GENERAL AGREEMENT ON

TARIFFS AND TRADE

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Basic Document for the Consultation[1]

Attached is the basic document provided by India for the consultations.

[1] Material supplied by the Indian authorities.

89-1367

SECTION-I

BALANCE OF PAYMENTS : POSITION AND PROSPECTS

Macro-economic Trends in the Economy

During the period 1987-89 the Indian economy first suffered a significant setback on account of an unprecedented drought and then experienced an exceptionally strong recovery.

During 1987-88 the drought resulted in a fall in agricultural production by about 2 percent as compared to the previous year. Industrial growth, however, remained bouyant recording 7.3 percent. As a consequence real GNP recorded an increase of 3.6 percent. The overall inflation rate was contained at 11.1 percent.

During 1988-89 both agricultural and manufacturing sectors have registered higher rates of growth and most of the key infrastructural sectors have performed well. Agricultural production is estimated at having grown by about 20 percent. The real GNP is expected to increase by over 9 percent and the inflamation rate has been moderated to 5.7 percent.

The pressure on the Balance of Payments has intensified since 1987 on account of a surge in import demand and rising debt service payments principally resulting from bunching of repayment obligations to the IMF and other sources. Debt servicing (i.e. interest plus payments) on Government and non-Government accounts, has increased from $2664 million in 1985-86 to $4374 million in 1988-89. Interest payments alone on the above accounts have risen from $1361 million in 1985-86 to $1928 million in 1988-89. There was a sharp decline in foreign exchange reserves and the import cover of five months in 1987 had fallen to 2.5 months in March 1989 and further to less than two months in August, 1989.

Behaviour of the Balance of Payments during 1987-88

The statement at Annexure-I gives India's balance of Payments from 1984-85 to 1987-88. During 1987-88, imports rose sharply by 11.7 per cent as against a rise of only 2.6 percent in the preceding year, but because of a strong growth in exports 21.4 per cent, the trade deficit narrowed down marginally by 2.0 per cent to $7,170 million. However,

due to a steep fall in net invisible receipts (18.8 percent) the current account deficit widened by 6.4 per cent to reach $4,853 million. The current account deficit during 1987-88 exceeded the earlier high of $4,854 million recorded in 1985-86. The current account deficit/GDP ratio averaged 2.1 percent per annum during the first three years of the Seventh Plan (1985-86 to 1989-90). This is significantly higher than the average of 1.3 per cent registered during the Sixth Five-Year Plan (1980-81 to 1984-85).

There was a substantial increase in exports during 1987-88, but imports recorded a greater increase of 11.7 per cent, which resulted in only a marginal reduction in the trade deficit. Of the total increase in imports of $2,076 million during 1987-88, 32.8 per cent was accounted for by POL and 67.2 per cent was under non-POL(Table-1).

Table 1 : Imports - POL and Non-POL

($ Million)

	1984-85	1985-86	1986-87	1987-88
POL	3,532	3,138 (-11.2)	1,588 (-49.4)	2,269 (+42.9)
Non-POL	12,181	14,160 (+16.2)	16,152 (+14.1)	17,547 (+8.6)
Total	15,713	17,298 (+10.1)	17,740 (+2.6)	19,816 (+11.7)

Non-oil imports, which rose in U.S. dollar terms by 16.2 per cent in 1985-86 and by 14.1 per cent in 1986-87, moved up by 8.6 percent in 1987-88.

The rise in value of POL imports during 1987-88 is attributable to increase in prices of crude oil. The growth in non-POL imports was primarily due to imports of capital goods, intermediate goods and raw materials. The share of capital goods in total imports during 1987-88 was around 43 per cent as against 28 per cent in 1984-85. Capital goods, iron and steel and non-ferrous metals which are intimately linked with industrial production, absorbed nearly one-half of the import bill in 1987-88 as against about one-third in 1984-85, reflecting the impact of import liberalisation. Imports of capital goods, iron and steel, non-ferrous metals, chemicals and precious and semi-precious stones, accounted for 64 per cent of total import bill as against only 45 per cent in 1984-85. The

surge in imports of capital goods and raw materials during the Seventh Plan period reflects greater attention being paid to technology upgradation, modernization and export promotion.

The growth in exports noticed in 1986-87 continued strongly in 1987-88. Exports in rupee terms which went up by 15.0 per cent in 1986-87 rose further by 23.1 per cent in 1987-88. In U.S. dollar terms also, exports rose by 10.1 per cent in 1986-87 and substantially by 21.4 per cent in 1987-88. In volume terms, estimates indicated a growth of 9 per cent in 1986-87 and 12 per cent in 1987-88. Manufactured goods (including primary product based) now accounts for 75-80 per cent of exports.

While the trade deficit in 1987-88 continued to be large, the net invisible earnings deteriorated further during the year. While official transfers remained around the same as in the previous year, other invisible receipts (net) declined sharply by 18.8 per cent to $1,906 million. Net invisible receipts, which had strongly supported the Balance of Payments in the second half of the 1970s, have been tapering off, declining from $4.9 billion in 1980-81 to $1.9 billion 1987-88. Such receipts which covered 65 per cent of trade deficit in 1980-81 could offset only 51 per cent of the trade deficit by 1984-85 and only 27% by 1987-88.

Table 2 : Net Invisibles (excluding Official Transfers)

	Amount in $ Million	Percentage of trade deficit
1980-81	4,896	64.9
1981-82	3,914	57.3
1982-83	3,321	55.6
1983-84	3,243	57.1
1984-85	2,867	50.7
1985-86	2,716	34.7
1986-87	2,347	32.1
1987-88	1,906	26.6

The sharp fall in net invisible receipts during 1987-88, notwithstanding an improvement in earnings from travel and

private transfer receipts, was mainly due to larger outgo on investment income account and an adverse turnaround in "miscellaneous" account. The larger outgo on account of investment income was particularly due to higher interest payments and service charges on foreign loans and credits, which went up by 19.5 per cent over the year. The miscellaneous account showed for deterioration of $364 million during the year reflecting mainly larger remittances of technicians' fee, professional services agency services,etc.

Current Account

The current account deficit increased from $4,563 million in 1986-87 to $4,853 million in 1987-88. During the first three years of the Seventh Plan, the annual average of the current account deficit was $4.754 million, more than twice the annual average of $2,328 million during the Sixth Plan period.

Capital Account

The large current account deficit which emerged during the Seventh Plan were financed by net capital inflows from abroad which amount to $4.0 billion, $4.6 billion and $5.8 billion respectively during the first three years of the Seventh Plan. The composition of the net capital inflow is given in table 3 below.

Table 3 : Net Capital Inflow

($ Million)

	1984-85	1985-86	1986-87	1987-88	Annual average 1985-86 to 1987-88
Total	2,852	4,000	4,617	5,779	4,799
Of which					
1. External assistance -loans(net)	1,186 (41.6)	1,370 (34.3)	1,415 (30.6)	2,148 (37.2)	1,644 (34.3)
2. Commercial borrowings (net)	934 (32.7)	954 (23.9)	1,965 (42.6)	1,100 (19.0)	1,340 (27.9)
3. Non-resident deposits	739 (25.9)	1,444 (36.1)	1,291 (28.0)	1,419 (24.5)	1,385 (28.9)

Figures in brackets represent percentages to total.

Repurchases from IMF

Repurchased from IMF under EFF (excluding Trust Fund loans) amounted to $932 million, as against $526 million in 1986-87.

Financing

The deficit on external sector transactions on current account (including "errors and omissions") and repurchases from IMF amounted to $6,516 million as against $5,188 million in 1986-87. This was financed largely by net capital inflows from abroad ($5,799 million) or 88.7 per cent) and the balance ($737 million or 11.3 per cent) by the use of foreign exchange reserves. As a result, the import cover of the foreign exchange reserves (comprising foreign exchange foldings of RBI, gold and SDRs) declined from 4.6 months in 1985-86 to 3.6 months in 1987-88.

Balance of Payments Development during 1988-89

Balance of Payment data for 1988-89 are not yet available. Trends in major components of balance of payments are discussed below.

Foreign Exchange Reserves:- Foreign exchange reserves comprising foreign exchange holdings of RBI, gold and SDRs declined sharply by $1,421 million. The level of reserves at the end of March, 1989 ($4,802 million) was the lowest level since March, 1982. This has fallen further to $3,451 million in August, 1989.

The graphs at Annexure-II show the relative position of monthly reserves (defined to include gold, foreign currency assests, SDRs and reserve position in the IMF) during the current year and the previous four years in SDR and US $ terms as also in terms of months of annual import cover. In August, 1989 the reserves provided less than 2 months of import cover.

The pressure on Balance of Payments was further intensified during 1988-89. While the details of the Balance of Payments are being worked out, it is evident

that an upsurge in imports coupled with stagnation in invisibles earnings have more than offset a strong growth of merchandise exports of 15.5 per cent in US $ terms. The sharp increase in imports during the year was primarily due to rise in import demand associated with strong economic recovery, spillover of essential imports necessiated by 1987 drought and an upturn in international prices of metals, chemicals and edible oils. Invisible earnings remained more less stagnant despite some increase in tourism earnings. Altogether, the current account deficit during 1988-89 is expected to be over $7 billion or around 2.8 percent of GDP, much higher than witnessed in the past.

External assistance and Commercial Borrowings

The net inflow of external assistance during 1988-89 was $2,422 million lower than in the preceding year(Table 4). The net inflow of commercial borrowings seems to have been higher during the year.

Table 4 : External Assistance

(In U.S. $ Million)

	1985-86	1986-87	1987-88	1988-89 @
1. Loans	2,039	2,485	3,529	3,252
2. Grants*	362	329	352	316
3. Gross Utilization	2,401	2,814	3,881	3,568
4. Repayments	634	920	1,219	1,146
5. Net(3-4)	1,767	1,894	2,662	2,422

@ Provisional

* Covered under official transfers in Balance of Payments statistics.

Repurchases from IMF

Repurchases from the IMF under EFF peaked during 1988-89 amounting to $1,068 million (SDR 804 million) as against $932 million (SDR 704 million) in the preceding year.

Prospects

On account of the large debt service obligations and the need for imports for technology upgradation and modernization programme for industries, the balance of payments would remain under pressure over the medium term. The large current account deficit experienced in the Seventh Plan, however, are unsustainable. There is a need to aim at much higher growth in exports than achieved in the past three years and/or substantiall larger external borrowings, if the present momentum of liberal import policy is to be maintained. External debt has been mounting and the large debt service ratio is a matter of concern. Prospects for India to secure more concessional assistance are not very promising. The pressure on balance of payments stemming from the liberalization of import policy which has led to a surge in the import of capital goods, raw materials, intermediates and inflow of technological services would continue over the medium term. Government's policy will continue to be aimed at limiting the trade deficit to manageable proportions, through an expansion in exports and better import management to maintain the viability of balance of payments.

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 offices 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. Since 1985, the Government has announced an Import and Export Policy for a three-year period with the objective of providing a stable regime of economic policies, which would minimise year to year uncertainties and help industry to plan their economic activities in a longer-term prospective. In April, 1988, the Import Export Policy for 1988-91 was announced. 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.

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

India's import policy is designed to achieve the national objectives of rapid industrial and economic growth, self-reliance and raising the standard of living of the people. The main objectives of the current Import Policy are :

(i) to stimulate industrial growth by providing easy access to essential imported capital goods, raw materials and components to industry and to sustain the movement towards modernisation, technological upgradation and making the industry progressively competitive internationally:

(ii) to give a fresh impetus to export promotion by improving the quality of incentives and their administration; and

(iii) to simplify and rationalise Policy and Procedure.

The import licensing system classifies imports of raw materials, components, consumables and spares into three categories, viz. Restricted, Limited Permissible and Open General Licence. Indigenous availability is the main determinant of the degree of restriction on the import of particular products. Where domestic production is adequate, the specified intermediates are placed in the Restricted List. Imports of such items are not normally permitted. Where domestic production is significant, but the quantity of production of production and delivery schedule are not adequate, the specified intermediates are placed in the Limited Permissible category and import licences are issued on imports. Raw materials, components, consumables and spares, which do not appear in

either of the two lists, are placed on Open General Licence". Thus, import of items which are considered essential but are not available domestically, are placed under Open General Licence (OGL). Another consideration for placing items on the OGL List is to expose the domestic industry to international competition so that domestic manufacturers of such items are encouraged to modernise their industry and make their product more cost effective.

Commodities or groups of Commodities covered 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 the capital goods licensing procedures. These licences are granted after establishing the need for import and the non-availability through indigenous 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.

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 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 such as dry fruits is 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 applied on a 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. The Government of India does not direct the importers to buy from any particular source.

With certain countries, 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. These arrangements help in conserving freely convertible foreign exchange. 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 the most favourable terms of payments and trade.

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 :

Since the last consultations in 1987, import liberalisation measures have continued in tandem with measures taken to liberalise the industrial and fiscal policies and to streamline investment procedures. More specifically these measures have been undertaken to enable the domestic industry to modernise, raise productivity, enhance quality, reduce costs and become more competitive. Government has also initiated action to further improve transparency of the import policy by drawing up details of import restrictions on a tariff line basis. The exercise is complex and involves interpretation of various elements of the import policy against each tariff line. A special Cell has been created for this purpose and it is expected that this work will be completed during the current three year period of the Import Policy (1988-91).

The salient features of the changes introduced in the current Import Policy announced in 1988 and since then are as follows :

1. A number of capital goods were already allowed to be imported under OGL in the Policy for 85-88. 99 items of machinery mainly for the manufacture of silk, sports goods, bicycle components and forged hand tools were added to the list. The list of machinery under OGL for leather processing, tea processing, electronic components and electric lamp manufacture was enlarged. Since March 1988 137 items of capital goods have been further added to the OGL list. Now the number of capital goods items on the OGL list is 1200.
2. The list of raw materials, components and

consumables allowed for import under OGL was also expanded particularly under chemicals and allied items, and engineering and allied items. Since March 1988, 343 additional items have been added to the list;

3. 209 items of life saving equipment and 108 items of life saving drugs were put on OGL for import by all persons. Value limits for import of drugs and medicines by hospitals/medical institutions and individuals have been doubled. Similarly the value limits for import of medical instruments and equipment have also been doubled.

4. The number of items allowed to be imported for stock and sale i.e. items in which there is no actual user restriction under OGL has been increased from 51 in 1985-88 to 74 in 88-91. Among important items added to the list for stock and sale purposes are cinematographic films, not exposed, outboard motors, photographic films, pulses and certain spices.

5. The list of canalised items was further reviewed and 26 items were decanalised.

General Policy in the use of restrictions for BOP reasons

The 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 through technology upgradation and modernization. For more than three decades balance of payments problem has persisted in India due to structural factors arising out of the process of development. Imports have had therefore to be controlled through licensing arrangements.

Annex I

Statement 1

India's Balance of Payments : 1984/85 to 1987/88

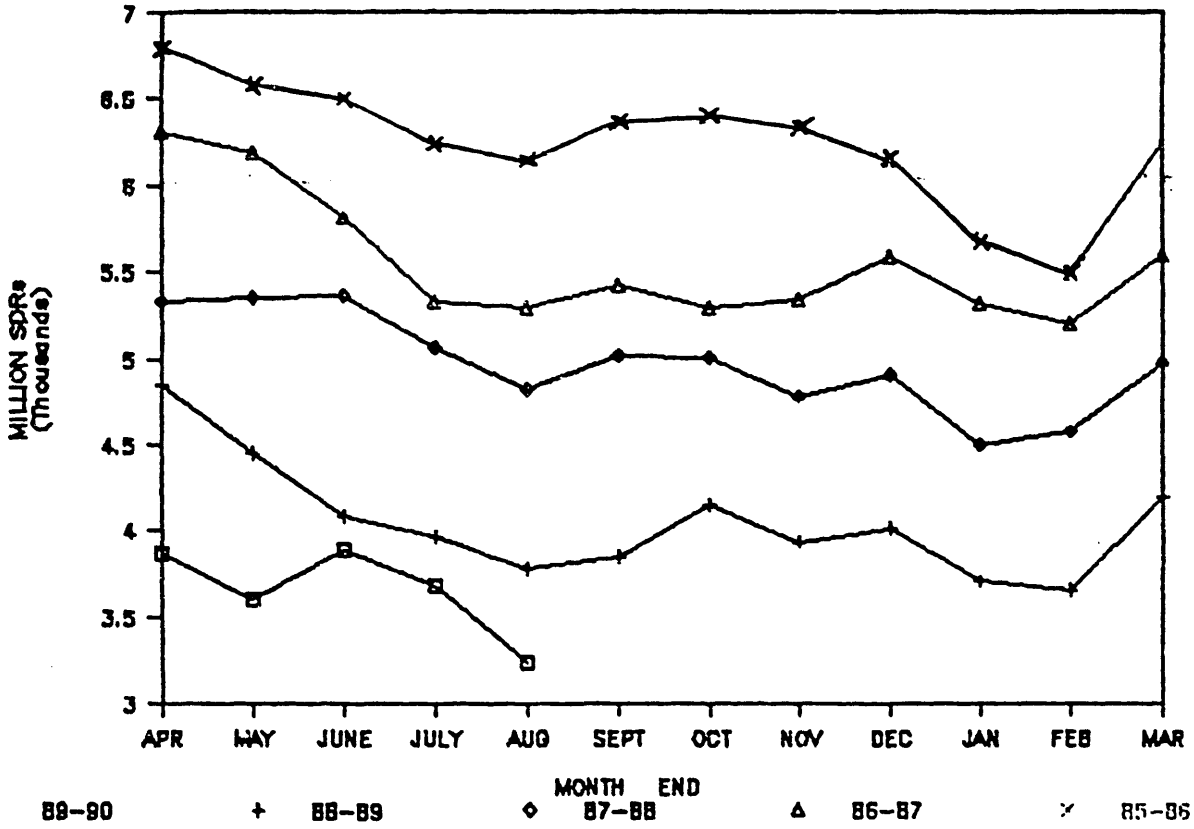
(U.S.$ Million)

	1984-85	1985-86	1986-87	1987-88
A. Current Account				
1. Exports, f.o.b.	10,059	9,463 (- 5.9)	10,420 (+10.1)	12,646 (21.4)
2. Imports, c.i.f.	15,713	17,298 (+10.1)	17,740 (+ 2.6)	19,816 (+11.7)
3. Trade balance	-5,653	-7,835	-7,320	-7,170
4. Non-monetary gold (net)	17	24	-	-
5. Official transfers	370	251	411	411
6. Other invisibles (net)	2,867	2,716	2,347	1,906
7. Current Account (net)	-2,399	-4,845	-4,563	-4,853
B. Capital Account				
1. Private capital (net)	918	1,709	1,774	1,734
2. Banking capital (net)	-163	152	-55	58
3. Official capital (net)	2,096	2,130	2,898	3,987
4. Total Capital Account (net)	2,852	4,000	4,617	5,779
C. IMF (net)	54	-207	-526	-932
D. Total Current Account, Capital Account and IMF (net)	507	-1,052	-472	- 6
E. Errors & Omissions (net)	272	474	-101	-731
F. Reserves & Monetary Gold	-779	577	573	737
Memorandum Items				
1. Current Account Deficit as % of GDP	1.2	2.3	2.0	1.9
2. Current Account Deficit excluding A-5 as % of GDP	1.4	2.5	2.3	2.1
3. Import cover of Reserves (no. of months)	4.5	4.4	4.3	3.6
4. Foreign Exchange Reserves - year-end (Excluding Reserve Position in the Fund)	5,951	6,520	6,574	6,223
5. Exchange : 14.5 $ = Rs. (Annual Average)	11.8886	12.2349	12.7782	12,9658

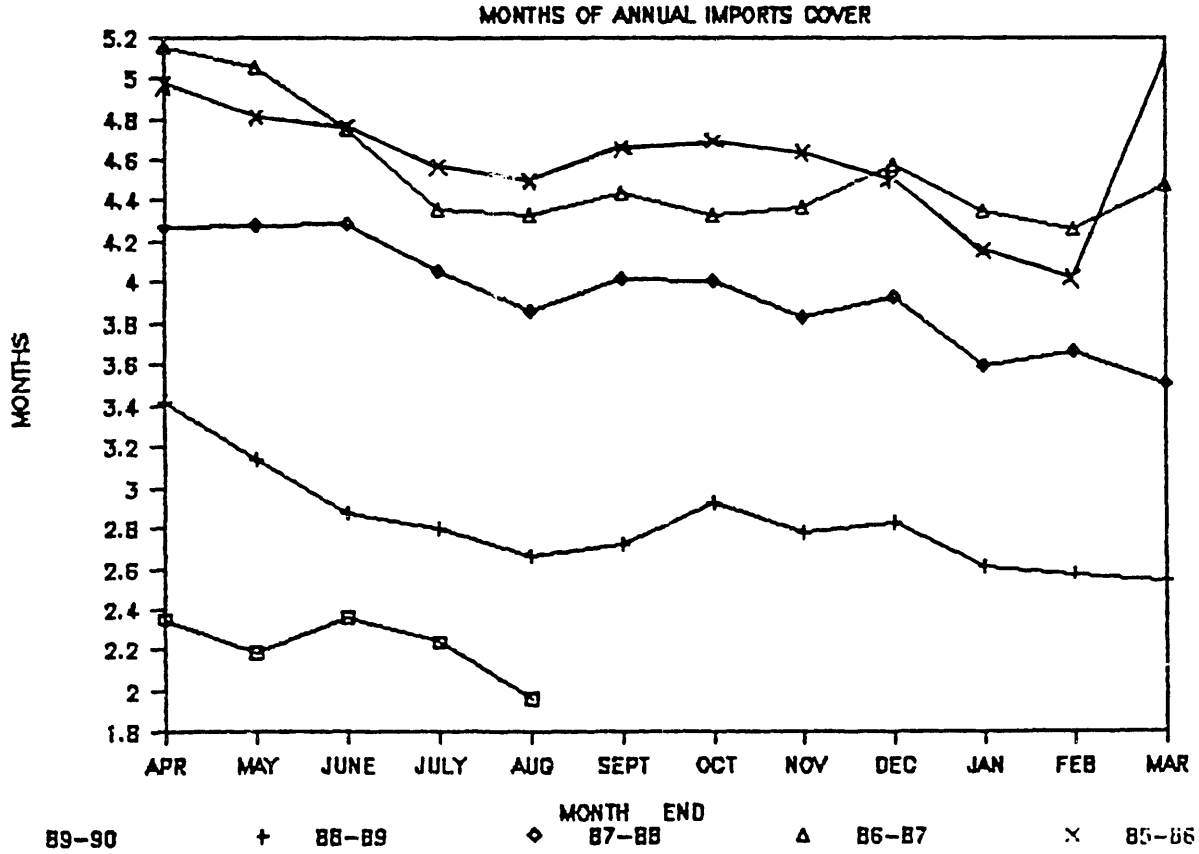
Note : Figures in brackets represent percentage variation over the previous year.

Annex II

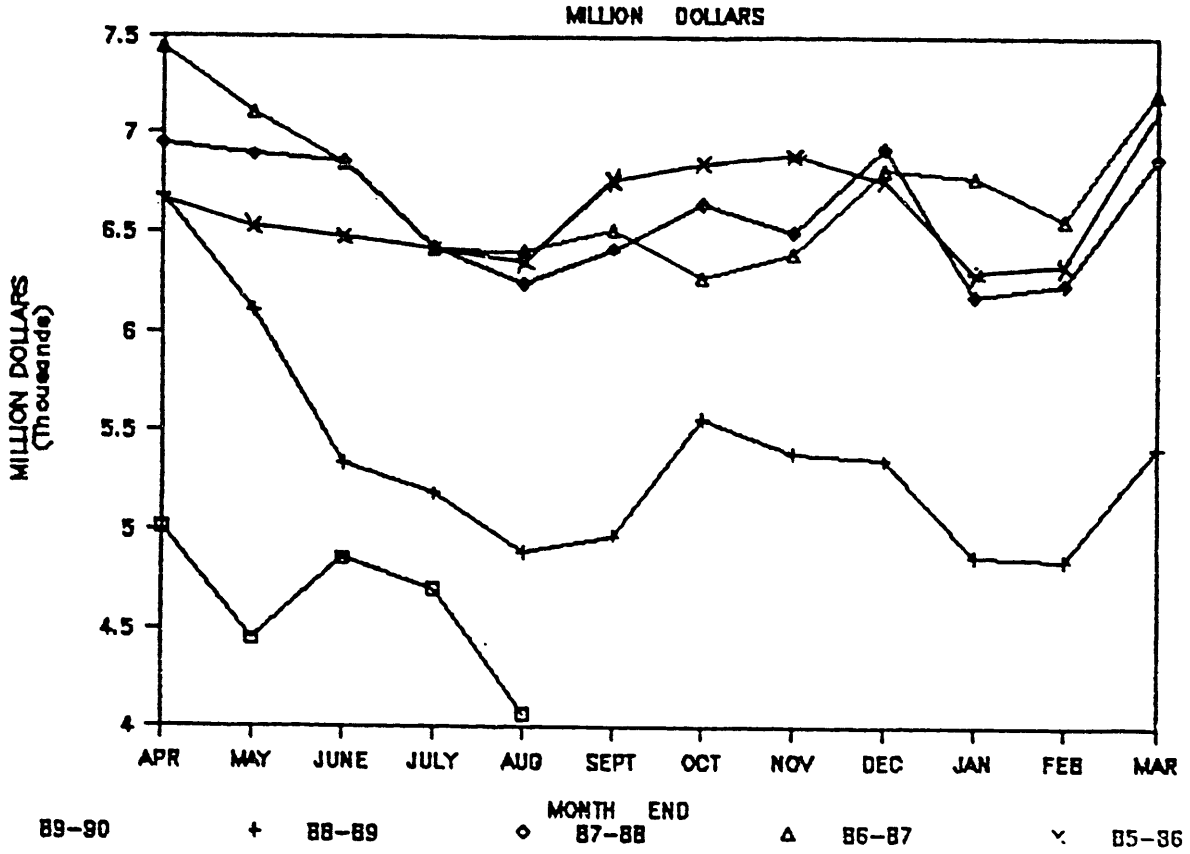
GRAPH 1 : MONTHLY RESERVE LEVELS IN MILLION SDRS



GRAPH 2: MONTHLY RESERVES AS NUMBER OF MONTHS OF ANNUAL IMPORTS COVER



GRAPH 3 : MONTHLY RESERVE LEVELS IN MILLION DOLLARS



The concept of Reserves includes the following :

(i) Foreign Currency Assets
(ii) SDRs
(iii) Gold valued at 35 SDRs per Oz and
(iv) India's Reserve Position in the Fund