

GENERAL AGREEMENT ON TARIFFS AND TRADE

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REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON INDIAN-REGULATORY DUTY

1. In April this year the Government of India notified the CONTRACTING PARTIES that, in view of the sharp decline in its foreign exchange reserves, it had imposed a regulatory duty of 10 per cent ad valorem on all imports into India with certain specific exceptions (GATT/AIR/457).
2. The Committee has, on the instructions of the Council (C/M/27) examined the balance-of-payments aspects of the levy. The Committee had before it the text of the statement made by the representative of India at the Council meeting on 12 July 1965 (L/2458/Rev.1) and background material supplied by the representative of India (L/2447 and BOP/55), as well as the documentation provided by the International Monetary Fund as noted in paragraph 4 below.
3. The Committee met on 5 November 1965. This report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

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

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision¹ and background material from the last consultation with India under Article XIV of the Fund Agreement.

"The Fund invites the attention of the CONTRACTING PARTIES to the background papers which it has provided. As indicated in those papers, India's reserves gradually strengthened from the end of 1962 to May 1964 but then declined sharply. On March 19, 1965 the Fund approved a stand-by arrangement under which India was authorized to draw from the Fund up to the equivalent of \$200 million over the next 12 months. Of this amount, \$175 million had been drawn by the end of September. Over-all, India's reserve position continues

¹Reproduced in Annex I.

to be difficult. The general level of the various restrictive and regulatory duty measures being applied by India does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves."

Opening statement of the representative of India

5. In his opening statement, the full text of which is reproduced in Annex II, the representative of India recalled that the considerations leading to the imposition of the regulatory duty on imports had been set out in the Finance Minister's statement in the Indian Parliament on 17 February 1965 (circulated as L/2447). Information on subsequent economic trends and the policy measures adopted was contained in the documentation submitted to the Committee.

6. The representative of India recalled that the serious pressure on reserves which had led to the imposition of the regulatory duty had been the result of a rising debt service burden, larger imports of food and requirements for development and an expansion of exports at an inadequate rate. The utilization of external assistance and the proportion available in non-project form had shown improvement but this had not sufficed to prevent the fall in reserves.

7. He said that the regulatory duty was one of a series of measures to deal with the balance-of-payments situation and explained the rationale behind the adoption of this measure. Other measures had since been taken in the budget for 1965-66 to strengthen the balance of payments. It had also become necessary to suspend the issue of fresh import licences, other than against assistance and private capital inflow, for a period during the first half of 1965, the full import control policy for the year subsequently being published on 15 July 1965. A scheme of advance deposits was also enforced for a short time, being removed at the time of the presentation of the supplementary budget for 1965-66 in August 1965. In the supplementary budget the import tariff was rationalized, its structure being readjusted to suit the present stage of Indian development. Duties bound under the GATT were not raised above the bound levels.

8. The representative of India said that the balance-of-payments situation had become even more acute as a result of recent developments on India's borders and it was now considered essential to strengthen the balance of payments even more rapidly than had been visualized earlier. He referred to certain measures which had recently been announced to further this objective.

9. In conclusion the representative of India stated that the difficulties connected with the balance of payments were, however, likely to continue in view of the expected decline in production in certain crops during the current year which would have effects on both the import and export sides and in view of the growing import requirements for development purposes. It was, he said, against this background that the levy of the regulatory duty on imports must be viewed.

Discussion

10. The members of the Committee expressed their thanks to the representative of India and to the representative of the International Monetary Fund for the full and informative documentation and statements which had been made available. There was also a general expression of sympathy and understanding for the difficult balance-of-payments situation in India. Hope was expressed that this situation might soon improve. In view of the statements presented by India and the International Monetary Fund, there was recognition that special measures were required to overcome the difficulties.

11. With respect to the development of the balance-of-payments situation as such, and prospects for the immediate future, the representative of India clarified in response to a question, that his Government hoped that no further decline in reserves would occur during the current financial year 1965-66, although he emphasized that in view of the very low level of reserves at the beginning of the year even this achievement would present no solution to the problem. In the first half of the year (April-September) reserves had fallen from Rs.1,160 million by about Rs.50 million notwithstanding a drawing from the Fund of \$75 million under the stand-by credit of \$200 million (\$100 million had already been drawn) and a rescheduling of a repurchase obligation on an earlier drawing from the Fund amounting to \$25 million. For the second half of the year it was still hoped to avoid any decline in reserves for the year as a whole, after meeting a Fund repurchase obligation of \$75 million next March. Furthermore, in the succeeding half year, April-September 1966, it would be necessary to meet a Fund repurchase obligation of \$50 million whereas in the comparable half year of 1965 there had been a net drawing from the Fund of a total of \$75 million.

12. Interest was also expressed in knowing how India views results of its efforts to stimulate the inflow of private foreign capital. The representative of India explained that results appear to be quite encouraging, even though no precise quantitative figures can be cited. In general, it appears that India's growing industrialization is creating a market sufficiently large to present interesting possibilities to foreign enterprises in such fields as petrochemicals and metals for which a substantial market is a prerequisite.

13. Commenting on the very wide range of measures taken by India to cope with her balance-of-payments difficulties and in particular on the new and relatively high tariff described by the representative of India, members of the Committee asked whether it might not be possible to envisage a relaxation of some of the other controls. They recognized that the 10 per cent import surcharge imposed in 1963 had already been withdrawn but wondered whether other relaxations might not be possible. In reply, the representative of India emphasized that India is very interested in importing just as much as can be financed by available earnings and foreign aid, in order to press ahead with development plans. The restraints which have been imposed are only those which are essential but the Government is on the alert to introduce more flexibility and simplification wherever possible. As an

example he cited the fact that certain categories of industrial licence holders may now use part of their licences to import any components and spare parts they may need without special endorsement of their licences. However, so long as exports do not rise sufficiently and foreign aid is inadequate to cover import needs, restraints will be needed, even though the absolute level of imports is expected to increase. In this connexion he recalled that the Finance Minister's message of 19 August had specifically mentioned India's desire to move toward further liberalization, and he added also that more liberal policies on the part of India's trading partners could make a significant contribution to improvement of India's export earnings.

14. Among other measures adopted by India recently to help overcome the balance-of-payments difficulties, special interest was expressed in the new tariff, which had come into effect on 19 August 1965. In general the rate structure which had been adopted was designed to adapt the tariff to India's changed economy, in that while it was formerly of great importance to facilitate the importation of capital equipment by low rates, much machinery is now available internally, so that India has thought it appropriate to approach the practice of most developed countries in making machinery dutiable at rates at least as high as those imposed on raw materials. Consequently machinery, apart from a few items chargeable at lower rates, had been given a statutory rate of 40 per cent, like raw materials, but the effective rate had temporarily been put five points lower in recognition of the difficulties which an abrupt increase to the full rate might cause, particularly to projects for which financing has already been arranged on other assumptions. With respect to the possibility that India may at a later time wish to renegotiate rates of duty bound in GATT, which for the time being remain at their old level, the representative of India assured the Committee that India would, when the time came, approach the CONTRACTING PARTIES under the relevant procedures of the General Agreement in order to renegotiate these obligations. Obviously at that time the nullification or impairment of some concessions obtained by India would need to be taken into account.

15. With regard to the regulatory duty itself, the representative of India explained in answer to a question that its purpose was envisaged as three-fold; in restraining imports, it would help overcome the immediate balance-of-payments crisis, but beyond that it would also bring in needed revenue and would also help combat inflation by absorbing a certain amount of purchasing power. He confirmed that the regulatory duty is regarded as a temporary measure, but pointed out that it would be impossible to predict when it might be possible to remove the duty, since that would depend upon a number of other factors, including export trends and policies of trade partners. He nevertheless expressed the hope that it will be possible to remove the duty in due course.

16. Concerning the application of the regulatory duty, it was noted that it applies to most products, and the question was asked whether it also applied equally to imports from all sources. The representative of India confirmed that not only the regulatory duty but also all other Indian import duties are

completely non-discriminatory so far as source of supply is concerned, apart from historical tariff preferences sanctioned by the GATT. Import licensing against convertible foreign exchange is also completely non-discriminatory. Imports financed with tied aid have however to be purchased in the country providing aid, but otherwise procurement in India is carried out strictly on commercial considerations. India is fully aware of the need to maximize resources by purchasing from the most competitive sources, and does generally trade on a fully multilateral basis in accordance with her GATT obligations.

General

17. The Committee has carried out the examination of the balance-of-payments aspects of the levy, in accordance with the request of the Council. It noted the statement by the International Monetary Fund that the general level of the various restrictive and regulatory duty measures being applied by India does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves. There was recognition that special measures were required to overcome the difficult balance-of-payments situation of India.

ANNEX I

International Monetary Fund Executive Board Decision
Taken at the Conclusion of the Fund's Consultation
with India on 30 July 1965

1. The Government of India has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.
2. The strains experienced by the Indian economy during the past year, in the form of a sharp increase in prices and acute external payments difficulties, were attributable in part to a stagnation in the output of foodgrains for three consecutive years. This stagnation was also reflected in a slow growth of aggregate output, especially on a per capita basis. These developments point to the need to give the highest priority to increasing agricultural production.
3. The monetary expansion in the past three fiscal years has been excessive, primarily because large-scale defense requirements superimposed on the needs of the development effort led to increased use of Reserve Bank resources by the Government; the expansion of bank credit to the private sector was also large. In the budget for the current fiscal year, a substantial reduction in the government reliance on bank financing is envisaged. In September 1964 and February 1965, the Reserve Bank raised the Bank Rate and took other measures to tighten credit. The Fund notes the Government's determination to achieve its budgetary target and to take such credit control measures as would be needed to slow down the rate of monetary expansion. The Fund welcomes the decision of the authorities to avoid inflationary financing of the Fourth Plan and hopes that it will be strictly adhered to.
4. The external payments position has become increasingly difficult. The present system of exchange and trade controls and export promotion arrangements is complex and severely restrictive. In view of this and the growing foreign exchange needs related to economic development, further measures are needed to strengthen the balance of payments, and should be designed to stimulate exports and contribute to the liberalization of restrictions on trade and payments.
5. In concluding the 1964 consultations the Fund has no other comments to make on the transitional arrangements maintained by India.

ANNEX IIStatement by the Representative of India

The considerations leading to the imposition of the regulatory duty on imports have been set out in the Finance Minister's statement in Parliament on 17 February 1965, which has been circulated as GATT document L/2447. Information on subsequent economic trends and the policy measures adopted is contained in the various documents circulated for the meeting.

At the time the regulatory duty was imposed, the foreign exchange reserves of India, excluding gold, had fallen to a level of around Rs.1,000 million; over 1964-65 as a whole, the decline in reserves was as much as Rs.720 million and there had been a fall of Rs.170 million despite drawal of Rs.476 million from the International Monetary Fund even during the October 1964-March 1965 half year when there is normally some improvement. The decline in reserves has continued since. During April-September 1965, there was a decline of Rs.50 million, and in addition there was a drawal of Rs.360 million (\$75 million) against a standby which was negotiated last March, from the International Monetary Fund. The level of reserves on 29 October 1965 at Rs.1,343 million excluding gold, was equivalent to less than six weeks' imports. This is inadequate, particularly in view of the fact that India has an outstanding commitment to repurchase \$125 million from the International Monetary Fund.

The serious pressure on reserves has been the result of a rising debt service burden, larger imports of food and requirements for development, and expansion of exports at an inadequate rate. While the utilization of external assistance and the proportion available in non-project form have shown improvement, this has not sufficed to prevent the fall in reserves.

During 1964-65, imports amounted to Rs.13,630 million as compared to Rs.12,030 million in the previous year. The increased payments for food purchased outside Public Law No. 480 alone rose by Rs.290 million between the two years, in spite of an increase in foodgrains output of over 10 per cent. This was because stocks had been depleted as a result of the stagnation in agricultural output in the previous years. Increased imports of other commodities were the result of a faster tempo of development and some liberalization of import licensing during that year. A high level of imports has continued during the current fiscal year.

The level of exports during 1964-65 at Rs.8,030 million showed a rise of only Rs.10 million in comparison with the previous year. During 1964-65, there was some lag between export shipment and receipts, partly on account of an interest

rate differential between the United Kingdom and India until February. This gap has narrowed in recent months. Currently, however, exports are running at levels slightly below those of last year. For April-August 1965, customs data indicate exports of Rs.3,140 million as against \$3,260 million in the corresponding period last year. In part, the fall in exports is the result of lower world prices for items such as iron ore and sugar. The availability of vegetable oils for export has been negligible owing to a poor crop.

The debt service burden is mounting in spite of gradual improvement in the terms and conditions of fresh assistance. The payments of interest and amortization of loans amounted to Rs.1,210 million in 1964-65 as compared with Rs.1,110 million in the previous year; in the first half of the current fiscal year such payments have amounted to Rs.700 million - nearly 40 per cent more than in the comparable period of last year.

While the payments on invisibles account are governed by the exchange control, there has been a steady decline in receipts in recent years.

The balance-of-payments position during last year and during the current year would have been even worse but for the substantial improvement in the utilization of external assistance, which in turn has been possible, in part, because of the larger share of non-project assistance. Aid utilization in 1964-65 was Rs.5,026 million of which non-project assistance amounted to Rs.1,910 million. Utilization of project assistance in the previous year was Rs.2,564 million and of non-project assistance Rs.1,500 million.

The regulatory duty is one of the series of measures designed to deal with the balance-of-payments situation. It seeks to effect a measure of economy in imports. No doubt imports are restricted through quantitative controls. There are, however, commodities such as petroleum products for which the use of quantitative restrictions is administratively inconvenient. It has been the practice to inhibit the consumption by duties, providing exchange allocations adequate to satisfy the demand. Further, in the case of imports for which the foreign exchange necessary has to be determined on an ad hoc basis, such as imports of machinery and spare parts, detailed physical screening of the list of goods proposed to be imported cannot be fully effective and a price deterrent for imports was judged to be necessary. Over the years considerable capacity has been built up within the country for the manufacture of numerous items of industry, transport, power, mining and other equipment. A higher level of import duty on the finished goods encourages industry to actively seek local substitutes, thereby resulting both in some reduction in aggregate foreign exchange outlay and more efficient use of the foreign exchange that is, in fact, spent on imports. While the regulatory duty is thus conceived as an instrument to relieve the heavy pressure on India's balance of payments, it is not likely to result, as it has not, in an absolute decline in imports. India's needs for imports will grow with development; the problem is only to put a restraint on the growth consistent with the ways and means position. It may be added that the regulatory duty has, consistently with the objective behind it, been applied in a wholly non-discriminatory manner as between commodities; only a few exceptions have been made.

The Finance Minister observed, while introducing the regulatory duty along with other measures: "The strictest fiscal and monetary discipline has to be observed in the interest both of stability of prices and of improvement in the payments position." The measures taken included the increase in the bank rate by a full percentage point from 5 to 6 per cent, a further stiffening in the terms of lending by the Reserve Bank to the commercial banks in the interest of credit control, a decision to review all demands for imports against free foreign exchange and an appeal to the Aid India Consortium for maximum possible assistance in non-project form. Just about that time, India approached the International Monetary Fund for a standby credit of \$200 million.

Further measures have since been taken to strengthen the balance of payments. The budget for 1965-66 visualized a nominal surplus for the first time in many years. In order to stimulate private savings and investment, personal income taxation was reduced at all levels; and in order to stimulate industrial growth, concessions were given to priority industries in corporate taxation. The budget contained special provisions for stimulating exports. A number of concessions in taxation were given to an important export industry, namely, tea, following the recommendations of a committee. A new scheme of tax credit certificates was introduced under which exporters are granted tax credit certificates up to 15 per cent of the value of the exports. The tax credits so far announced cover around half of India's export. It may be added that adoption of more liberal commercial policies by India's trading partners can make a very useful contribution to these efforts.

As the pressure on reserves continued to recur in the earlier part of the current fiscal year, it became necessary to suspend the issue of fresh import licences other than against assistance and private capital inflow from about the middle of May, licensing being resumed from 1 July 1965. The import policy for the current year was announced on 30 June in so far as established importers are concerned and the procedure with regard to actual user licensing was announced on 2 July. The full import trade control policy for the year was subsequently published on 15 July 1965.

In order to phase the utilization of licences already issued, a scheme of advance deposit against imports was introduced under which importers were required to make a deposit of 25 per cent of the value of imports. The deposits were refundable after a period of two months. This was essentially a transitional measure. In the supplementary budget for 1965-66, which was presented in August 1965, the import tariff was rationalized and at the same time it was announced that the advance deposits would no longer be called for. As a result of the supplementary budget, the tariff structure has been readjusted to suit the present stage of Indian development. Unnecessary discrimination as between tariff items has been removed, the broad structure of rates adopted being 35 per cent for machinery (with lower rates for certain items, such as those important for agriculture), 40 per cent for basic industrial raw materials, 60 per cent for other intermediate goods and 100 per cent or the previously existing rates for consumer goods.

It may be noted that the surcharges on duties levied earlier have been withdrawn, with a view to simplification. Duties bound under the GATT were not raised above the bound levels, but it was stated that in due course renegotiation might be sought on some of these items. Certain excise duties were also raised. A supplementary budget was necessary because it was found that expenditures were running at levels higher than anticipated and it was thought desirable to take timely action in the interest of stability. The rationalization of the import duty structure would also, it was stated, help import substitution.

The balance-of-payments situation has become even more acute as a result of recent developments on India's borders. The policy of the Government of India continues to be to pursue development vigorously while making adequate provision for the country's defence. It is now considered essential to strengthen the balance of payments even more rapidly than was visualized earlier. Certain measures have been recently announced to further this objective. Reference was made earlier to the reduction in inward remittances on account of invisibles. Under the National Defence Remittance Scheme certain import facilities are granted against inward remittances to Indian nationals by way of gifts, family remittances and transfer of capital. A new Gold Bond Scheme has been announced providing for the return after fifteen years of gold subscribed in the form of bullion or ornaments, with an interest rate of slightly below 4 per cent. New series of Government bonds have also been issued to mobilize internal resources.

While all these measures will be of help, the difficulties of balance of payments are likely to continue in view of the expected decline in production in certain crops this year. Failure of rains has affected the groundnut crop and also the cotton crop in several parts of the country. No firm estimates of crop are yet available, but it is feared that the decline in oilseeds' production will be substantial and that the cotton crop may be about 5 per cent lower. The position regarding food grains is also difficult. Production of rice will at best be the same as last year; as regards wheat, sowings have been reasonably satisfactory, but the position will be known only after a few months, since the main crop is harvested in March-April. Government is determined to intensify procurement operations and also improve the machinery for distribution, introducing rationing in towns with the population of more than a million. With the best effort, however, some imports of food grains will be necessary and this will put a pressure on the balance of payments.

A decline in output of commercial crops such as cotton and oilseeds will tend to reduce export earnings and in spite of the concerted effort being made to step up exports, a substantial improvement will be difficult to achieve in the short run. Import requirements, both for food and articles needed for development are growing. The Indian balance of payments will thus continue to be under considerable pressure during the coming year. While capital inflows will be of considerable assistance, it will continue to be imperative to take all measures necessary for restraining imports and making the best use of the foreign exchange available. It is against this background that the levy of the regulatory duty on imports must be viewed.