial production in general and export production in particular. Exporters, not entitled to any other export incentives, were provided ad hoc licences to the value of 5 per cent of the f.o.b. value of their exports to facilitate import of capital goods, spares and instruments necessary to upgrade technology. Companies securing project contracts in India against global competitive bidding were permitted to import machinery and equipment required for project construction which did not involve the outflow of foreign exchange from the country, without the need for prior indigenous clearance from the Directorate-General of Technical Development. Service Centres recognised by the Development Commissioner for Small Scale Industries were permitted to import spares and components up to the value of Rs 100,000 per annum to encourage their growth and help generate employment for skilled technicians.

26. In the 1990 Policy, 82 capital goods, consisting mainly of machinery relating to the electronics, textiles, food processing and sea food sectors,were added to the OGL List. At the same time, 17 items of Capital Goods were shifted from the OGL list because of their indigenous availability. The imposition of restrictions on the import of goods once they are produced domestically seems to suggest that availability continues to be defined in physical rather than economic terms. Twelve items were added to the list of life-saving drugs allowed for import under OGL. The minimum value limit of Rs 5,000 on import licences issued to dealers

engaged in dry fruits trade was raised to Rs 20,000.

Other Changes in Import Policy in 1990

27. Soon after the announcement of the April 1990 Policy, several other changes were made. Primary product trade with Nepal was freed from regulation. A similar facility was also granted to certain manufactured materials from Nepal, where these contained not less than 65 per cent of Nepalese materials. The requirement of indigenous clearance was dispensed with for capital goods imports under international competitive bidding procedure for externally aided power projects.

28. From July 1990, in response to growing balance of payments difficulties, steps were taken to curtail selected imports which were perceived to be inessential or of low priority. Particular emphasis was placed on discouraging the build-up of stocks of imported inputs. Thirty-four items of capital goods and 13 items of raw materials were shifted from the OGL list to the licensing category on 20 July 1990 (see L/6765).[6] The "residual" category of imports under Open General Licence, comprising unlisted items of raw materials, components, consumables and spares, was shifted to the Limited Permissible list with effect from 6 November 1990. Several items were shifted from OGL to the licensable category initially for a period of 3 months. These amendments were then extended to the end of June, 1991 and further to the end of July, 1991. The import of gold for use by jewellery exporters was stopped, and provisions made to supply jewellers with confiscated gold. The facility for the import of dry fruits for stock and sale purposes, and provisions for granting separate licences for the import of almonds, were withdrawn with effect from 1 April 1991 (see L/6839).

29. Restrictions were also placed on the import of components, spares and raw materials, particularly in electronics, automobiles and consumer durables. Actual Users engaged in the manufacture of automobiles, electronic items and consumer durables were required from 20 July 1990 to follow the List Attestation Procedure (see Appendix 1) for import of raw materials and components under OGL (see L/6765). A 15 per cent cut was

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[6]These included hydraulic baling presses for the jute industry, and certain items from the following categories: machinery for printing and allied processes, machine tools, cinematographic studio and film laboratory equipment, machinery for the manufacture of telecommunication equipment and components, and dairy industry equipment.

made in the import of components, raw materials and after sales service spares by Actual Users operating in the automobiles, electronics and consumer durables sectors with effect from 24 July 1990 (see L/6765). The cut was applicable to imports under OGL as well as under Supplementary Licences. On 9 October 1990, it was decided to exempt Actual Users engaged in the manufacture of automobile head lamps and bulbs, automobile bodies, automotive tyres and tubes, and plastic products manufactured by use of imported polymers from these cuts (see L/6846). Furthermore, to prevent the curtailment of industrial production, the cuts can be restored on the surrender of REP or Additional Licences (see L/6765). The cut of 15 per cent on imports of raw materials components, consumables and spares under Open General Licence by Actual Users engaged in the manufacture of automobiles, electronics and consumer durables was withdrawn in August 1991.[7] Consequently, the requirement of obtaining OGL Import Entitlement Certificate for imports of listed OGL items, i.e. those appearing in Lists 8 and 10 of Appendix 6 of the Import and Export policy for 1990-93, was also abolished (see L/6846).

30. The 1990/91 budget rationalized the existing customs duty rates (basic plus auxiliary) on imported items. At the same time, customs duties were increased on a broad range of items, including chemicals and petrochemicals, iron and steel, and non-ferrous metals, while customs duties were reduced on imports of pharmaceuticals, standard newsprint, textiles, stainless steel and various machinery. In November 1990, the basic customs duty on high grade, raw, ground sponge iron imported for the manufacture for iron powder was increased from 30 per cent ad valorem to 50 per cent. The customs duty on computer equipment and software was reduced by 25 per cent. Specific items, when imported for use in ready-made garments or the hosiery industry, were exempted from basic customs duty in excess of 40 per cent ad valorem, and auxiliary duty in excess of 5 per cent ad valorem. On 15 December 1990, the auxiliary duty rates on imports were increased for product categories previously subject to the rates of 30 per cent or 45 per cent, to 50 per cent, and for product categories subject to the rate of 5 per cent, to 25 per cent. Import duties for carpet grade wool, other raw wool, rayon grade wood pulp and other wood pulp were also increased.

31. In March-July 1991, the Reserve Bank of India announced several measures to moderate import growth and protect foreign exchange reserves. The cash margins/deposit requirements for opening Letters of Credit (LCs) for imports other than capital goods was raised from 50 to 133.33 per cent

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[7]Ministry of Commerce Public Notice, No. 199-ITC (PN)/90-93, 29.08.1991.

on 19 March 1991, and then to 200 per cent on 22 April 1991. For imports under specific licences, cash margins were specified at 110 per cent. Margins for LCs under other categories were also raised.[8] Imports of capital goods became permissible only through foreign currency lines of credit available with financial institutions or subsequently against 360 days of supplier's credit (see L/6839). From 9th May 1991 a surcharge of 25 per cent was imposed on bank credit for imports to discourage the use of bank credits to finance imports. Subsequently, imports by units in Export Processing Zones, 100 per cent Export Oriented Units and by exporters of major products were exempted from cash margin requirements to facilitate critical imports required by the exporters. Recently, in view of the improvement in foreign exchange reserves position and import compression levels achieved, the Reserve Bank of India reduced import curbs relating to cash margins requirements to 25 per cent with effect from 1 January 1992.

32. Consequent on the policy decision to withdraw subsidies on interest rates, and with a view to ensuring early repatriation of export proceeds and to make credit costly to those who delay repatriation of export earnings, the RBI restructured the interest rates on pre-shipment and post-shipment credit during April-October, 1991. To facilitate availability of adequate export credit, the refinance facility by RBI to the commercial banks was enlarged. For the first time in India, a scheme for pre-shipment credit in foreign currency was introduced by the Exim Bank on 28 November 1991, to finance foreign exchange costs of import inputs for export production payable in foreign currency from the proceeds of the relevant exports on a self-liquidating basis. A new schemme for post-shipment export credit, denominated in United States dollars, was also introduced by the RBI on 21 December 1991 as an additional finance facility to exporters.

Policy changes since July 1991[9]

33. Under policy changes introduced in July 1991, the Import Replenishment Licensing Scheme has been enlarged and restructured. The REP licences have been renamed "EXIM Scrip" and are freely tradeable.[10] All

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[8]The imports exempted from these restrictions include imports by Government departments, petroleum and lubricants, fertilisers, edible oils, newsprint, foodgrains and life saving drugs.

[9]See document L/6969, 10 January 1992.

[10]Exports to hard currency areas were made eligible for Exim Scrips valid for hard currency imports while exports to rupee areas would be issued Exim Scrips valid for imports from these areas only.

exports, other than gems and jewellry, certain metal-based handicrafts, cinema films and books and journals, were accorded a uniform REP rate of 30 per cent of the f.o.b value of exports - representing a significant increase over the previous rates of between 5 per cent and 20 per cent for most categories.[11] The new REP scheme clearly gives maximum incentive to exporters whose import intensity is low since they are free to sell their surplus entitlements at a premium to other manufacturers.

34. A large number of items previously subject to various restrictions were permitted to be imported using Exim Scrips:

- any items in the limited permissible or non-sensitive canalized lists, and goods listed in List 8 part I and List 10 of Appendix 6 of the Import/Export Policy 1990-93;

- export and trading houses were entitled to import "limited permissible " and "non-sensitive canalized" items to the full value of the additional licences given to them;

- imports of raw materials, components, consumables and spares, previously allowed against supplementary licences. For these goods no indigenous clearance or certification of essentiality is now required. The supplementary licensing system for most raw materials, components and spares was abolished;

- manufacturers of capital goods listed in Appendix 4 of the Import/Export Policy were permitted to meet their full requirements of raw materials, components and consumables through Exim Scrips; the facility was also extended to imports of after-sales service spares by manufacturers of machinery and equipment listed in Appendix 9 of the Order; replenishment of 30 per cent was extended to a number of other products from Appendix 12 of the Order;

- the category of Unlisted OGL was abolished and items previously falling under the category were made importable only through the Exim Scrip scheme.

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[11]For the exports of certain products, such as value-added agricultural products, electronics, bulk drugs, marine products and certain categories of advanced engineering goods, the Exim scrips rate has been set at 40 per cent of the f.o.b. value.

35. Given the changes in the trade régime, and the devaluation of the exchange rate, the Cash Compensatory Scheme was deemed redundant and was suspended with effect from 3 July 1991. All imports actually affected until midnight 2 July 1991, remained entitled to the benefits of CCS.

36. On 24 July 1991, the budget for 1991/92 introduced several changes in taxes on both imports and exports. The ad valorem rate of basic and auxiliary customs duties was reduced to a maximum of 150 per cent. Import duties on capital goods for general projects and machinery were reduced from 85 per cent to 80 per cent. More items were included in the list of machinery which is charged a concessional duty of 50 per cent under a technology upgrading scheme. A duty relief of 10 percentage points was given to almost every item which suffered an increase of 20 percentage points on 15 December, 1990. On some items, deemed to be important for reasons such as environmental protection and export promotion, the customs duty rates were rolled back to those prevailing before 15 December, 1990.[12] To encourage the growth of the finished leather and artifical diamond industries, the import duty on certain raw materials required by these industries was reduced from 150 per cent to 40 per cent. To promote tourism, the import duty on adventure sports equipment was reduced from rates between 100 and 300 per cent to 40 per cent. Tax concessions were also extended to exports of software and processed minerals, and to 100 per cent Export Oriented Units.

37. Further measures announced in August-October 1991[13] include:

- increased Exim Scrip allowances for exporters of engineering goods, stainless steel products; exporters operating under the Duty Exemption Scheme; producers of a variety of processed food, drug, electronics and high technology engineering products; exports made on the basis of duty free imports obtained against advance licences; 100 per cent Export Oriented Units and exporters operating in export processing or free trade zones; exporters working under customs bond;

- simplification of procedures for imports of capital goods (including the indigenous availability clearance) and of the system of Advance Licences;

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[12] These items include waste paper, wood in the rough, ethylene, machinery for fuel injection equipment and certain items of machinery for printing and newspaper industries.

[13] See L/6969.

- transfer of a number of chemicals and other raw materials and consumables from "restricted" to "limited" permissible status;

- entitlement of a number of raw materials, components and consumables to be imported against Exim Scrip

- de-canalization of some products, either to open general licence or to Exim Scrip status;

- abolition of the 15 per cent cut on OGL imports by manufacturers of cars, electronic items and consumable goods;

- further expansion of Exim Scrip facilities in September 1991;

- liberalization of certain foreign exchange procedures in respect of Open General Licence items imported by manufacturers subject to the Phased Manufacturing Programme.

38. A decision was made to harmonize the classification system used in the import-export policy and the systems used by Customs.[14] This was intended to reduce the scope for discretionary decision making at lower levels and introduce greater transparency in the import policy, including the tariff structure. The office of the Chief Controller of Imports and Exports was redesignated as the Directorate General of International Trade, with the principal function of promoting exports and facilitating imports.

39. Among the planned future changes are the removal over three years time of all import licensing for capital goods and raw materials, except for a small negative list. Furthermore, all items except those that are essential are planned to be decanalised. It is planned to replace the EXIM Scrip with Foreign Exchange Certificates (FECs) which will be more easily tradeable and more effective in the area of service exports. Finally, it is hoped to make the rupee fully convertible on the trade account in 3 to 5 years.

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[14] A copy of the Import-Export Policy 1990-93 classified according to the Harmonized System, was sent to the GATT Secretariat in November 1991 (L/6910).

IV. Changes in industrial policy

40. To complement the changes in trade policy, certain changes in industrial policy were announced on 24 July 1991. These changes related to the areas of industrial licensing, foreign investment, foreign technology agreements, public sector policy and the Monopolies and Restrictive Trade Practices (MRTP) Act. Industrial licensing was abolished for all industries except for certain specified ones, which will continue to be licensed because of strategic and security concerns, safety and environmental concerns or because they produce articles of "elitist consumption".[15] To facilitate foreign investment in high priority industries, requiring large investments and advanced technology, approval was given for 51 per cent foreign equity ownership (instead of the previous threshold limit of 40 per cent) in 34 categories of industries.[16] Foreign equity will be required to cover the foreign exchange needed for imported capital goods. The Reserve Bank of India will monitor the payment of dividends to ensure that outflows of foreign exchange are balanced by export earnings over a period of time. A four-member Board was formed to negotiate with large foreign companies who intend to make long term investments in India, and serve as a single window clearance agency for projects. The Government has decided to allow 100 per cent equity participation in the power sector and international companies have also been allowed to explore natural gas and develop gas fields. The Government will give automatic permission for technology agreements related to high priority industries within specific parameters (a maximum lump sum payment of Rs 10 million; or royalties of 5 per cent for domestic sales and 8 per cent for exports, subject to total payments of 8 per cent of sales over a 10 year period).

41. Future public investment will mostly be limited to areas of strategic importance, high technology, essential infrastructure and oils and mineral resources. Areas of exclusivity for the public sector are to be opened up to the private sector, while the public sector will also be allowed to enter areas not specifically reserved for it. In a bid to subject certain public enterprises to the discipline of the market, the Government has decided to partially disinvest its holding in the equity share capital of these companies. Accordingly, up to 20 per cent of their equity will be offered to investment institutions, the employees and the general public.

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[15] Industries which will continue to be licensed include coal, petroleum, sugar, motor cars, cigarettes, hazardous chemicals, drugs and pharmaceuticals.

[16] These include metallurgical industries, electrical equipment, industrial machinery, agricultural machinery, drugs and pharmaceuticals, hotels and tourism-related industry.

It has been recognised that the "interference" of the Government through the Monopolies and Restrictive Trade Practices Act in the investment decisions of large companies has had an adverse effect on industrial growth. The Government intends to restructure the MRTP Act so that approval will no longer be required for the expansion of existing units or the establishment of new undertakings by companies with assets over Rs 1 billion. The provisions relating to mergers, amalgamations and takeovers will also be repealed. Instead, the emphasis will be on regulating monopolistic, restrictive and unfair business practices.

V. Macroeconomic and trade developments[17]

Introduction

42. In the last three years of the Seventh Five-Year Plan (1987/88-1989/90), the average annual rate of growth of India's real GDP was about 6½ per cent, 1½ per cent above the Plan's target.[18] Growth resulted largely from a rapid expansion of industrial production - which benefited from the liberalisation of industrial and trade policies - and the services sector. Contrary to expectations, agricultural performance was poor except in 1988/89. The share of private investment in GDP averaged 13 per cent. Funds to finance increased investment came not from savings in the public sector (as called for by the Plan), but rather from foreign sources. The continuation of the process of import liberalisation to remove the anti-export bias of the trade régime, and the adoption of a flexible exchange rate policy, were largely responsible for the significant growth of export volume. The international reserve position of India, however, weakened during the period 1987/88-1990/91 largely as a result of the increase in the government budget deficit (especially in the budget of the Central administration), which in turn widened the current account deficit. In the period 1987/88-1989/90, a number of measures to deregulate financial markets were taken, together with tax reforms seeking to widen the tax base and improve tax administration. The recently approved 1991/92 budget contains taxation and expenditure reforms that aim at achieving a notable reduction in the overall public sector deficit.

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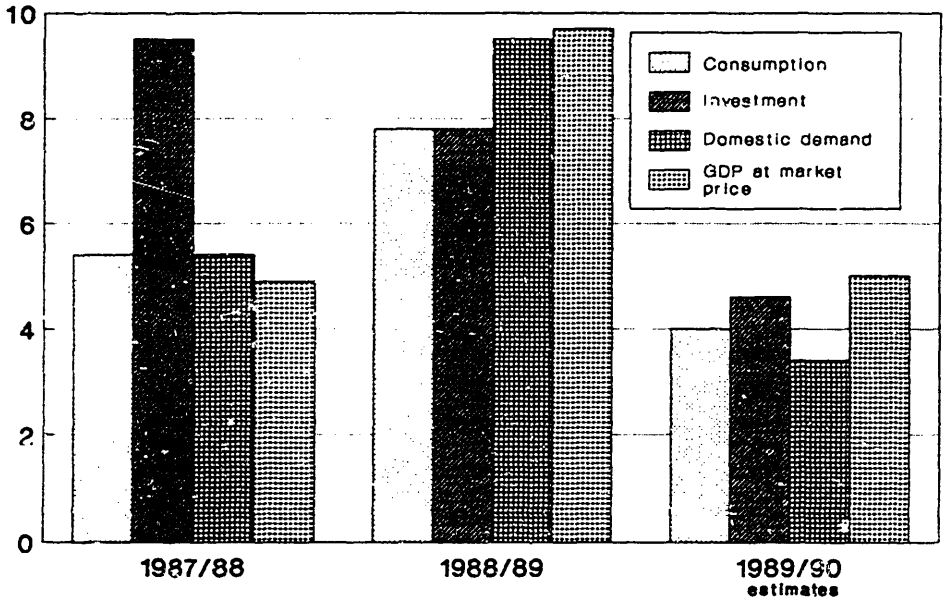
[17] Data contained in this section are drawn principally from IMF sources.

[18] The fiscal year starts on April 1.

Aggregate supply and demand

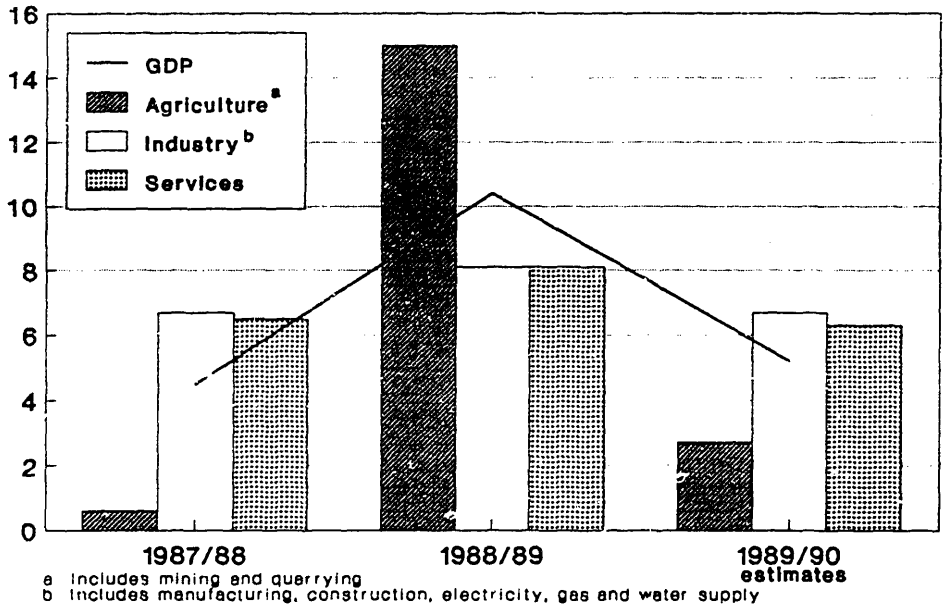
43. The rate of growth of real GDP in 1987/88 increased to 4.9 per cent from 4½ per cent in 1986/87 (Graphs 1 and 2), despite the worst drought in Indian history. In 1988/89, output increased significantly, growing more than 9½ per cent. The growth of GDP dropped again to about 5 per cent in 1989/90, mostly due to the deceleration in the growth of domestic demand and to a lesser extent, in the growth of gross fixed capital formation. Preliminary official estimates put the growth of real GDP in 1990/91 at 5 per cent.

Graph 1
GDP at constant market prices by expenditure components
Annual percentage change



Source: IMF.

Graph 2
GDP at factor cost by sector
Annual percentage change



a Includes mining and querrying
b Includes manufacturing, construction, electricity, gas and water supply
Source: IMF.

44. In 1987/88, despite the effects of drought, the share of domestic capital formation in GDP rose to nearly 22½ per cent as a result of the strength of private sector investment. The public sector, in contrast, reduced capital formation in an effort to maintain total outlays within budgeted limits in case of a rise in current expenditure. Domestic capital formation was on average about 24 per cent of GDP in 1988/89-1989/90, the highest level since 1950/51. This resulted from the continued buoyancy of the private sector's gross capital formation.

45. In 1987/88, gross domestic savings increased to nearly 20½ per cent of GDP despite the decline in savings of the public sector (reflecting primarily increased central government current expenditure). In the period 1988/89-1989/90, gross domestic savings continued to rise, reaching 21.7 per cent of GDP (the second highest level since 1950/51) while public domestic savings (the excess of public receipts over public current expenditure - which excludes government capital expenditure) declined to just 1.7 per cent of GDP. Largely due to the continuation of the financial liberalisation programme, which drew resources into new assets offering a higher real return and strong income growth, domestic private savings jumped from 18 per cent of GDP in 1987/88 to 20 per cent in 1989/90.

46. In 1987/88, agricultural output in value added terms showed almost no growth (about ½ per cent) as rainfall was 80 per cent below normal levels in 60 per cent of the country. With the exception of oilseeds and sugarcane, the output of all crops declined. Agricultural output recovered in 1988/89, growing 15 per cent. Good rains, the effects of price changes and the largest ever rise in the consumption of fertilisers (more than 25 per cent), contributed to the strong recovery (yields per hectare for all major crops increased between 13 and 31 per cent). In 1989/90, value added in agriculture grew a modest 2.7 per cent, causing agriculture's share in GDP to fall to just over one-third.[19]

47. After a slowdown in the pace of reform in 1987/88, the Indian government continued its policy of liberalisation of industrial activity during the period 1988/89-1990/91. Measures included the halving of the number of industries requiring licenses to expand capacity; an increase in the threshold for investment and foreign exchange outlays requiring license; a further relaxation of controls on market activities of dominant companies; greater freedom for firms to adjust their output capacity to improve cost-efficiency in the long-run; the simplification of procedures for manufacturers to use licensed capacity to produce similar products (broadbanding); establishing growth centres to facilitate the location of industries in less developed regions; and steps to simplify the administration of industrial policy by removing procedural impediments. Similarly, trade policy liberalisation has improved firms' access to cheaper imported inputs, while export promotion policies together with a more flexible exchange rate policy, have resulted in a doubling of the volume of manufacturing exports. 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. Policy measures for the revival of sick industrial units continued to be pursued, contributing to the increase in subsidies and thus to the budget deficit problems. At the end of 1988, the total of "sick" and "weak" units was 242,584, of which nearly 93 per cent were considered non-viable. Total outstanding bank credit to all units was nearly 2 per cent of 1988/89 GDP, with 45 per cent of it locked into non-viable units.

48. In 1987/88, industrial output in value added terms grew a robust 6.7 per cent.[20] Growth of the manufacturing sector was almost 8 per cent. Largely as a result of government incentives to promote the electronics and

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[19]Government subsidies on imported and domestically produced fertilisers increased from 0.6 per cent of GDP in 1987/88 to 1 per cent in 1989/90.

[20]Industry includes manufacturing, construction, electricity, water and gas supply.

computer sector, electric machinery was the fastest growing sector, followed by chemicals and chemical products (except petroleum and coal) and other manufacturing. In 1988/89, value added by industry rose about 8 per cent and in 1989/90, more than 6½ per cent, accounting for 27 per cent of GDP. In 1988/89-1989/90, manufacturing grew at an average rate of more than 8½ per cent. The most rapidly growing sectors in 1989/90 included textile products, non-metallic products and machinery and machine tools. In 1989/90, instead, gross output growth was more evenly distributed across sectors. The growth of industrial production decelerated in 1990/91. However, the deceleration was confined to the mining and electricity sectors as manufacturing output growth jumped to 9.2 per cent. In the first half of 1991/92, industrial production was inhibited by import restrictions. Raw materials, components and capital goods have been particularly scarce.

49. In 1988/89-1989/90, crude oil production recovered growing at an average rate of 6 per cent, after a small decline in 1987/88. Refinery output grew between 2½ per cent and nearly 6½ per cent largely due to increased capacity utilization. However, both sectors reported declining output in 1990/91. Crude oil production dropped more than 5½ per cent, partly due to disturbances in Assam. In the period under analysis, imports of oil continued to increase.

50. During the period 1987/88-1989/90, the services sector continued to increase its share of total output reaching 39 per cent in 1989/90. The 7 per cent average annual growth in the period 1987/88-1989/90 resulted primarily from the strong growth of industrial demand for transportation and trade related-services, the liberalisation of financial markets which generated high rates of growth of banking and insurance services, and the rapid growth of public administration and defence.

Prices and employment

51. Inflation declined modestly over the period 1987/88-1989/90 (Table 1). In 1989/90, however, two events foreshadowed a future worsening of inflation in India: (1) the rise in the central government deficit and the corresponding increase in the growth of broad money (M3); and (2) the increase in the domestic money price of imports that resulted from a large depreciation of the rupee. As a result, and despite an excellent agricultural performance, the March 1990 wholesale price index (end of period) was 9.1 per cent above the year earlier level. Inflation continued to accelerate in 1990/91 as the wholesale price index rose by 12.1 per cent and the change in the consumer price index more than doubled to 13.6 per cent. In the first five months of 1991/92, the consumer price index rose by 13 per cent, compared to less than 10 per cent in the same period of 1990/91.

Table 1
Price indexes, 1987/88 - 1990/91

	Weight	Annual percentage change			
		1987/88	1988/89	1989/90	1990/91
		Period average			
Wholesale price index	100.0	8.2	7.4	7.4	10.1
Primary products	32.3	11.3	4.9	2.1	13.0
Fuel and power	10.7	3.5	5.4	3.7	12.1
Manufactures	57.0	7.2	9.3	11.3	8.2
Consumer price index	100.0	9.2	9.0	6.6	11.2
GDP deflator	100.0	8.6	8.2	6.7	10.5
		End of period			
Wholesale price index	100.0	10.7	5.7	9.1	12.1
Primary products	32.3	15.7	-0.2	6.4	17.1
Fuel and power	10.7	5.3	5.1	6.2	14.4
Manufactures	57.0	8.9	9.2	11.1	8.9
Consumer price index	100.0	9.8	8.6	6.6	13.6

Source: IMF.

52. The Seventh Plan targeted an annual growth rate of employment of 4 per cent, double annual population growth. However, according to preliminary information, employment in the organised sector (i.e., the public sector and non-agricultural private firms employing less than 10 employees), grew at a rate of 1½ per cent per annum. Moreover, almost all of the increase occurred in the public sector. One of the factors contributing to the slow growth of employment is the institutional distortions that affect the labour market, which raise the cost of labour and create incentives for more capital-intensive production processes.

Public finance

53. The consolidated public sector of India comprises the Central Government, the State governments, the Union Territories and Central and State public enterprises. After having declined in 1987/88 and in 1988/89, the deficit of the consolidated public sector is estimated to have increased in the period 1989/90-1990/91, passing from 10.3 per cent of GDP in 1987/88 to 12½ per cent in both 1989/90 and 1990/91 (Table 2).[21] This was largely due to the increase in the deficit of the central Government (including the Oil Coordination Committee) which increased from an average of nearly 7.6 per cent of GDP in 1987/88-1988/89 to 9 per cent in

[21] Figures for 1990/91 refer to IMF data.

1989/90-1990/91. The finances of the States and Union Territories also deteriorated in the period under consideration, passing from an average deficit of 3.8 per cent of GDP in 1987/88-1988/89 to an estimated 4½ per cent in 1990/91. The major factors behind these developments include stagnant revenue, the increasing burden of interest payments, and the growth of subsidy outlays. Interest paid by the central government reflected both a larger debt and higher interest rates. Domestic liabilities of the central government grew from less than 52 per cent of GDP in 1987/88 to nearly 54½ per cent of GDP in 1990/91, and the government had to pay higher interest rates due to increased competition for funds as financial market liberalisation proceeded.

Table 2
Consolidated Public Sector, 1987/88-1990/91[a/]

	1987/88	1988/88	1989/90	1990/91	
				Budget[b/]	Revised estimate
			In billions of rupees		
Total revenue and grants[b/]	753.9	875.9	1,012.6	1,200.6	1,111.9
Tax revenue	569.8	669.3	767.6	891.8	860.7
Non-tax revenue[b/]	179.2	200.6	235.9	300.7	243.0
Grants	4.9	6.0	9.1	8.1	8.2
Total expenditure and net lending[c/]	1,095.2	1,269.8	1,564.2	1,733.9	1,755.5
Development	688.0	795.5	997.5	1,080.0	...
Non-development	433.7	505.0	598.6	682.0	...
Loan repayments	-26.5	-30.7	-31.9	-28.1	...
Overall deficit (-)	-341.3	-393.9	-551.6	-533.3	-643.7
			In per cent of GDP		
Revenue and grants	22.7	22.2	22.9	23.4	21.6
Total expenditure and net lending	32.9	32.1	35.3	33.8	34.2
Overall deficit (-)	-10.3	-10.0	-12.5	-10.4	-12.5

a/ Covers consolidated budgetary transactions at Central and State Governments including Central and State public enterprises and the Oil Coordination Committee (OCC).
b/ Including internal resources of Central and State enterprises.
c/ Including investment spending by Central and State enterprises.

Source: IMF.

54. Total revenue and grants of the central government stagnated at 11½ per cent of GDP in 1987/88-1990/91. Most of the tax revenue in the period 1987/88-1990/91 came from excise taxes (which remained the major source of tax revenue) and from taxes on international trade - import volume growth was buoyant and the domestic currency depreciated. In 1990/91, despite post-budget increases in custom duties and excise levies, tax revenue was lower than expected. Several tax reforms in recent years have widened the tax base, reduced the nominal marginal tax and streamlined the administration of the tax system. Changes in 1990/91 included an increase in the exception limit on personal income; a widening of the personal income tax base; the simplification of the system of tax allowances; and the reduction of the rate of corporate income tax.

55. Total expenditure and net lending of the central government grew 0.4 per cent of GDP to 20.1 per cent between 1987/88 and 1990/91. This resulted from a rise in current expenditure, largely on interest payments and subsidies. Gross interest payments rose from 17.2 per cent of total expenditure and net lending of the central government in 1987/88 to 21.1 per cent in 1990/91. Over the same period, subsidies (notably for fertilisers and export promotion) rose from 9.1 to 10.3 per cent of total expenditure and net lending. Capital expenditure and net lending declined during the same period, mostly as a result of the pressure to reduce the primary deficit of the central government.[22]

56. The Central government deficit has increasingly been financed by the domestic banking system, notably the Reserve Bank of India (RBI) (Graph 3). The share of domestic financing is estimated to have increased from nearly 89½ per cent in 1987/88 to nearly 93 per cent in 1990/91. After increasing to nearly 69 per cent in 1989/90, the share of the banking system dropped to 61 per cent in the 1990/91 budget. Budget financing through "small savings" rose from 14½ per cent in 1987/88 to 20 per cent in 1990/91.[23]

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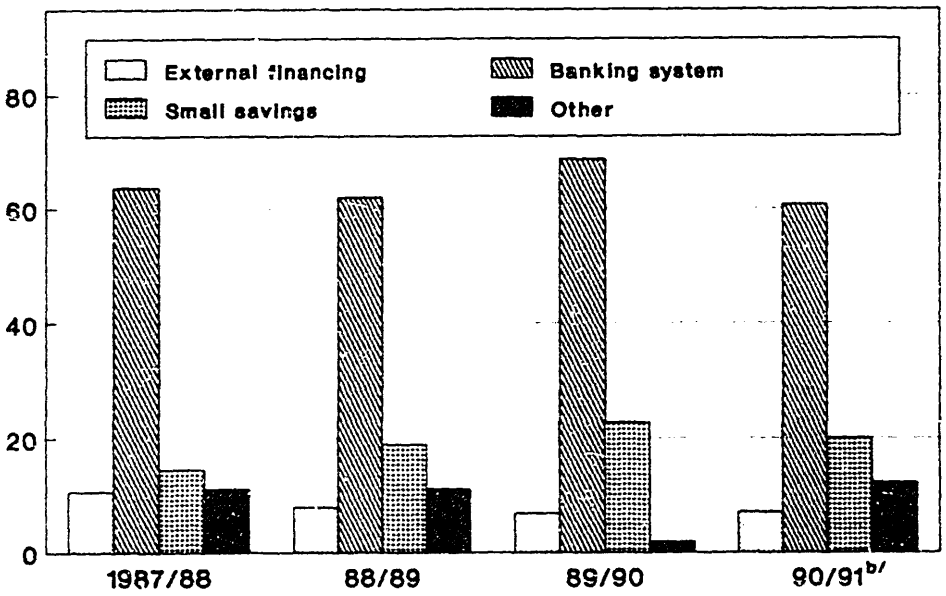
[22]Data supplied by the Indian authorities show a small decline in total Central Government expenditure but a larger rise in subsidies.

[23]Small savings include post office deposits, "national" savings, and social security certificates.

Graph 3
Sources of Central Government budget deficit financing[a/]
Share



a/ Excludes OCC balance.
b/ Official revised estimate.
Source: IMF.

57. After some improvement in 1988/89 mostly due to a decline in expenditure that more than offset a drop in tax revenue, the finances of the State and Union Territories worsened in 1989/90, causing their budget deficit to increase to 4.1 per cent of GDP. According to IMF estimates for 1990/91, the deficit increased further to 4½ per cent of GDP. The major factors behind this widening of the deficit were a rise in non-development expenditure and interest payments. Beginning in 1990/91, transfers from the Central government to the States will be based on the projected deficit; any overrun will not be covered by the Central government.

58. The central government budget for 1991/92 aims to achieve a deficit of 6½ per cent of GDP against an estimate of 9 per cent the previous year. A number of measures for controlling expenditures and increasing government revenue are called for. On the expenditure side, it is recognised that the reduction of interest payments is possible only in the medium-term as a by-product of the reduction of the overall budget deficit (interest payments for the fiscal year 1991/92 are estimated to have risen to about 42 per cent of central government revenue. Expenditure-reducing measures include the elimination of export subsidies; the freeing of the prices and trade of certain fertilisers; an increase of 30 per cent in the price of all other fertilisers (the first in 10 years); the elimination of the subsidy on sugar; and increases of between 10 and 20 per cent in the

prices of petroleum products (excluding kerosene for non-industrial use and diesel). In contrast, a 6 per cent rise in food subsidies is provided for. Different schemes for assistance to agriculture are to be continued and new ones introduced, including credit availability to offset the rise in the prices of fertilisers.

59. In the central government budget for 1991/92, a number of measures are to be taken on the revenue side. These include reductions of taxes on dividend income and long-term gains obtained by offshore funds; the sale of 20 per cent equity in selected public sector undertakings; a rise in corporate taxes; the reduction of the depreciation rate allowed for tax benefit; the increase of the basic exemption from taxes on long term capital; the withdrawal of the tax exemption for the Industrial Development Bank; and a new tax of 3 per cent on interest earnings of financial institutions, banks and private finance companies. In order to provide for foreign exchange mobilisation, incentives have been given to professionals earning income in a foreign currency, including authorising the State Bank of India to issue bonds denominated in U.S. dollars with interest exempt from tax and no limit on total investment. In the area of indirect taxes, the budget provides for reductions in most categories of excise and customs duties, while cigarettes and consumer durables are in for higher taxes.

Money and credit

60. The Indian financial system comprises the Reserve Bank of India (RBI), commercial banks, specialized lending institutions and other nonbank institutions. The Government determines annual targets for aggregate and sectoral credit expansion, although there has been a progressive switch to targeting monetary aggregates instead. The responsibilities of the RBI go beyond the management of monetary and credit conditions to include the provision of financing to the public sector - the Central government and the States - and of preferential financing to specified activities. Recently, advances to the States have been severely limited.[24] Although a significant number of measures have been taken since 1985/86 to liberalize

[24] The instruments of monetary policy used by the RBI are the cash reserve ratio (now at the maximum permitted level of 5 per cent) and an additional statutory liquidity ratio (SLR); refinance policy by the Reserve Bank (used mostly for exports in the last part of the 1980's); bank lending guidelines; selective credit controls (including priority credit guidelines); interest rate policy; and open market operations.

monetary and financial markets and make them more efficient, banks still operate under severe constraints - in particular, they have no control over deposit rates or rates on priority loans.

61. The RBI financing of the government has constituted in recent years the major source of increases in reserve money. Also commercial banks refinance the government - at below market interest rates. In the period 1985/86-1990/91, net credit from the banking system to the government averaged about 44 per cent of total domestic credit.

62. The annual rate of growth of broadly defined money (M3) increased to more than 19 per cent in 1989/90 from nearly 16 per cent in 1987/88 (Table 3). Net Reserve Bank credit to central government, which oscillated between 2 and 3 per cent of GDP over 1987/88- 1989/90, reflected mainly the evolution of the central government deficit. The growth rate in RBI credit to the commercial sector also accelerated over the period. In July 1989, the various reserve ratios were consolidated at 15 per cent, the maximum permitted by law, in a move by monetary authorities to further restrict liquidity. During 1990/91, there was a deceleration in the rate of growth of broad money to 14.9 per cent. However, the share of credit going to the government rose, due to the higher central government deficit. In 1989/90, partly reflecting continuous strain in the balance of payments position of the country, net foreign assets of the banking system - excluding the revaluation of gold reserves - declined. In 1990/91, the rate of growth of net foreign assets was positive again at nearly 29 per cent. Data for the period August 1990/March 1991 show an acceleration of the annual growth rate of M3, mainly due to more rapid growth of credit to the government, together with a drop in the net foreign asset position of the banking system. Data for the first half of 1991/92 show a deceleration in the growth of M3 to less than 16 per cent nearly 18 per cent in the same period of 1990/91. Net Bank credit to the government was partly responsible for the slower expansion of M3, but there was also a large reduction in the growth of bank credit to the commercial sector (12 per cent against more than 16 per cent the previous year).

Table 3
Selected factors affecting changes in broad money (M3)

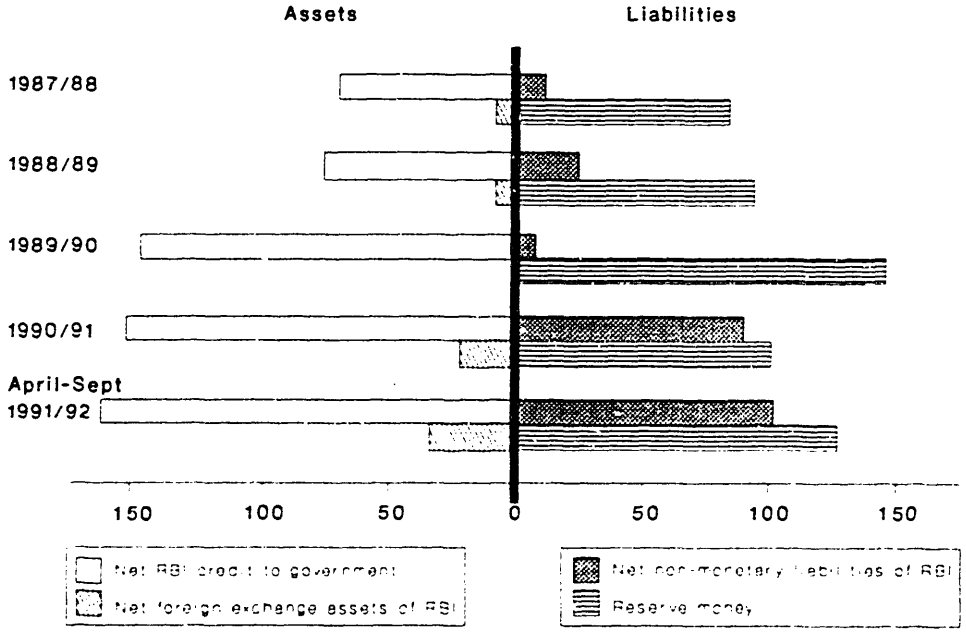
	Percentage change					
	1987/88	1988/89	1989/90	1990/91	1990/91 Sept.	1991/92 Sept.
Broad money (M3)	16.0	17.8	19.4	14.9	17.7	15.8
Selected sources of change in M3						
- Net bank credit to government	17.1	14.3	21.4	19.7	19.2	18.9
- Bank credit to commercial sector	13.5	19.0	18.6	14.1	16.2	12.0
- Banking sector's net non-monetary liabilities other than time deposits a/	(11.4)	(13.3)	(18.3)	(26.8)	...	...

a/ Includes investment in securities by banks, RBI commercial credit, and credit extended by cooperatives.

Source: Economic Survey 1990-91, Ministry of Finance, Government of India and IMF.

63. The growth of reserve money in India has traditionally been closely linked to the size of the budget deficit. Between 1987/88 and 1990/91, RBI credit to the government was the main factor explaining the growth of reserve money (Graph 4), whereas in 1990/91, the other sources of change in reserve money had even a net contractionary effect. More specifically, net RBI credit to government represented about 74 percent of the 18½ per cent average annual change in reserve money in 1987/88-1988/89, while in 1989/90, an acceleration in the growth of reserve money to more than 23 per cent was largely the result of a deterioration of the Central government finances - with net RBI credit to the government accounting for more than 96 per cent of the increase. Measures taken by the authorities to reduce liquidity resulted in a deceleration of the rate of growth of reserve money to 13.1 per cent in the period 1990/91. However, net RBI credit to the government was equivalent to nearly 300 per cent of the rise in reserve money, but was partially offset by a strong net contraction in RBI credit to banks and to the commercial sector. Reserve money growth accelerated again to more than 16½ per cent in the first half of 1991/92. This was mostly due to the growth in net RBI credit to the government. However, claims to banks rose significantly (57 per cent against a decline of nearly 7 per cent in the same period of the previous year).

Graph 4
Selected sources of change in reserve money
Billion rupees, end of period



Source IMF

64. Bank interest rates in India have traditionally been set administratively rather than by market forces. Beginning in April 1987 a series of changes were introduced with the aim of reducing the cost of funds and imparting flexibility to interest rate policy. However, the Government continues to obtain a large part of its finance requirements through issues of 3-month Treasury bills at a below the market rate of 4.6 per cent, unchanged since 1974 (rates on 5-15 year bonds are in the 10-11 per cent range). In 1989, money market rates on transactions among banks and financial institutions were freed, as were the rates payable on large deposits, including certificates of deposit (CDs). Interest rate ceilings on non-priority lending were replaced by interest rate floors resulting in higher rates on commercial bank loans. Measures accompanying the 1991/92 budget have authorised the private sector to float mutual funds. As well the restrictions on the coupon rates on corporate bonds have been removed. In the first seven months of 1991 major increases have occurred in several interest rates.

Balance of payments and current account

65. During the second half of the 1980's, the Indian authorities continued the process of structural reforms initiated at the beginning of the decade. These reforms have affected, directly and indirectly, the balance of payments performance of the country (Table 4). Import liberalisation measures reduced the anti-export bias of trade policy, lowered the costs of industrial imports and increased the efficiency of the export sector. As a result, in the period 1987/88-1990/91, the volume of merchandise exports grew significantly. The flexibility of the exchange rate policy served to partly absorb the continuous deterioration in the country's terms of trade during the period (Graph 5). Nonetheless, the current account deficit widened as fiscal and monetary imbalances increased. Interest payments on foreign debt also grew rapidly. After a marginal reduction in 1987/88, the current account deficit of India is estimated to have increased to an average of 3.1 per cent of GDP in 1988/89-1989/90 and to 3.4 per cent of GDP (or $ 9.8 billion) in 1990/91 (Graph 7).[25] The combination of an increased current account deficit and a decline in net capital inflows caused the level of international reserves (excluding gold) to drop to about two weeks of merchandise imports in June 1991 from 4.5 months in 1987/88 (Graph 6). Reserves started to increase in September, however, and were at $ 2.8 billion at the end of November 1991 (equivalent to 1.4 months of 1990/91 imports).

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[25]According to the Indian authorities, the Gulf crisis' impact on the current account - including a rise in the import bill, losses in workers' remittances, emergency repatriation, and export losses - amounted to about $ 2.9 billion.

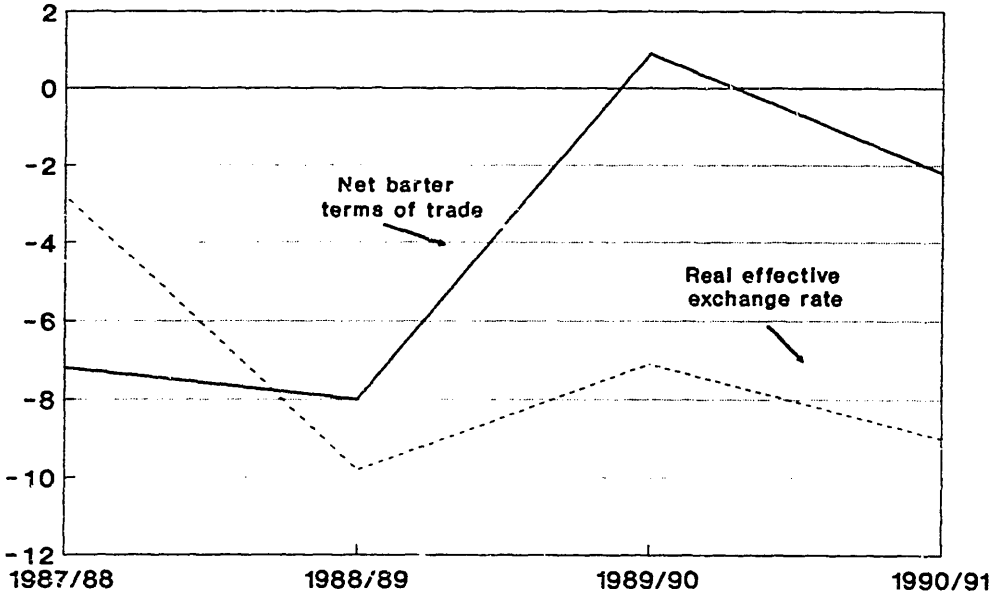
Table 4
Balance of payments, 1987/88 - 1990/91

	Million U.S. dollars			
	1987/88	1988/89	1989/90	1990/91[a/]
Trade balance	-6,918	-9,077	-7,469	-8,734
Exports, f.o.b.[b/]	12,643	14,262	16,945	18,479
Imports, c.i.f.[c/]	19,561	23,339	24,414	27,214
Of which: Oil	3,114	3,021	3,765	5,726
Invisibles balance (net)	742	283	-598	-1,079
Nonfactor services	545	731	800	1,162
Net investment income[d/]	-2,519	-3,095	-3,687	-4,236
Transfers	2,716	2,647	2,289	1,995
Current account	-6,176	-8,794	-8,067	-9,813
Capital account	6,805	8,398	8,103	6,954
Direct and portfolio investment	181	298	341	370
Net aid	2,907	3,102	2,996	2,979
Loans	2,514	2,626	2,504	2,452
Disbursements	3,618	3,594	3,537	3,699
Amortization	1,104	968	1,033	1,247
Grants	393	476	492	527
Commercial borrowing	1,361	2,157	2,505	2,350
Disbursements	1,950	2,862	3,146	3,147
Medium- and long-term	1,728	2,609	2,229	1,847
Short-term (net)	222	253	917	1,300
Amortization	589	705	641	797
Private nonguaranteed borrowing	58	-105	-86	230
Bilateral agreements	127	182	-529	-903
Nonresident deposits	1,878	2,576	2,223	1,049
Other capital including errors & omissions[e/]	293	188	653	878
Overall balance	629	-396	36	-2,859

a/ Estimates.
b/ Excluding crude oil exports.
c/ Including net crude oil imports.
d/ Includes accrued interest on nonresident deposits.
e/ Also includes valuation adjustment on non-U.S. dollar reserves.

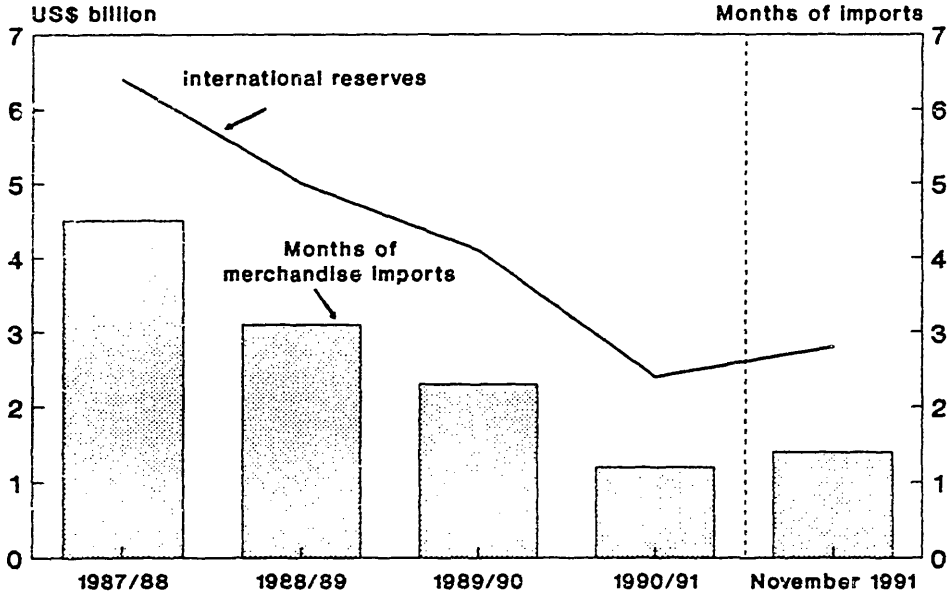
Source: IMF.

Graph 5
Net barter terms of trade and real effective exchange rate
Annual percentage change; end of period



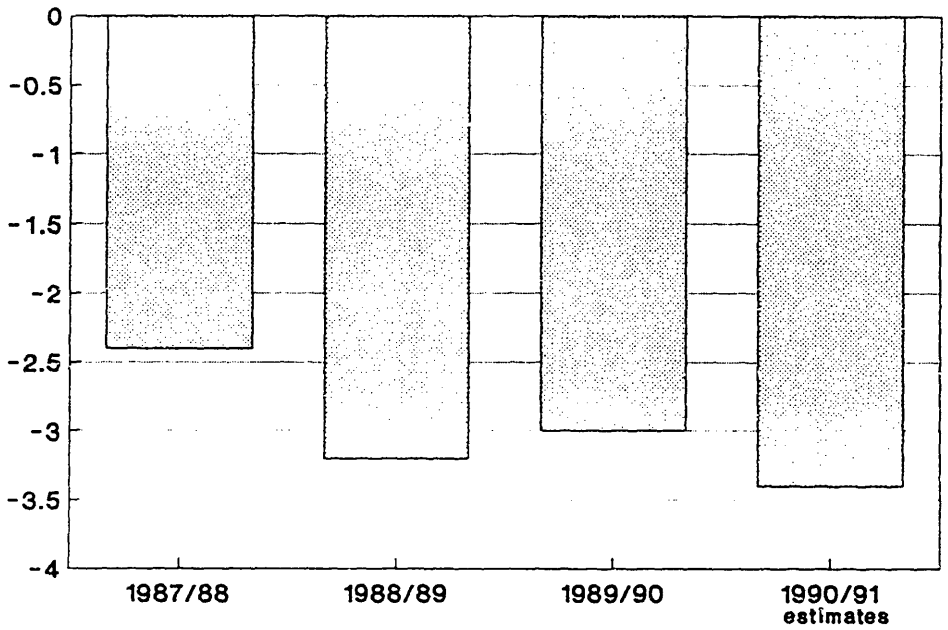
Source: IMF.

Graph 6
International reserves (excluding gold) and months of merchandise imports



Note: Import figures for June 1991 are considered with respect to merchandise imports of 1990/91
Source: IFS, IMF, August 1991.

Graph 7
Current account balance
Percentage of GDP



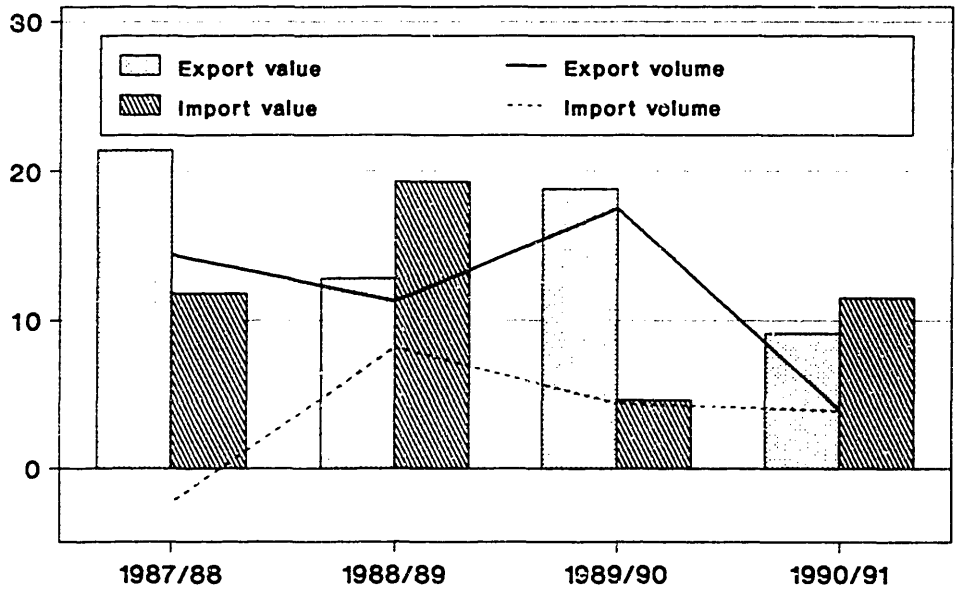
Source: IMF.

A. Merchandise trade

66. In 1987/88-1990/91, the annual growth of the volume of merchandise exports averaged about 12 per cent while the growth in the volume of merchandise imports averaged 3½ per cent (Graph 8). The excellent merchandise export performance was largely due to the improvement in the incentives given to exporters, including lower interest rates on export credit, more generous drawback and cash compensatory arrangements, more competitive access to raw materials and capital equipment because of reduced trade barriers, and a more flexible exchange rate policy that permitted an average annual depreciation of the real exchange rate of the rupee of about 7 per cent in 1987/88-1989/90. In 1990/91, export growth slowed mostly due to less buoyant world demand for imports and trade developments in Central and Eastern Europe and the USSR (traditionally important trading partners for India). The dollar value of merchandise imports grew an average of about 12 per cent per annum in 1987/88-1990/91 mostly due to rises in import prices. In the year 1988/89, the sharp increase in the value of merchandise imports of more than 19 per cent was due to both domestic demand pressures and the restocking needs caused by the previous years' drought. The trade deficit (on a customs basis) rose

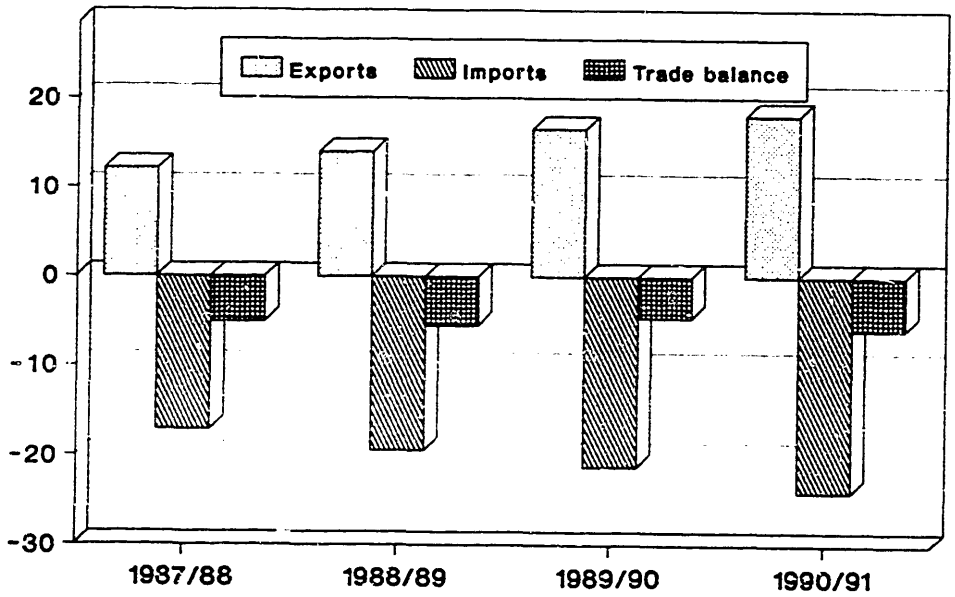
to $ 5.5 billion in 1988/89, declined to $ 4.6 billion in 1989/90, and rose again to nearly $ 6 billion in 1990/91. (Graph 9) Recent data for the first half of 1991/92 show, however, more than a halving of the merchandise trade deficit to about $ 1.34 billion (compared to $ 3.04 billion in the first half of 1990/91). This resulted from a substantial reduction in the value of India's trade, but particularly of imports, which fell by 17½ per cent while overall exports dropped by more than 6 per cent. However, exports to hard currency areas rose more than 51½ per cent, while exports to rupee payment areas fell by 54 per cent.

Graph 8
Value and volume of merchandise imports and exports, 1987/88-1990/91 a/
Annual percentage change



a/ Balance of payments basis, not of crude oil exports.
Source: IMF.

Graph 9
Value of merchandise trade, 1987/88-1990/91 a
US$ billion



a Customs basis
Source: IFS, IMF, August 1991.

67. Export growth was mainly in manufactured goods, whose share in total merchandise exports rose to nearly three quarters between 1987/88 and 1990/91 (Table 5). Textiles and garments, engineering goods and chemicals were the fastest growing categories. Reflecting the import liberalization measures, the share of intermediate goods imports increased. Fertilizers and chemicals, petroleum products and gems were most conspicuous categories (Table 6). Over the period 1987/88-1989/90, the volume of capital goods imports fell to around one quarter of the total.

Table 5
India - Principal merchandise exports, 1987/88 - 1990/91
(Value percentage share)

	1987/88	1988/89	1989/90	1990/91[a]
Tea and coffee	5.3	4.5	4.5	4.1
Oil cakes	1.2	2.0	2.0	1.9
Marine products	3.4	3.1	2.5	3.0
Iron ore	3.5	3.3	3.3	3.2
Oil products	4.1	2.5	2.5	2.9
Textiles and garments	20.6	17.8	19.0	20.7
Leather and leather goods	8.0	7.5	7.0	7.9
Engineering goods	9.6	11.4	11.9	12.0
Gems and jewellery	16.7	21.7	19.1	16.0
Chemicals	5.3	7.7	10.6	9.2
Others	13.7	12.4	12.1	14.0
Total	91.4	93.9	94.5	94.9
Memorandum item:				
Total merchandise exports (f.o.b.)	12 086	13 976	16 613	18 122

a Preliminary.

Note: Shares do not add up to 100 because some exports categories are not included.

Source: IMF

Table 6
India - Principal merchandise imports, 1987/88 - 1989/90
(Value percentage share)

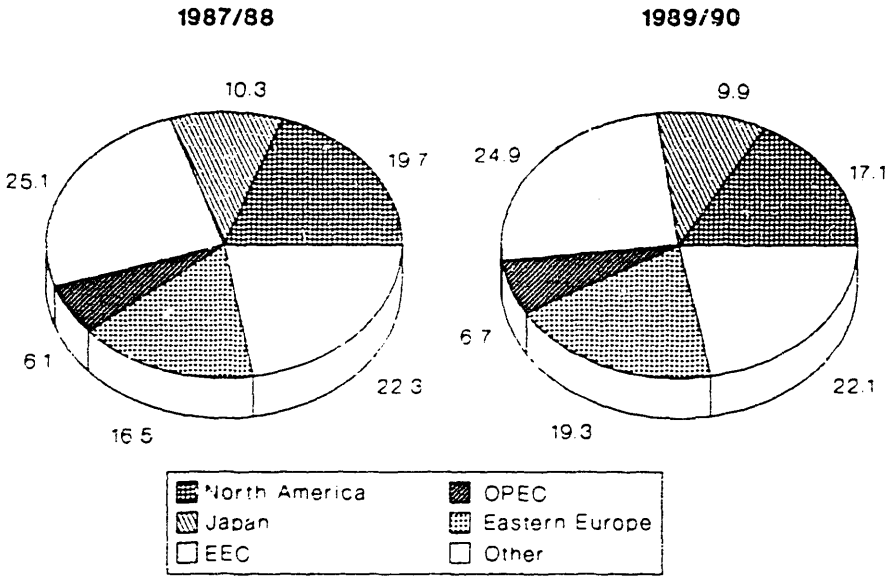
	1987/88	1988/89	1989/90[a]
Foodgrains	0.3	2.7	1.1
Edible oils	4.4	2.6	0.6
Fertilizers	2.3	3.3	5.0
Iron and Steel	6.0	6.8	6.5
Petroleum and petroleum products			
- Crude oil	13.8	10.0	11.8
- Petroleum products	4.4	5.5	5.9
Nonferrous metals	2.8	2.8	3.5
Gems	9.0	11.2	12.0
Chemicals	4.9	6.7	6.0
Machinery and transport equipment	21.0	18.4	19.7
Others	31.1	30.0	27.9
Total	100.0	100.0	100.0
Memorandum item:			
Total merchandise imports (c.i.f.)	**17 152**	**19 504**	**21 252**

a Estimates.

Source: IMF

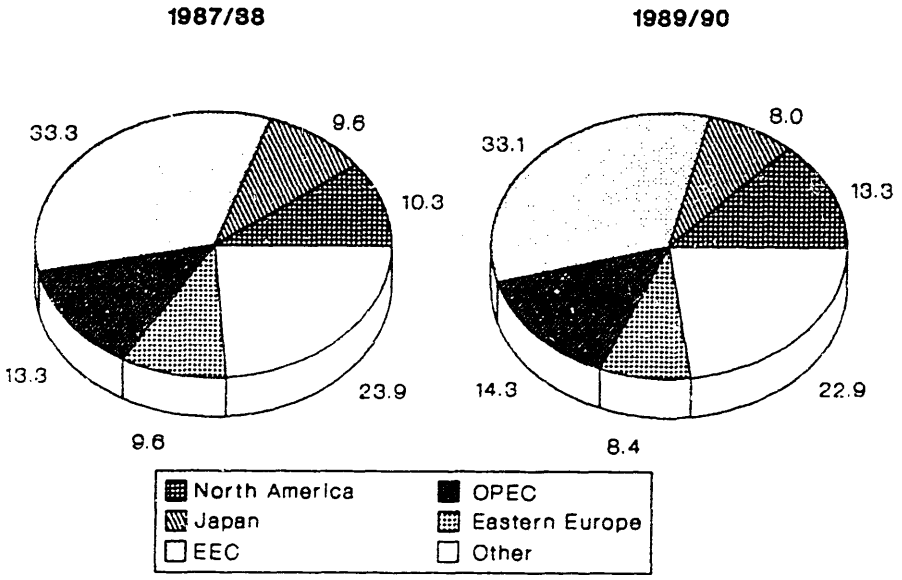
68. The pattern of merchandise exports of India shows that between 1987/88 and 1989/90 there was a shift towards trading with OPEC and Eastern Europe at the expense of North America, the European Communities and Japan (Graph 10-11). This pattern was reversed afterwards.

Graph 10
Regional pattern of merchandise exports
Percentage share



Source: Economic Survey 1990-91, Ministry of Finance, Government of India

Graph 11
Regional pattern of merchandise imports
Percentage share



Source: Economic Survey 1990-91, Ministry of Finance, Government of India.

a. The invisibles balance

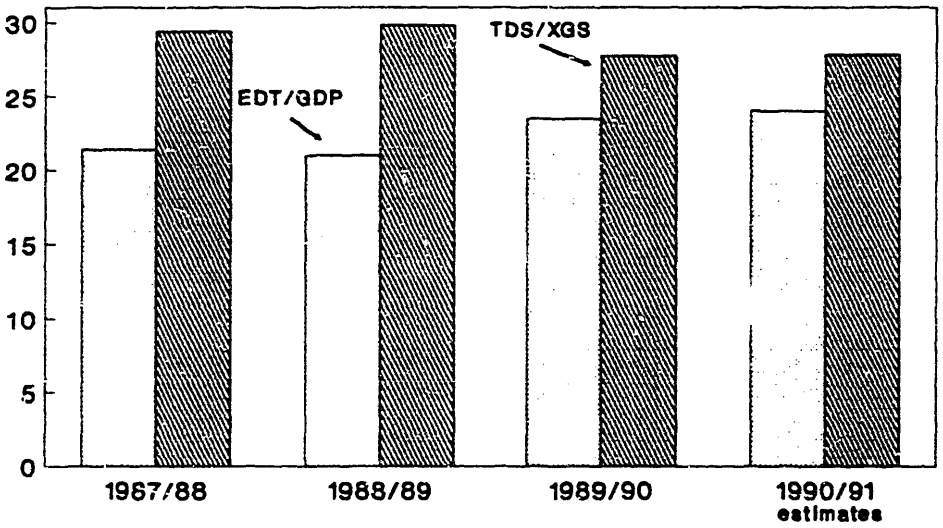
69. In the period 1987/88-1990/91, the services balance of India passed from a surplus of $ 742 million to a deficit of more than $ 1 billion. This resulted largely from the increase in net outflows of net investment income, notably interest payments, as a result of the growing external debt. According to preliminary data for 1990/91, the rise in net inflows related to tourism is likely to have stabilised due to the decline in tourists arrivals. Workers' remittances, the major component of private transfers, were severely hit by the Gulf crisis in 1990/91 (however, they had been declining prior to the crisis). The crisis also imposed the cost of repatriating non-resident Indians. Interest payments are estimated to have continued their upward trend growing more than 15 per cent. Net receipts of official transfers (including food assistance) are expected to have increased more than 16 per cent.

B. The capital account and external indebtedness

70. In the second half of the 1980s, current account deficits exceeded the availability of aid on concessional terms. As a result, external borrowing from commercial banks and deposits from non-resident Indians were increasingly used by the authorities. International reserves were also reduced. Consequently, the share of net external aid in current account financing declined from 47 per cent 1987/88 to about 30 per cent in 1990/91. Reduced need for drought-related aid and delays in providing the domestic fund counterparts to foreign aid, were also responsible for the decline. Net commercial borrowing together with non-resident deposits steadily increased their shares of total capital inflows from about 47½ per cent in 1987/88 to nearly 58½ per cent in 1989/90. This share, however, declined in 1990/91 mostly as a result of a halving of the inflows of non-resident deposits. Net direct investment and portfolio investment inflows have risen between 1987/88 and 1990/91 but they are still a very modest component of the capital account.

71. In 1990/91, provisional data show a slight drop in net aid inflows, excluding official transfers, of about $ 17 million to nearly $ 2980 million. Net commercial borrowing is estimated to have declined to $ 2.3 billion, largely as a result of the downgrading of India's credit rating in a context of reduced availability of international credit. Net inflows under the Foreign Currency Non-Resident Accounts declined by 89 per cent and the outflow of Non-Resident External Rupee Accounts - not protected against exchange rate risk - recorded some rise. According to the latest statistics, the recent partial relaxation of foreign direct investment restrictions has not yet produced a significant change in this flow of funds. The financing need was covered by a further decrease in external reserves and exceptional financing from the IMF. Measures adopted in July 1991, strengthened somewhat the external liquidity position of India.

Graph 12
External debt indicators
Percentage



Note: EDT refers to total external debt
TDS refers to total debt service
XGS refers to current receipts

Source: IMF.

72. India's ratio of total external debt to GDP increased from less than 21½ per cent in 1987/88-1988/89 to an estimated 24 per cent in 1990/91 (Graph 12). The value of total external debt of India was an estimated $ 66.5 billion in 1990/91. The bulk was medium- and long-term debt which represented more than 72 per cent, about the same proportion as in 1987/88; the share of short-term debt, in contrast, was 8.7 per cent up from less than 6½ per cent in 1987/88; non-resident deposits represented more than 15 per cent of the total in 1990/91, with debt to the IMF accounting for the remainder. The share of long-term debt on concessional terms declined over the period 1987/88-1990/91. The debt service ratio to current account receipts improved to 27.8 per cent last year (after peaking at almost 30 per cent in 1988/89), reflecting mostly strong merchandise export growth and reduced liability toward the IMF. The share of interest payments in total debt service increased to nearly 57½ per cent in 1990/91 from about 47 per cent in 1987/88.

C. The exchange rate system

73. India maintains a complex exchange rate system that affects particularly direct foreign investment, nonresident deposits and payments for invisibles. There are also exchange restrictions resulting from bilateral payments arrangements. It applies a 15 per cent tax on foreign exchange for travel abroad and an exchange rate guarantee on interest and principal on foreign currency resident accounts. Recently, a number of measures liberalising payments on current and capital accounts have been introduced (see Section IV).

74. India fixes the value of the rupee in relation to a weighted basket of currencies of major trading partners within a margin of 10 percent. The intervention currency is the pound sterling. The RBI makes periodic changes in the exchange rate. Between 1987/88 and 1990/91, the rupee depreciated more than 38 percent with respect to the dollar and more than 50 per cent with respect to the pound sterling and the deutsche mark. The real effective exchange rate depreciated an accumulated 28.7 per cent between 1987/88 and 1990/91. Beginning in October 1990, the real exchange rate of the rupee appreciated as a result of a depreciation of the nominal exchange rate that did not fully offset inflation in India. Late in 1990, the RBI proceeded to adjust downward the nominal exchange rate. In July 1991, the exchange rate was devalued by 18.7 per cent with respect to the dollar and the authorities announced their intention to keep the rate stable subsequently.

APPENDIX 1

1. Actual User means a person who applies for/secures a licence for the import of any item (or an allotment of an imported item) for his own use, and not for business or trade in it. Actual User (Industrial) means an industrial undertaking engaged in the manufacture of any goods for which it holds a license or registration certificate from the appropriate Government authority.

2. Registered Exporter means a person holding a valid Registration Certificate issued by an Export Promotion Council, Commodity Board or other registering authority designated by the Government for the purpose of export promotion.

3. Export House/Trading House/Star Trading House means a Registered Exporter holding a valid Export House/Trading House/Star Trading House Certificate issued by the Chief Controller of Imports and Exports, New Delhi. Export Houses are Registered Exporters with a net foreign exchange earnings (NFE) of not less than Rs 60 million in the base period, Trading Houses have a NFE of not less than Rs 300 million, while Star Trading Houses have a NFE of not less than Rs 1250 million (with exports spread over a minimum of two export product groups and the NFE from a single product group not exceeding 75 per cent of the NFE prescribed for recognition). Recently, an option has also been provided to get these status based only on the past one year performance in terms of NFE. The NFE Value for this purpose is Rs 120 million for Export House; Rs 600 million for Trading House and Rs 1500 million for Star Trading House.

4. General Currency Area Licences are valid for import from all countries except those from which import is prohibited, while Specific Licences are valid for import from specified country or countries (generally the former CMEA countries).

5. Open General Licence (OGL): Instead of licences for particular purposes, the Government may give general permission for the import of certain goods, subject to specific conditions. Such permission is called the OGL. The list of such items is given in the published Import Policy Book. Under OGL, the import of certain items is allowed for actual users only while other items can be imported for stock and sale purposes also.

6. Supplementary Licences: Actual Users (Industrial) whose requirements of imported raw materials, components, consumables and spares cannot be fully met under the provisions of the OGL or from the supplies by the canalising agencies, may apply for the grant of a Supplementary Licence. Imports of goods on the Restricted List and the Limited Permissible List

may be allowed against such a licence. From 4 July 1991, Supplementary Licences can only be used by producers in the small scale sector and those producing life-saving drugs/equipment.

7. Automatic Licences: these can be used for the import of raw materials and components (including those on the on the Restricted List and the Limited Permissible List) by all actual users (industrial) to the extent of 50 per cent of the value of the Supplementary Licence issued to them in the preceding year to enable procurement of the necessary imported inputs without delay. The quantity/value of the regular Supplementary Licence is subsequently adjusted to take into account the Automatic Licence.

8. Advance Licences and Blanket Advance Licences are given in advance to Registered Exporters to enable the duty free import of items used in the manufacture of the export product.

9. Import Replenishment (REP) Licences can be obtained by registered exporters up to a specified percentage of the value of realised exports. These licences are transferable and may be used to import raw materials, components, consumables and packing materials on the list of limited permissible and the list of non-sensitive canalised items. In addition, against the export of specific products, the REP Licences are valid for the import of items on the restricted list and the list of sensitive canalised items. These licences may also be used to import permissible capital goods without undergoing the essentiality and indigenous clearance requirements. For gems and jewellery, the import of all items required for export production is allowed under these licences.

10. Additional Licences are given to Export Houses, Trading Houses in addition to their entitlement of REP Licences. They were transferable and could be used like REP Licences.

11. Special Additional Licences are given to Star Trading Houses. They are transferable.

12. Diamond Imprest Licences allow the import of rough diamonds to be eventually exported as cut and polished diamonds. The value of such licences is debited to the REP entitlement.

13. Import-Export Pass Book Scheme (in use until 1 April 1990) was designed to provide duty-free inputs for export production to manufacturer-exporters and Export/Trading Houses. The maximum import entitlement was related to export performance, and the beneficiaries were subject to certain export obligations.

14. List Attestation Procedure: Under this procedure customs authorities allow clearance of imported components under OGL on the basis of lists attested by the concerned sponsoring body.