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SECTION - I

BALANCE OF PAYMENTS - POSITION AND PROSPECTS

(a) Macroeconomic Trends in the Economy

The performance of Indian economy since the beginning of this decade has been relatively satisfactory. GNP has grown at an average rate of about 5 % per annum and while the agricultural sector has maintained a modest rate of growth of 3.5%, recent revised estimates suggest that industrial production has been expanding at close to 8% per annum over the last four years. The fastest growing sector in the economy, however, continues to be services i.e. the non-manufacturing sector. These trends have been complemented by comparatively low inflation rates. Inflation peaked to 17% after the second oil price shock in 1980/81 but has been kept in check at below 6% per annum over 1981-87.

Given the low level of per capita income, India has relatively high savings rate of about 22.8%(gross domestic savings as a proporition of GDP in 1985-86). Gross investment as proportion of GDP was estimated to be about 24.6% in 1985-86, implying dependence on external resources to the extent of 1.8% of GDP. The foreign exchange reserves provided for less than 5 months import cover in these two years.

(b) Behaviour of the Balance-of-Payments

Complete Balance-of-Payments data is not available beyond 1985/86 but some partial indicators are available for 1986/87. Before discussing the more recent developments, it is useful to note a few salient features of the Balance-of-Payments in the early 1980s.

[1]Material supplied by the Indian authority.

(i) Like most other non-oil exporting developing countries, India suffered a massive deterioration in its external accounts after the second oil price shock. Visible trade deficit widened to US$7.5 billion in 1980/81, which represented about 4.7% of GDP. Although the invisibles account showed a surplus of $4.7 billion (2.9% of GDP), the current account deficit was 2.8 billion in 1980/81 (1.7% of GDP). Despite higher long term capital inflow of loans and grants ($2.1 billion) and drawing $1.04 billion from the IMF foreign exchange reserves declined by $653 million in that year.

(ii) India negotiated a loan of SDR 5 billion from the IMF under the Extended Fund Facility in November 1981 as a three year Balance-of-Payments support while adjustment measures were being aimed at closing the disequilibrium. The trade balance narrowed somewhat in 1981/82 due mainly to rapid import substitution in the energy sector but with lower net invisible earnings, the current account deficit deteriorated to $3.1 billion (1.9% of GDP). Foreign exchange reserves declined by $1.8 billion despite drawing $710 million from the IMF.

(iii) There was a distinct improvement in the Balance-of-Payments in 1982/83. Trade deficit narrowed further to $5.9 billion(3.5% of GDP), however, with a decline in net invisibles balance, the current account deficit improved only marginally to $2.8 billion (1.7% of GDP). With the help of drawings of $1.96 billion from the IMF, the country's reserves increased by $646 million. In view of the expected improvement in the Balance-of-Payments and on account of measures initiated to attract portfolio investments of Non-Resident Indians in the Budget of 1983-84, the agreement with the IMF was terminated on 1 May, 1984.

More recent trends

India's Balance-of-Payments has been under strain over 1983-86. This trend has continued during 1986-87 and into the current year, although detailed data on the various accounts is not available beyond 1985/86 (see Annexure Table I). The developments of the main categories of the Balance-of-Payments are discussed below:

(a) Current Account

The current account deficit which has ranged between $2.6 billion and $3.1 billion annually over 1980-85, sharply deteriorated to $5.3 billion in 1985-86. Despite the second oil price shock and other exogenous developments like global recession, the current account deficit had been kept in check below 2% of the GDP. However, with the deterioration in 1985-86, the deficit peaked to 2.7% of GDP.

Despite a distinct improvement in the trade deficit, there does not appear to have been a significant improvement in the current account during 1986-87.

The trade balance improved continuously over 1980-85, from a deficit of $7.5 billion in 1980-81 to $5.6 billion in 1984-85[1]. As a proportion of GNP, the deficit was narrowed from 4.7% in 1980-81 to 3.1% in 1984-85. This trend was reversed in 1985-86 when the deficit reached an unprecedented $7.8 billion, although as a proportion of GDP it was 3.9% i.e. lower than the level reached after the second oil price shock in 1980/81. This deterioration was caused mainly by a decline in exports by 5.9% (dollar terms) and an increase in imports by 10.1% According to the preliminary trade statistics, the deficit in 1986-87 was reduced to $5.9 billion because of a nominal growth of 9.6% in exports and marginal increase of 0.2% in imports compared to the previous year. Figures for the first quarter of the current year indicate a continuation of the favourable trend. This is subject to considerable uncertainty because the management of drought in many parts of the country may result in increasing quantum of imports. Moreover, the drought conditions are likely to adversely affect the agro-based exports.

A disturbing, though not entirely unexpected development, has been the continuous decline in the surplus on the invisibles account. At current prices,

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1 The trade balance as recorded by DGCI&S statistics is different from that shown in the Balance-of-Payments statistics of RBI e.g. the RBI statistics shows a deficit of $7853 million and DGCI&S of $7155 million in 1985-86. The main reason is that RBI statistics records actual payments while DGCI&S records the value of goods exported and imported.

the surplus has declined from *$4.74 billion in 1980/81 to $2.53 billion in 1985-86. The cushion that the surpluses on this account provided in absorbing the trade deficit after the second oil price shock is no longer available; and recent trends in the world economy do not suggest any prospects for a major improvement in this account in the near future. In terms of individual sub-categories, net foreign travel receipts have declined sharply from $1,360 million in 1980/81 to $635 million in 1985-86, investment income account has turned negative to the extent of $776 million from a surplus of $614 million in 1980/81, and private remittances, which provided the major boost to the invisibles account in the early 1980s, have, in fact, declined from dollar 2.6 billion in 1983/84 to $ 2.2 billion 1985/86.

Capital Account

The capital account (including errors and omissions) recorded surpluses of $3.6 billion and $4.9 billion in 1984/85 and 1985/86 respectively. The main component in this account is the official long term capital inflows which were $2.1 billion and $2.4 billion in these two years. Apart from amortization payments for outstanding external debt, the only other significant item in this account is private long term capital inflows. These inflows, which are due largely to fiscal and interest rate benefits offered to Non-Resident Indians, have grown in net terms from $91 million in 1980/81 to $1924 million in 1985/86. Recent estimates show further growth of these deposits. The total deposits of Non-Residents in the various types of external accounts were about $6200 million on 31st May 1987.

Overall Deficit and the Methods of Financing

The overall deficit (combined current and capital account) in the balance of payments which peaked to an unprecedented $2.5 billion immediately after the second oil price shock in 1981/82 has gradually declined thereafter. From a deficit $547 million in 1983/84, the overall balance of payments turned into a surplus of $725 million in 1984/85. However, with a sharp increase in the current account deficit in 1985/86, the balance-of-payments was in deficit by $371 million.

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*Exchange rate for conversion of Indian Rupee into US$ is given at Annexure-II.

The overall deficit, which requires financing either by transaction with the IMF or by changes in foreign exchange reserves, has been relatively low in recent years. After adjusting for transaction with the IMF, India added $747.5 million and $778.8 million to its foreign exchange reserves in 1983-84 and 1984-85. Reserves, however, declined by $577.3 million in 1985-86 and further by an estimated $537 million in 1986/87.

Prospects

The pressure on Balance-of-Payment is expected to persit throughout the rest of the decade and into 1990s. Debt-service on past borrowings is expected to increase significantly in the years ahead. The inflow of remittances from expatriate Indians may not be buoyant as in the recent past. The recent relief from lower prices for imported oil has already proved transitory as international oil prices have recovered from the trough of mid-1986. Furthermore, India's degree of self-sufficiency in petroleum has declined from the peak attained in 1984-85 because the scope for further increase in domestic production is limited. Since invisibles are not expected to grow, the only way that the current account can be managed is by narrowing the trade deficit. This is especially so because India is already availing of most of the available official assistance. Furthermore, the level of reserves is also not sizeable enough to accommodate significant overall deficits. Prudent Balance-of-Payments management in the future years would not commend that India increases its external liability on account of commercial borrowings and thereby its debt-service ratio.

Government policy has aimed at strengthening sectors with high export potential while keeping the import regime moderately liberal to encourage healthy competition and upgrade the industrial technology in the country.

SECTION - II

IMPORT REGIME

(a) Legal and Administrative basis of the import restrictions:

The imports and Exports(Control)Act, 1947, empowers the Central Government to prohibit, restrict, or otherwise control imports. In exercise of the powers conferred by this Act, the Imports(Control) Order,1955 has been issued. The Schedule to the said Order contains the list of articles import of which is controlled. The import of such items is prohibited except:

(i) under and in accordance with a licence or a Customs Clearance Permit issued under the said Order, or

(ii) if it is covered by Open General Licence(subject to such conditions as may be stipulated), or

(iii) if it is covered by the Savings Clause 11 of the Imports (Control Order).

Import of gold, silver, currency and currency notes, bank notes and coins is controlled by the Reserve Bank of India, under the Foreign Exchange Regulations Act. Imports from the Republic of South Africa and South West Africa are prohibited.

2. The Imports(Control) Order, inter-alia, specifies the conditions governing grant, amendment, transfer, suspension or cancellation of import licences.

3. Import control is administered by the Import-Export Control Organisation of the Ministry of Commerce headed by the Chief Controller of Imports and Exports. Besides the main office at New Delhi, the organisation has regional office in different parts of the country.

4. Imports and exports are regulated through the Import and Export Policy announced by the Chief Controller of Imports and Exports by a Notification published in the Gazette of India. Upto 1984-85, the Import and Export Policy was being announced in April every year.

5. With the objective of providing a stable regime of economic policies which would minimise year-to-year uncertainties and thus help industry to plan their economic activities in a longer-term perspective, Government announced in April 1985 Import Export Policy for a period of three years 1985-88. Amendment to the policy, where necessary, is notified by means of Public Notices by the Chief Controller of Imports and Exports from time to time.

6. The Handbook of Import-Export Procedures is issued as a supplement to the Import Policy and contains relevant procedures and other details.

(b) Methods used in restricting imports

Imports Policy has been designed to achieve the objectives of economic development envisaged in the development plans of the country. Imports in India are regulated through qunatitative controls and tariffs.

The Import Policy, by regulation of imports, not only meets the objectives of maintaining continuous availability of essential items of mass consumption but also seeks to achieve the objective of providing imported inputs, where needed, to industry in India. Present licensing system essentially involves categorisation of importable items under different lists (depending on the domestic availability) which represent varying levels of restrictions. The import of items covered by these lists are regulated through various categories of licences.

As against this, the import of items which are considered essential, but are either not available within the country or their import is considered desirable have been placed under Open General Licence (OGL) which represents a state of minimum control. All eligible persons could import these items freely without having to procure a specific import licence. For seeking a licence, the procedures as notified in the Import Policy and the Handbook of Import-Export Procedures are required to be followed. Though licensing system still continues to be the main instrument for regulation of imports, a decision has been taken to place greater reliance on the tariff mechanism as an instrument of import control. With this end in view, Government of India has set up an inter-ministerial committee for suggesting a mechanism for harmonising the structure of tariffs and import licensing policy and for laying down the principles for moving over from physical to

fiscal controls. As a result of suggestions made by this Committee, 32 items of machine tools have already been shifted to OGL in March, 1986. The Committee is in the process of identifying other product groups, import of which can be released from physical controls.

Commodities or Groups of Commodities affected by the various forms of import restrictions.

(i) Capital Goods

The present regime for the import of capital goods provides for 3 categories: First, where domestic production is nil or marginal or where regulation through tariff is preferred, specified Capital Goods can be imported under OGL. Second, where there is adequate domestic production and imports are an exception rather than the rule, the specified capital goods are placed on a Restricted List. Third, where capital goods are not specified in either of the two aforesaid categories, imports are subject to capital goods licensing procedures. These licences are granted after establishing the need for import and the non-availability through indegenous sources.

(ii) Raw materials, consumables, spares, etc.

Imports of raw materials, components, consumables and spare parts for industry are classified into four categories:

1. Banned items;
2. Restricted items;
3. "Limited" permissible items;
4. Canalised items.

2. Presently, import of only one item i.e. fats/oils etc. of animal origin is banned. In respect of items appearing in the restricted list and in the list of limited permissible items, the degree of restriction implicit is inter-alia a function of the proportion of estimated domestic demand that can be met through domestic production. Where domestic production is adequate to fully meet the requirement of the domestic industry, specified intermediates are placed in the restricted categories and imports are an exception rather than the rule. Where domestic production is significant, but available quantity, quality and delivery schedule are not

optimum, the specified intermediates are placed in the Limited Permissible category and import licences are issued on merits. Those intermediate goods which are not specified in the aforesaid two categories or are not canalised for import through a State Trading agency, are placed on Open General Licence.

(iii) Consumer Goods

As a rule, the Import Policy does not permit the import of consumer goods, except for a limited range of essential commodities such as, food grains, edible oil, medicines, books, etc. Import of a few consumer items like dry fruits are permitted on a restricted basis.

(c) Treatment of imports from different sources including information on the use of bilateral agreements:

Licences for imports including Open General Licence are valid for import from any country having trade relations with India. The restrictions are largely on account of Balance-of-Payments grounds and are on non-discriminatory basis. The Government of India has signed trade agreements with a number of foreign countries. These agreements do not involve specific commitments on import of any goods, nor do they limit the imports either in terms of items or value, these merely indicate the commodities, the import or export of which the partner countries intended to facilitate. These bilateral agreements are thus of indicative nature, and not a binding commitment. The Government of India does not direct the importers to buy from any particular source.

With certain countries, however, India has concluded special payments and trade arrangements which provide for payments for all commercial and non-commercial transactions in non-convertible Indian rupees through a central clearing account. The underlying principle in such bilateral agreements is the balanced growth of trade with mutuality of benefits. These bilateral arrangements have not been at the expense of other countries with whom India conducts her trade on a multilateral basis.

State Trading

Import of certain essential items like cereals, edible oils, fertilizers, petroleum products, drugs and

certain raw materials are canalised through Public Sector agencies such as State Trading Corporation, Minerals and Metals Trading Corporation etc. The concerned agencies import these commodities under OGL on the basis of the Foreign Exchange made available in their favour for this purpose. The policy for canalisation of certain items through the designated public sector agencies has been evolved with a view to effecting economical imports for the actual users, particularly small users, by securing most favourable terms of payments and trade.

2. Purchases by the public sector agencies are guided by the normal commercial considerations and are entirely non-discriminatory in nature.

Measures taken since the last consultations in relaxing or otherwise modifying import restrictions

The Government of India has been rationalising its import licensing policy, in accordance with the growing needs of the country and its policies. The import policy for 1985-88 not only maintained the liberalisation achieved in earlier years but further consolidated the same in accordance with India's national objectives as enshrined in the development plans. The policy has been announced for the first time for a period of three years with the objective of bringing in continuity and stability in import policy.

2. With a view to achieving the country's objectives of modernisation and technological upgradation of industrial production, increase in exports and efficient import substitution, the Import and Export Policy for 1985-88 has been under review on a continuing basis and has undergone further changes consistent with the broad objectives of the three years policy as mentioned hereafter.

3. The changes in Import and Export Policy are in the nature of further liberalisation, procedural simplification and removal of bottlenecks and constraints in obtaining supply of essential inputs required for industrial production.

Salient feature of the present liberalisation regime

For speedy implementation of programmes and to accelerate production, 210 items of industrial machinery were included for import under OGL in the three-year

Import Policy, announced in April 1985. Subsequently, 158 more items of Capital Goods have been added to the OGL list. This mainly relates to sectors like electronics, automobiles, gems and jewellery, leather, machine tools, garments, etc.

2. Licensing has been reduced by abolishing the category of automatic licences and most of the items of the automatic permissible list have been shifted to Open General Licence resulting in an addition of over 400 items in the OGL.

3. The policy for import of Capital goods against licences granted to registered exporters have been further liberalised. Now, manufacturer-exporters would be able to import Capital Goods upto a maximum value of Rs.7.5 million.

4. The general structure of the Open General Licence list for import of raw materials, components and consumables has been retained and new items have been allowed for imports under OGL to Actual users (Industrial).

5. The policy for canalisation was reviewed and the procedures for supply of materials have been streamlined. As many as 53 items were decanalised in the import policy for 1985-88.

6. A special provision has been made for meeting import requirements for technology development in some priority areas viz., export production, environment, agriculture, improving of nutrition, eradication of major communicable diseases, low cost housing etc.

7. The Import Policy for Computer Systems has been liberalised. The imports of computer systems costing less than 1 million (c.i.f.) has been allowed under OGL by all persons for their own use. The policy for import of computer spares has also been liberalised.

8. A new scheme known as the Import-Export PassBook Scheme was introduced, on 1st January 1986 for manufacturer exporters, to provide a duty free access of imported goods for export production. This scheme has been further simplified by eliminating the need for obtaining advance licences repeatedly.

General Policy in the use of restrictions for BOP reasons

General Policy in the use of restrictions for balance-of-payments reasons, is to give priority to imports required for the development of the economy and for meeting essential consumer needs. Preference is, therefore, given to import of capital goods, industrial raw material and articles of mass consumption. Generally, import of luxury consumption goods are discouraged.

Import policies in India seek to provide for imports which are essential to support levels of consumption, investment and production. The policy has been guided by the need to provide a growing volume of imports to support increased private and public investment, rapid growth and improved economic efficiency. For more than three decades an acute balance of payments problem has persisted in India due to the structural factors arising out of the process of development. Imports have had therefore to be controlled through licensing arrangements.

Annexure I

INDIA's Balance of Payments:

(US$ million)

		1983-84	1984-85	1985-86
I.	Current Account	(-) 2605.5	(-) 2909.8	(-) 5279.0
	(a) Trade Balance	(-) 5677.8	(-) 5653.4	(-) 7835.0
	(b) Invisibles balance	(+) 3072.3	(+) 2726.6	(+) 2532.7
	(c) Non-Monetary Gold movement	--	(+) 17.0	(+) 23.3
II.	Capital Account(NET)	(+) 2058.5	(+) 3634.5	(+) 4908.4
	(a) Private(Net)	(+) 714.3	(+) 1020.1	(+) 1924.2
	(b) Government(Net)	(+) 247.1	(+) 1170.1	(+) 1167.7
	(c) Amortization payments(Gross)	(-) 780.4	(-) 761.0	(-) 1196.7
	(d) Banking capital (Net)	(+) 175.6	(-) 162.7	(+) 152.1
III.	Long term capital inflow (loans & grants	(+) 2175.8	(+) 2095.8	(+) 2387.0
IV.	Errors & Omissions	(-) 473.9	(+) 272.2	(+) 474.1
V.	Overall deficit	(-) 547.0	(+) 724.7	(-) 370.6
	financed by:			
	(a) Transaction with IMF(Net)	(+) 1294.5	(+) 54.1	(-) 206.7
	(b) Allocations of SDRs	---	---	---
	(c) Changes in Foreign Exchange Resources (+Decline -Increase)	(-) 747.5	(-) 778.8	(+) 577.3

Official Exchange Rates

	Rupees per $	Rupees per SDR
1980/81	7.9092	10.1777
1981/82	8.9692	10.3354
1982/83	9.6661	10.5631
1983/84	10.3400	10.9405
1984/85	11.8886	11.9329
1985/86	12.2349	12.9232
1986/87	12.7782	15.4472

(Source:Department of Economic Affairs.)

EFFECTS OF IMPORT RESTRICTION/LIBERALISATION ON TRADE

The trends in India's overall imports, exports and balance of trade for the last few years are given below:

INDIA's BALANCE OF TRADE

(In million Rupees)

Years	Exports	%variation	Imports	%variation	Balance of trade
1980-81	8484.69	-	15866.52	-	- 7381.83
1981-82	8703.02	+ 2.57	15171.42	- 4.38	- 6368.40
1982-83	9107.47	+ 4.64	14786.46	- 2.53	- 5678.99
1983-84	9449.43	+ 3.75	15310.89	+ 3.54	- 5861.46
1984-85	9878.10	+ 4.54	14412.29	- 5.86	- 4534.19
1985-86*	9000.44	- 8.88	16155.39	+12.09	- 7154.95
1986-87 (P)	9821.46	+15.31	15700.22	+ 4.56	- 5878.76
1985-86 (P)	8516.92		15015.47		- 6498.5

* - Updated figures
P - Provisional

Source - DGCI&S, Calcutta.

The exchange rate used for conversion of Indian Rupees into US dollars is given at Annexure II.

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