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GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

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

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

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

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with India. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of India. The statement made was as follows:

> "The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of March 3, 1967, and particularly to paragraphs 2 and 4 which read as follows:
>
> > 'The Fund welcomes the major changes in India's economic policies that have occurred since the last consultation. The change in the value of the rupee and the substantial liberalization of import restrictions together with the new priorities in the Fourth Plan should do much to increase the rate of economic growth.

'A policy of financial restraint coupled with active efforts to expand exports should do much to ensure the success of the exchange rate change and the import liberalization program introduced in 1966. If such measures are supported by an adequate inflow of foreign assistance, the Government should be able to make substantial further progress in removing restrictions on external trade and payments.'

"The general level of restrictions of India which are under reference does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves."

Opening statement by the representative of India

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

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

Balance-of-payments position and prospects

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

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

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

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

10. The representative of India agreed that it was important to keep working toward lower industrial costs, and he pointed out that in India increased attention is being given to feasibility studies and project reports of proposed new industries. He added that one difficulty facing Indian producers had fortunately become less serious, namely the small size of the units, for as the market grew, many producing units also grew to an economic size. Industrialists had themselves become more conscious of the need for efficiency, and they were being encouraged to keep efficiency in mind by such policies as the relaxations

of industrial licensing and the priority in licensing of imports of capital goods, components and materials which was given to good export performance. It was necessary in this connexion that more aid be given in an untied form so that it would not be necessary for India to ask her producers to take on the added costs sometimes involved in purchasing from a specified country source.

11. One member asked whether India's export taxation on certain commodities was compatible with the objective of export promotion. It appeared that this form of tax might work against export promotion and the question was asked whether consideration had been given to replacing such levies by some equivalent revenue-raising measure. He added that such export taxes could hardly improve India's terms of trade significantly. The representative of India assured the Committee that the taxes in question were not regarded primarily as revenue measures and were not levied in a situation where exports were being impeded. The export levy was used on certain products of which India is a major supplier mainly to keep unit values up and to keep the terms of trade favourable. Every such levy was carefully watched and adjusted so far as possible to avoid interference with growth of exports. It was of course a delicate matter to manage these duties, as too frequent or too ready change would encourage buyers to hold off in an effort to bring about a reduction in the levy, but within this limitation India did attempt to manage the levies so as to avoid conflict with growth of export earnings.

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

Alternative measures to restore equilibrium

13. From the outset of the consultation it was recognized that putting a stop to inflation was one of the primary objectives which India was seeking to attain and that this was an area in which fiscal and monetary policies played a major rôle. India was commended for its courage in adopting the devaluation of last

year and representatives hoped that it would produce additional beneficial results for India's balance of payments. The careful balanced budget was also praised, as were the new measures to raise and collect taxes. For good results to be realized, however, it was also recognized that sustained budgetary prudence and restraint would be required. Members asked whether the Five-Year Plan was considered to place enough restraint on governmental spending, and whether it was really believed that it would be possible to avoid deficit financing and still attain the planned growth rate of 5½ per cent per year.

14. The representative of India replied that his Government was fully determined to avoid inflationary financing, as it was well recognized that that could only lead to further price increases and to still greater balance-of-payments difficulties. The objectives of fiscal and monetary policy would be to secure growth with stability. He believed that the conflict between the growth objective and the need to overcome inflation could be exaggerated since the principal area in which investment and increased production would be needed was agriculture, where there was much need, and room, for increased productivity. In response to a related question, the representative of India added that along with pursuit of fiscal stability, India would certainly keep constantly in mind the possibility of further relaxation in direct controls; he cited as recent instances some easing in restrictions on coal and steel.

15. Another aspect of India's plans which had already been touched upon was noted again at this point - the importance of export promotion. It was noted that India had adopted a variety of measures ranging from exhortation to higher internal taxes on export goods, cash rebates for exports and other measures of like nature. Special interest was expressed in learning whether India felt, for example, that exports of jute goods could be made more competitive. The representative of India again drew attention to the central importance of higher agricultural production not only as a means of enhancing the domestically available food supply but as a source of materials for export products. As exports usually absorbed only a relatively small part of the output, there would be a multiple effect upon exports, as a result of higher production. As regards the jute industry, the export levy on jute had been adjusted downward recently, but beyond a certain point, further downward adjustment would simply lower the export price without adding to the total earnings from exports. To have gone further in this case would also have hurt Pakistan. Outside the agricultural sector, iron ore and fish exports seemed to be increasing rather well and hides and leather goods had benefited from the devaluation. Producers of engineering goods had been optimistic regarding export possibilities; it might be that the failure of results to match expectations simply meant that an unusually long time was required for a given stimulus to work its way back into deliveries; in that case improvement might show up soon now.

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

System and methods of the restrictions

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

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

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

20. On commercial sales under free foreign exchange India tried to do its best and such licences carried freedom to select goods from any country source, but free exchange was in very short supply and to obtain the largest total import of needed goods, including food, it was necessary to use all the credits available and to save free exchange for goods that could not be obtained otherwise. Diverting free exchange to purchase of things which might be had otherwise would further reduce total imports. In short, India had very little room in which to manoeuvre.

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

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

23. A question was also asked about what was understood to be a relatively new system under which small firms might apply and obtain free-exchange licences from local controllers of imports located in ports of entry. Members expressed interest specifically in learning what proportion of available free licences was being distributed by this method and on what basis a firm might choose to approach either a local or the central licensing authority. The representative of India replied that the authority to which any firm applied for licence was prescribed by regulation and that it was not within the discretion of the individual firm, large or small, to decide which authority it would apply to. Generally speaking, large firms were required to go to the central licensing authority and smaller ones to local authorities. Until recently small firms were required to go to local licensing authorities through State directors of industry, but a recent change enabled them to go direct to local authorities for licences. In 1966, immediately after the liberalization measures, it was at first arranged, for obvious practical reasons, to grant all licences to small firms out of free foreign exchange. But it had now been seen that India could not afford that practice, so that even though it involved much additional administrative work, an effort was being made to use funds obtained under assistance arrangements even for these small licences accorded to small firms. The representative of India stated that he would supply some information on this point at a later stage.

24. Members of the Committee also reverted to the question of India's bilateral trade and payments agreements, some with other contracting parties to GATT. They recalled their view that such agreements, in some cases providing for bilateral settlement of accounts in inconvertible rupees, have an inherently discriminatory effect and reduce the freedom of Indian industry to buy in the most advantageous markets. The subject was not a new one, in consulations with

India, and the question was asked what consideration had been given in India to past Committee views on the bilaterals. More particularly, members were interested to know whether experience really buttressed the theoretical rationale to the effect that bilaterals helped promote new exports to new markets or helped dispose of stocks that had been difficult to sell on the world market. Were such benefits really sufficient to outweigh the disadvantages? Finally, a plea was made that effective traditional suppliers be given more consideration especially where a relatively recent bilateral agreement disturbed traditional commercial links.

25. The representative of India pointed out that most of the agreements in question were in fact with countries having centrally-planned economies, where the bilateral agreement constituted the only basis on which India could develop trade. In those cases there could be no doubt that the agreements made possible access to additional markets and led to development of a significant volume of trade appropriate to the trade pattern one might expect, given the relative stages of development of the countries involved. The partner countries had also, as a result of the agreements, taken a real interest in developing trade with India; as India applied to such imports the same criteria of essentiality as those applied to other imports, there seemed to be no reason to think in terms other than of sustaining and developing the trade on a long-term basis. Generally speaking, India's attitude towards trade with other countries was to develop trade on a multilateral basis. Naturally, India was doing its best, in its own interest, to ensure that imports were obtained from the most effective sources, subject only to the limitations inherent in the fact that some foreign exchange resources were not freely convertible, yet had to be used fully. In this connexion he again stressed the need for an improvement in the amount, terms and forms of aid, and for India's exports to have freer access to world markets.

26. Members also noted that State trading and Government monopolies were used to handle a considerable volume of India's import trade. Although they understood that there was no intent to restrict imports on balance-of-payments grounds through the operation of these agencies, they would be interested to have confirmation that such operations were not being extended and that the Government of India intended to give up, when possible, remaining monopoly functions and phase out remaining bulk-buying practices so that trade might return to private hands for such items as food grains, fertilizers and petroleum products.

27. The representative of India said that his Government actually found that State import of bulk items, with purchasing often on the basis of tenders, was a good system; for India's purposes it was in fact probably better and more advantageous than a system of all-private import would be likely to be. Often there were economies that could be realized by purchasing on a bulk basis, as for example in shipping. Then too, bulk-buying avoided the risk that Indian

buyers might be competing with one another to bid up the price of scarce goods, as once happened in sulphur. For small users, there were obvious advantages in bulk Government import. Actually his Government's view was a pragmatic one: where there seemed to be advantage in bulk-purchasing only a part of the supply, private importers were allowed to trade alongside the State agency, and where it seemed more advantageous for the State agency to handle the entire supply, that was done.

Effects of the restrictions

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

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

Conclusion

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

ANNEX I

OPENING STATEMENT BY THE REPRESENTATIVE OF INDIA

1. The Government of India is glad to have this opportunity of reviewing with contracting parties taking part in this consultation the recent developments in the Indian economic situation with special reference to the restrictions on imports for balance-of-payments reasons. The very useful paper prepared by the International Monetary Fund in connexion with the 1966 Article XIV consultation has already been circulated to members, as also a Government of India paper describing the recent changes in the restrictive system.

2. The current economic situation in India is dominated by the effects of two successive droughts. Imports of foodgrains have been substantially increased, both against assistance provided by friendly countries and through use of India's foreign exchange earnings. Even so, the per capita availability of foodgrains has declined substantially and there has been considerable pressure on the price level. The major objective of fiscal and monetary policies has been to counter inflationary trends. There has been a reduction in the levels of public and probably also of private investment; and the effect of this reduction in investment levels and of a fall in demand for several consumer goods due to lower incomes has been to slow down the growth rate of industrial production. The rate of utilization of assistance available to purchase components and raw materials from abroad has been lower than visualized due to the stagnation in industrial activity. Export earnings have declined in spite of the stimulus provided by the change in the par value of the Indian rupee on 6 June 1966, as a result of the reduced availability of supplies of agricultural products and unfavourable demand conditions abroad. There has been pressure on India's foreign exchange reserves because of higher debt servicing charges, larger payments for foodgrains and other items that cannot be financed under aid, and lower export earnings. The overall situation is thus one in which production and investment in the Indian economy are held back due to a shortage of foodgrains, while at the same time assistance available to finance components and raw materials is being utilized at a relatively slow rate. The Government of India has been discussing with friendly institutions and countries the provision of additional assistance in the form of food or its equivalent, namely, cash or items which would otherwise have to be financed from the country's export earnings. To an extent, assistance of this type has already been provided; and it is the Government of India's hope that further progress in this direction will be possible in the near future. Internally, the objectives of policy have been to raise agricultural production quickly, to distribute equitably such food supplies as are available, to avoid deficit financing, to encourage foreign exchange earnings from exports and invisibles, to intensify the family planning programme, and to create a more competitive situation in Indian industry through relaxation of administrative controls.

3. In 1966-67 wide areas of the country were affected by drought for the second year in succession. Foodgrains output was only around 76 million tons as compared to 72 million tons in 1965-66 and 89 million tons in 1964-65. Crop failures were particularly serious in parts of Bihar, U.P., Madhya Pradesh, Rajasthan and Gujarat. Stocks in the country were already low as a result of the drought in the previous year and it was clear that unless substantial additional imports were arranged it would be impossible to avoid severe hardship. Imports of foodgrains rose from 6.7 million tons in 1964-65 to 8 million tons in 1965-66 and 10.4 million tons in 1966-67. For the calendar year 1967 imports of the order of 10 million tons are visualized, During the first half of the year, imports were of the order of 4 million tons, which included gifts from Australia, Canada and the USSR and Public Law 480 supplies from the United States. For the second half of the year, the requirements were thus 6 million tons valued at $380 million f.o.b. Of this the United States agreed to make available 3 million tons valued at $190 million and has provided half this quantity. Canada has provided grain worth $45 million (0.6 million tons) as a grant. It was recognized that additional financing to the extent of $145 million would be necessary to cover the f.o.b. cost of the balance of 2.4 million tons. I shall refer later to the progress made in this regard.

4. Even with the significantly higher level of food imports, the public distribution system has been under severe strain. The closure of the Suez Canal in recent weeks has been a contributory factor. So far, however, it has been possible to greatly extend the free supplies of grains to people whose incomes have been wiped out in the famine affected areas, to provide limited rations against payment in these areas, and also to extend the rationing in urban centres. Even so, the prices of foodgrains have shown a marked upward trend. Over the twelve months ending 1 July 1967 the wholesale price index for foodgrains rose by as much as 37.8 per cent and for all food articles by 29.7 per cent and this followed an increase of 24.5 per cent in each case over the previous two years. Dearness allowances of industrial workers have been adjusted upwards under wage agreements to compensate for the higher cost of living, resulting in an increase in industrial costs. While the rise in the price of manufactures has been only 2.9 per cent over the last year, the price line for manufactures can be held only if there is a reversal in the trend of foodgrain prices and more generally of prices of all food articles.

5. The production not only of foodgrains but of other agricultural items also has been affected by drought. The output of raw cotton, raw jute, oilseeds, sugar cane and tobacco, to mention the most important among the commercial crops, was at significantly lower levels in 1966-67 than in 1964-65, though with the exception of sugar cane the position was somewhat better than in 1965-66. Substantial quantities of raw jute had to be imported in order to sustain production of jute textiles for export. Shortage of raw cotton led to short time working in textile mills and had an impact on the prices of cotton textiles. It was not possible to export any vegetable oils and the high prices inflated the cost of living. Similarly, sugar exports were lower and prices rose in the home market.

6. The highest priority has been attached to measures that will secure quick increases in agricultural output. The best strategy from the long-term and short-term points of view, is to concentrate on areas of high production potential, to increase inputs of fertilizers and pesticides to improve primarily minor irrigation facilities and to introduce high-yielding varieties on a large scale. Substantial foreign exchange outlays have been deployed on fertilizers in spite of the difficult balance-of-payments situation. As much as $270 million of foreign exchange has been provided for fertilizer import during 1967-68 as against only $98 million two years ago. An encouraging feature is that in spite of the considerably larger supplies, there is a shortage of fertilizers in relation to demand. Preliminary reports indicate that there have been marked improvements in yield as a result of the introduction of the new high-yielding varieties.

7. The population control programme is being vigorously pressed forward utilizing all standard methods and particularly the IUCD and sterilization.

8. The main objective of budgetary policy has been to counter inflationary trends by avoidance of deficit financing. The total Reserve Bank credits to Central and State Governments during 1966-67 was Rs 195 crores as compared to Rs 404 crores in the previous year. The Central Budget for the current year visualizes avoidance of recourse to Reserve Bank financing. It has been agreed with the State Governments that they will avoid unplanned overdrafts with the Reserve Bank of India. Substantial additional taxation was levied in the Central Budget presented recently, and many State Governments have levied additional taxes in order to finance development outlays.

9. The accent of the monetary policy has been on avoidance of excessive credit while meeting the genuine requirements for production, particularly in agriculture. The Reserve Bank has considerably extended its financing of the agricultural sector, through the co-operatives, and the commercial banks have also been asked to undertake the financing of agriculture more intensively than in the past. In the autumn of 1966 a relatively liberal credit policy was announced for the ensuing busy season in view of the expectation of better crops and larger imports under the liberalization programme. A more restrictive attitude was adopted when it became apparent that agricultural output would be lower than anticipated and that the demand for industrial imports would also not be at the planned levels.

10. The rate of growth of industrial production declined, and the general index of industrial production rose by only 2.7 per cent during 1966-67 as compared to 3.9 per cent in 1965-66. Industries based on agricultural raw materials such as sugar and cotton textiles were hampered by lack of raw material supplies. The demand for some consumer goods like cotton textiles was reduced due to lower incomes. The fall in public and probably also private investment outlays affected the demand for capital equipment of various kinds. In the case of some capital and producer goods industries there was a significant fall in levels of production.

11. The pattern of imports during 1966-67 reflected the highest priority given to the requirements of agriculture and the slowing down of the growth rate of industrial output. While trade data indicate a fall in total imports between 1965-66 and 1966-67 from $2,963 million to $2,691 million, imports of fertilizers rose from $82 million to $117 million. Foodgrain imports increased from $676 million to $813 million and those of raw jute from $19 million to $27 million. On the other hand, there was a drop in imports of mineral oils from $144 million to $87 million reflecting the establishment of additional refining facilities. There were sharp declines in imports of steel, non-ferrous metals, machinery and transport equipment, imports of these items taken together declining from $1,404 million to $972 million.

12. Industry is being encouraged to utilize capacity more fully through larger exports. It is expected that exports of steel and of a number of engineering products like machine tools will rise substantially. Industrial units are also being encouraged to diversify production in order to utilize capacity to manufacture items which are in demand. Up to 25 per cent of the capacity of an industrial unit can be utilized to manufacture items other than those for which it holds an industrial licence without securing Government's approval, if additional imported equipment is not required. A number of industries have been exempted from industrial licensing requirements. Distribution and price controls are kept under continual review and relaxed or removed whenever appropriate; for example, cement, steel and coal distribution and prices have been de-controlled. It has been announced that selective measures will be adopted consistent with the need to avoid inflationary financing, to promote demand for the products of specific capital and producer goods industries which are faced with specially acute problems.

13. The most notable liberalization has been with regard to import policy. Certain commodities of special importance for export production have been placed on open general licence; these include hides and skins, wattle bark and extracts and raw cashew nuts. A wide range of spare parts can be imported without licence from the United States against American assistance; and quotas for imports of spare parts against India's export earnings have been substantially increased. The freer availability of spare parts is facilitating the more effective use of the considerable volume of industrial, mining, transport, power and other equipment in the country. The procedures for grant of licences to small-scale industries were considerably simplified. In the case of fifty-nine industries accounting for about three quarters of the industrial production index, licensing is now on a need-based basis. Industrial units can apply for further licences at any time, after showing evidence of utilization of the earlier licences. The evidence required is opening of letters of credit to the extent of 90 per cent of the value of the licence or import of goods to the extent of 60 per cent of the value of the licence. The assurance of availability of licences when required is making it possible for industry to avoid carrying unnecessary stocks and to programme production in an orderly manner. It is, however, necessary to direct importers to specific sources of supply in accordance with credit availabilities from time to time. The

established importer policy has been streamlined by grouping of items into a few categories; and there is provision that a licence granted against past imports of any one item in the group can be utilized at the importer's discretion for import of any item falling within the group.

14. Overall export performance has been disappointing. Total export earnings during 1966-67 amounted to $1,558 million as compared to $1,693 million in the previous year and $1,714 million in 1964-66. Reduced supplies of agricultural raw materials were an important factor. There was dislocation in trading arrangements in the weeks immediately following devaluation. Unit values declined for a number of export commodities, partly because of slack world trading conditions and partly as a psychological response to devaluation. Import restrictions on products such as cotton textiles continued to hamper Indian exports. Export earnings from a few items such as fish and hides and skins in which supplies were elastic and foreign demand was good grew substantially. Nevertheless, the overall picture was one of a deterioration in export performance.

15. A number of policy measures were taken to promote export earnings. Provision was made for exporters to secure their full imported raw material requirements from preferred sources of supply. It was indicated that the requirements of exporting units for imported capital equipment would receive the highest priority. Marketing and other promotional efforts were intensified. In the Central Budget for the current year significant tax concessions were announced for the hotel industry, in order to promote tourist earnings.

16. The effect of reduced export earnings and of higher payments from the country's foreign exchange resources on account of debt servicing, food imports, and imports of a variety of items which could not be covered against external assistance was serious pressure on the reserves, which could be met only by a substantial drawing of $187.5 million on the International Monetary Fund. Leaving out of account transactions with the IMF foreign exchange reserves increased marginally over 1966-67 but there has been a decline of $60 million up to 14 July 1967.

17. The Consortium has recognized that India needs non-project assistance of $1,300 million (including food) during the current year. It has also recognized that a substantial proportion of the new aid has to be in a form equivalent to cash. India is faced with a large gap between the payments for imports which she has to make in free foreign exchange and her earnings of such exchange. Because of a variety of procedural reasons, aid is not available to finance some of the most essential imports. Freight on food shipments covered by aid is an instance. So far it has been possible to arrange aid of this kind to the extent of less than $60 million. It is the Government of India's hope that the remaining amount sufficient to cover commitments of food imports already entered into by India will be forthcoming in the near future; and that the target of total non-project aid indicated at the Consortium will be soon fulfilled.

18. Aid available for the purchase of components and raw materials from abroad is often tied not only by country but also by commodity; and in certain instances individual financing negotiations between suppliers and Indian importers are required to utilize assistance. The effect of aid tying is to reduce the extent to which Indian importers can be given flexibility in taking decisions regarding imports on purely commercial grounds. Relaxation of the restrictions on use of such assistance would promote the emergence of competitive conditions in the Indian industrial structure.

19. The tariff obstacles to India's exports have been somewhat reduced as a result of concessions negotiated in the Kennedy Round. In regard to relaxation or removal of quota restrictions, to which some products of substantial export interest to India are subjected in some developed countries, there has, however, been no progress. Early removal of these restrictions and application of tariff concessions fully, without phasing, would enable India to augment her foreign exchange earnings and this would, to some extent, ease her present balance-of-payments difficulties. The Government of India, therefore, hope that on these matters, early action would be taken by the developed countries.

20. While the past two years have been very difficult ones for the Indian economy, there is good reason to hope that in view of the policy measures that have been adopted, there will be a significant rise in output if weather conditions are not unfavourable. The requirements of longer-term growth are, therefore, not being ignored. While current investment levels have been reduced, work on project preparation has continued. If there has not to be a hiatus in development a significant rise in investment outlays will be necessary next year. The external financing for the new projects that have been undertaken are being negotiated with the institutions and countries providing assistance.

ANNEX II

INTERNATIONAL MONETARY FUND EXECUTIVE BOARD DECISION TAKEN AT THE CONCLUSION OF THE FUND'S CONSULTATION WITH INDIA ON 3 MARCH 1967

1. This decision is taken by the Executive Directors in concluding the 1966 consultation with India pursuant to Article XIV, Section 4 of the Articles of Agreement.

2. The Fund welcomes the major changes in India's economic policies that have occurred since the last consultation. The change in the value of the rupee and the substantial liberalization of import restrictions together with the new priorities in the Fourth Plan should do much to increase the rate of economic growth.

3. The Fund believes that the rapid rate of price increase over the last three years and the importance of preventing the exchange rate change from being undermined by excessive increases in domestic demand indicate the need for a policy of greater financial restraint. This can best be achieved by successful implementation during the forthcoming fiscal year of the Government's intention to reduce the government deficit financed through the banking system.

4. A policy of financial restraint coupled with active efforts to expand exports should do much to ensure the success of the exchange rate change and the import liberalization program introduced in 1966. If such measures are supported by an adequate inflow of foreign assistance, the Government should be able to make substantial further progress in removing restrictions on external trade and payments.