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EBS/83/130
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CONFIDENTIAL

June 24, 1983

To: Members of the Executive Board

From: The Secretary

Subject: India - Extended Arrangement - Program for 1983/84

This paper provides background information to the staff report on the program for 1983/84 presented by India under its extended arrangement (EBS/83/130, 6/24/83).

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Bruce Smith (ext (5)7301) or Mr. Baumgartner (ext. (5)7307).

Att: (1)

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INTERNATIONAL MONETARY FUND

INDIA

Extended Arrangement--Program for 1983/84

Prepared by the Asian and Exchange and Trade Relations Departments

June 21, 1983

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I. Summary of the 1983/84 Program

A. Assumptions

1. Weather conditions are assumed to return to normal and real value-added in agriculture, which declined by 2 per cent in 1982/83, is projected to increase by 5 per cent.

2. The terms of trade are projected to improve by 3.2 per cent, largely as a result of weak oil prices. It is assumed that world trade volume growth will accelerate substantially during the year.

B. Targets

1. Based on the expected recovery of agriculture and emergence of the industrial sector from the mild recession of 1982/83, growth of real GDP is projected to increase from 2 per cent in 1982/83 to 6.0-6.5 per cent in 1983/84.

2. Wholesale price inflation which was 6.5 per cent in 1982/83 (March-to-March), is projected to be 7 per cent in 1983/84 (original target 8 per cent).

3. Gross capital formation is projected to increase from 24.7 per cent in 1982/83 to 26.4 per cent of GDP in 1983/84 (original target of 26.5 per cent). The program includes targets for capacity additions in several key sectors.

4. The increase in investment is to be supported by a rise in gross domestic savings from 22.6 per cent of GDP in 1982/83 to 24.3 per cent in 1983/84, including an increase in public savings from 4.8 per cent of GDP to 5.4 per cent (original target 5.2 per cent).

5. Export volume growth is to increase from about 1 per cent in 1982/83 to 5 per cent in 1983/84 (original target 8 per cent). Imports of oil and bulk items are to decline, while imports of other items are projected to increase substantially in response to liberal import policies. The current account deficit is estimated to remain at 2.1 per cent of GDP (the original target of 2.2 per cent was revised to 2.1 per cent in May 1982). The overall balance of payments deficit is projected to increase from SDR 1.3 billion in 1982/83 to SDR 1.5 billion in 1983/84 (the orginal estimate was SDR 2.7 billion but was lowered to SDR 1.6 billion in May 1982).

C. Principal Elements of the 1983/84 Program

1. Monetary policy

a. The growth rates of narrow and broad money programmed for 1983/84 are 12.0 per cent and 15.0 per cent, respectively, compared with rates of increase of 14.6 per cent (M1) and 15.8 per cent (M3) in 1982/83. These projections are based on the forecasts for inflation and real growth, but also take into account the lagged effect on the demand for money of the decline in agricultural production in 1982/83.

b. Total domestic credit expansion is to be limited to 17.8 per cent and net credit to Government to 17.3 per cent, with ceilings on both aggregates set for September 30, 1983, December 30, 1983 and March 31, 1984 (performance criteria).

2. Fiscal policy

a. The budget deficit of the Central Government is projected to be equivalent to 6.5 per cent of GDP in 1983/84 compared with an estimated deficit of 6.3 per cent in 1982/83. Bank financing of the Government (Centre and States) is projected to amount to 3.4 per cent of GDP, somewhat more than the program target (3.3 per cent) and actual recourse to bank borrowing (3.0 per cent) in 1982/83.

b. Total public sector Plan outlays are to increase by 21 per cent with emphasis on key sectors. To finance the Plan, savings of the Central Government are to increase from 3.2 per cent of GDP in 1982/83 to 3.5 per cent in 1983/84 and savings of the States from 1.6 per cent to 1.9 per cent.

3. Policies to promote economic efficiency

a. Industrial policy

Measures to liberalize the regulation of industrial activity include an increase in the limit on investment below which an industrial license is not required and the exclusion from monopoly legislation of investment by large firms in eight nationally important industries; the flexible and pragmatic policy with respect to nonresident investment and foreign collaboration is to be continued.

b. Import liberalization

Significant steps have been taken to liberalize imports which result in a substantial increase in access to imports and an overall decline in the level of protection afforded to domestic industry.

c. Export development

In continuation of efforts during the last three years, measures have been introduced to improve exporters' access to imports of raw materials, capital goods and technology and extend import duty exemptions.

4. External borrowing

The ceiling on official contracting and guaranteeing of nonconcessional loans with original maturity of between 1 and 12 years is SDR 1.5 billion, with a subceiling of SDR 200 million on loans with original maturity of between 1 and 5 years (performance criteria).

II. An Assessment of the Import Policy for 1983/84

1. Summary

The import policy for 1983/84 aims at: (i) providing further impetus to exports, (ii) supporting the growth of indigenous industry by expanding access to foreign capital goods and technology, and (iii) simplifying import procedures. In pursuit of these objectives, the new policy announced in April contained a number of measures and the policy has been substantially strengthened by additional measures taken in May.

The policy announced in April 1983: (a) expanded the coverage of imports under Open General License (OGL) for units exporting 100 per cent of production; (b) provided greater flexibility in the use of REP licenses (special licenses issued against exports of manufactured products); (c) shifted a large number of capital goods items to OGL; (d) allowed OGL imports by nonresident Indians returning home to set up small-scale units; (e) raised the value limit on imports of foreign technology for export-oriented units; and (f) simplified procedures by shifting a large number of raw materials and component items to OGL and raising the value limit below which automatic licenses issued last year can be used in 1983/84 on a repeat basis. The policy also contained some measures which had the effect of reducing access to imports. In order to prevent speculative buildup of inventories, allowances for export houses were reduced and the limit on imports of spares for stock and sale was lowered. Also, imports by some manufacturers who are required to gradually reduce the import content in their production in accordance with conditions established under industrial licensing have been subjected to monitoring and must now obtain prior clearance of the import items and their values. Finally, several products were shifted to more restrictive licensing categories with a view to avoiding injury to domestic industries resulting from adverse developments in the world trade environment.

Additional measures were adopted in May 1983: (i) to expand substantially free imports of capital goods and technology against REP licenses by raising the value limits and allowing the importers to use REP licenses acquired from others for this purpose; (ii) to increase considerably access to imports of restricted raw materials and components by allowing manufacturers exporting at least 50 per cent of production to use freely their supplementary licenses, which are automatically available to them, for import of these items; (iii) to establish a one-window clearance procedure whereby imports of capital goods and technology would be allowed automatically, provided that such imports would reduce production cost by not less than 10 per cent; (iv) to increase the REP license entitlement by 10 per cent for exports which are shipped by Indian vessels; (v) to raise the effective value of automatic and REP licenses by 20 per cent when licenses are used for imports carried by Indian vessels, by not charging freight and insurance costs against the licenses; and (vi) to permit units in the Free Trade Zones to sell in the domestic market up to 25 per cent of production, against import licenses.

In addition, the 1983/84 budget included a relaxation of the baggage allowances for Indians returning from abroad. This relaxation would result in a substantial increase in imports of manufactured consumption goods, which are generally prohibited. The budget raised the auxiliary import duty by 5 percentage points for all products except petroleum and fertilizers. Also, basic customs duties were raised for certain specific products in order to protect industries where the international prices have fallen sharply during last year.

The impact of all these measures together, based on import values in 1982/83, is to increase the overall access to imports other than petroleum, fertilizers, edible oils and foodgrains by about Rs 9,400 million (about SDR 900 million), or 12.5 per cent. Within the larger overall amount, manufacturers will have substantially greater flexibility in selecting products to import; the proportion of REP licenses freely usable for limited permissible items and capital goods would rise by 16 percentage points to more than 60 per cent of REP licenses. Taking account also of the mechanisms for increases in the license values built into the licensing system, the total access to imports covered by the import policy is estimated to increase by 30 per cent in 1983/84, following a 21 per cent increase last year.

Within the overall increase in access, licenses for imports currently classified as automatic permissible items, the least restrictive import licensing category, are projected to increase by nearly 40 per cent in 1983/84. This increase largely reflects the continuation of the provisions created last year for these imports. Because of the marked increase in the licenses and the policy of issuing supplementary licenses automatically for up to 150 per cent of normal requirements, some of the potential access to automatic permissible items was unutilized last year. With an additional increase this year, it appears that licensing is no longer an effective constraint for automatic permissible items, and that domestic industry producing these items no longer benefits from protection by licensing. Such industries comprise 12 per cent of import-competing production. 1/

As a result, tariffs are the principal determinants of the level of protection for industries producing items under both the automatic permissible and Open General License (OGL) lists. These industries comprise about 20 per cent of import-competing manufacturing production. Protection for all products in this group was increased as a result of the 5 percentage points across-the-board increase in the auxiliary duties in the 1983/84 budget. For some of these products comprising about 1 per

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1/ Import-competing manufacturing production excludes food, cotton, and leather products and comprises about 60 per cent of total manufacturing production.

cent of import-competing products, additional protection was extended through selective upward adjustments of basic customs duties. 1/

For the rest of import-competing industries, comprising about 80 per cent of production, quantitative restriction on the volume of imports through licensing remains the effective determinant of the level of protection. 2/ The level of protection was lowered for this group of industries as the import policy measures raised access to imports of these products (based on 1982/83 imports) by about Rs 7,500 million (about SDR 700 million), or 2.3 per cent of the value of production of these products. It is estimated that this reduction in protection would be equivalent to that deriving from a 5-10 percentage point reduction in tariffs for these items. It may be noted that the increased imports of restricted items would include imports of manufactured consumption goods, which are generally banned under the import policy.

2. An analysis of the effects of 1983/84 measures

The following section provides a detailed analysis of the expected impact of the measures included in the import policy for 1983/84.

The 1983/84 import policy reclassified the licensing category for a large number of products. The value of imports in 1982/83 of the items shifted into OGL (net of those shifted into licensing) amounted to Rs 4,270 million or 50 per cent of OGL imports of raw materials and capital goods in that year (Table 1). The shifts occurred virtually entirely from items transferred from the automatic permissible list. Automatic licenses are issued for imports of automatic permissible items in an amount equal to 110 per cent of last year's actual consumption of these items. Thus, it would be expected that there would be a corresponding decline in the value of automatic licenses. This would in turn reduce the access to restricted items as these items may be imported under the automatic license up to 10 per cent of the license value.

This year, freight will not be included under the stated value for the purpose of calculating the utilization of any import license if imports were shipped by Indian vessels. Since freight amounts to about 20 per cent of f.o.b. value, this change raises the effective value of

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1/ These products included stryene butadrene rubber (increase of 20 per cent *ad valorem*); polyester fiber (increase of Rs 9 per kilogram); viscose staple fiber and viscose tow (increase of 10 per cent); high-performance viscose (increase of 20 per cent); and insulated electric wire, cable, bais and strips (increase of 10 per cent).

2/ Although there were a large number of shifts among various licensing categories, the value of domestic production in 1982 was small for most of the items for which the licensing category was changed. The only measurable change was an increase of a more restrictive category (i.e., limited permissible, nonpermissible and canalized) of raw materials and components; the increase in the value of production amounted to Rs 0.6 billion or 0.1 per cent of import-competing production.

Table 1. India: Changes in Access to Imports 1/

(In millions of rupees)

	Overall Access	Access to More Restricted Items 2/
Reclassification of licensing categories	650	-380
Expansion of OGL items	4,270	--
Raw material and components	(3,600)	--
Capital goods	(670)	--
Contraction of automatic permissible items	-3,600	-360
Expansion of banned items	-20	-20
Changes in OGL facilities 3/	100	50
Increase in effective value of automatic license by use of Indian vessels	2,250	230
Increase in REP license	2,100	2,100
For use of Indian vessels	700	700
For new markets or products	150	150
Effective value raised by use of Indian vessels	1,250	1,250
Automatic clearance of capital goods imports	3,000	3,000
Relaxation of baggage allowance	2,500	2,500
Reduction of imports of spares for stock and sale	-400	-400
Reduction in additional license entitlement	-600	--
Supplementary license for 50 per cent exporters valid for limited permissible items	--	400
Others 4/	-200	--
Total	9,400	7,500
(As ratio to non-oil imports 5/; in per cent)	(12.5)	(10.0)

Sources: Data provided by the Indian authorities and staff estimates.

1/ On the basis of import values in 1982/83.

2/ Consists of raw materials and components under limited permissible and banned lists, and capital goods under CG procedure and banned lists.

3/ Include expansion of OGL imports by 100 per cent export-oriented units, other units exporting 100 per cent of production, and by nonresident Indians returning home, and elimination of OGL imports by export houses without debiting license.

4/ Includes effects of the List Attestation procedure, additional incentives for purchase of indigenous products against import licenses, and the reduction of the limits of imports on dry fruits.

5/ Excluding also foodgrains, edible oils and fertilizer (products).

automatic and REP licenses correspondingly. About 30 per cent of imports are carried by Indian vessels. Therefore, access to imports will rise by 6 per cent, or Rs 2,250 million under automatic licenses and Rs 1,250 million under REP licenses. Also, if exports are shipped by Indian vessels, the REP entitlement would be 10 per cent higher. The value of REP licenses excluding those issued against jewelry amounted to about Rs 15,000 million in 1982/83, and about one half of exports (excluding jewelry) are normally carried by Indian vessels. Thus, additional REP licenses resulting from the new measure are estimated to total about Rs 700 million.

The policy for 1983/84 introduced the facility of one-window clearance for capital goods and technology imports for manufacturers who export at least 25 per cent of production. If the imports are expected to reduce production cost by at least 10 per cent, the clearance would be given virtually automatically without indigenous angle clearance. As for technology, imports up to Rs 10 million would be permitted for units exporting at least 25 per cent and less than 50 per cent of production (64 units would qualify), and there would be no value limit for units exporting at least 50 per cent of production (274 units would qualify). No guidelines are given for values of capital goods imports. Licenses of Rs 3,000 million are expected to be issued under this facility this year.

Indians returning from abroad may bring in consumption goods either as baggage or as purchases from duty-free shops. Foreign consumption goods are advertised extensively in India. The 1983/84 budget raised the duty free allowance, lowered duties to be levied, and virtually eliminated the products for which a prohibitive duty of 335 per cent would be levied. Also, Indians working abroad for one year may now bring in goods to the value of up to Rs 5,000 free of duties in addition to the allowances available to all persons. The relaxation is expected to increase the average direct imports by Rs 1,650 per person to Rs 4,650. The aggregate effect of the relaxation is estimated to increase imports by Rs 2,500 million.

Last year, manufacturers exporting at least 50 per cent of production were given supplementary licenses for imports of automatic permissible items in an amount equal to 50 per cent of the automatic license received in the preceding year. They are now allowed to use the supplementary license for imports of any restricted items under the limited permissible category. These units obtained an estimated Rs 800 million of automatic licenses, and this measure raises the access to limited permissible items by Rs 400 million.

Under the "phased manufacturing program", manufacturers are allowed to enter into production with a high level of import intensity subject to their commitment to reduce the import component of their production gradually over several years. Manufacturers could potentially import in excess of the commitment under the phased manufacturing program since virtually all of the relevant components have been shifted to OGL.

Thus, this year, the manufacturers under the program are required to submit the list of components to be imported for governmental clearance under the List Attestation procedure. If the total value of proposed imports of components is within the limit under the program, the list would be approved automatically. Otherwise, the proposed imports would be reduced by removing from the list items which are available from domestic sources and are of requisite quality. The impact of this clearance requirement on imports is expected to be small (at most, Rs 50 million) since manufacturers unable to observe the commitment are all smaller firms. This year, sales of indigenous material against an import license would receive benefits accorded to exports. This measure is expected to have a small effect on imports (at most Rs 50 million), since the additional incentives would not be large enough to compensate for the price differential in favor of purchases from foreign sources.

In the 1983/84 import policy, the entitlement for additional licenses was reduced by one third, except for those export houses that increased exports by more than 50 per cent. This measure would reduce the additional license entitlement by Rs 1,200 million. However, the entitlement was not fully utilized last year and supplementary licenses would be issued routinely for automatic permissible items (for which additional licenses are valid); as a result, the net effect on access is estimated to be no more than Rs 600 million.

The net increase in access brought about solely by the measures introduced in 1983/84 amounts to Rs 9,400 million, of which Rs 7,500 million would be restricted items. This represents 12.5 per cent and 10 per cent, respectively, of imports excluding petroleum, foodgrains, fertilizer products and edible oils.

Another issue related to access is the flexibility in selecting products under REP licenses, and flexibility has been enhanced in the 1983/84 policy in several areas. Free choice of limited permissible and canalized items is now permitted as follows: (a) for manufacturers who export at least 50 per cent of production, free choice is permitted for up to 100 per cent of REP licenses issued against own exports, an increase of 60 per cent from last year; (b) for export houses, up to 40 per cent of licenses issued against own exports; and (c) for units exporting 100 per cent of production, up to full value of licenses including those transferred to them (Table 2). These measures are expected to increase REP licenses freely usable for limited permissible items by Rs 1,700 million or 8.5 per cent of REP licenses issued in 1982/83.

REP licenses could be used for imports of capital goods and technology without indigenous angle clearance. The limit on capital goods imports was raised by Rs 3 million per unit to Rs 5 million for manufacturers who export at least 50 per cent of production (284 units would qualify). Also, the limit on technology imports was raised by Rs 1.5 million per unit to Rs 2 million for manufacturers who export at least 25 per cent of production or Rs 10 million annually (651 units would

Table 2. India: Use of REP Licenses, 1982/83-1983/84

	1982/83	1983/84
Raw material and components		
Any limited permissible and canalized items:		
Up to 40 per cent of license for all export-oriented units	8,000	9,000
Additional 60 per cent for units exporting at least 50 per cent	--	500
Up to 40 per cent of license for export houses	--	1,000
Up to full value of license transferred to units exporting 10 per cent	--	200
Products specified in the license	10,700	8,600 1/
Capital goods without indigenous angle clearance		
Up to Rs 2 million for all export-oriented units	1,000	1,400
Additional Rs 3 million for units exporting at least 50 per cent	--	900
Technology without indigenous angle clearance		
Rs 0.5 million for all export-oriented units	300	350
Additional Rs 1.5 million for units exporting at least 25 per cent	--	1,050
Total	20,000	23,000 2/

Sources: Data provided by the Indian authorities and staff estimates.

1/ Derived as a residual.
2/ Does not include special license for free import of capital goods for exporters who do not receive REP license.

qualify). The total amount of REP licenses that could be used for imports of capital goods and technology without indigenous angle clearance was thus raised by Rs 1,950 million or 9.8 per cent of REP licenses issued in 1982/83. It should be noted that importers may now also use REP licenses transferred to them for these imports. This would: (i) enable producers to import items of values which are high relative to their annual exports (and hence, their own REP entitlement); (ii) raise the premium on REP license, which would provide additional incentives for exporters; and (iii) make capital goods and technology imports more freely available to manufacturers who are not highly export-oriented.

Reflecting the increased access brought about by the measures introduced this year and mechanisms for built-in increases in license values introduced last year, the total value of various licenses issued plus OGL imports (excluding imports of petroleum, fertilizer products, foodgrains and edible oils) is projected to rise considerably in 1983/84. Capital goods are expected to rise by 43 per cent, manufactured consumption goods by about 55 per cent, and total imports by 30 per cent (Table 3).

Table 3. India: Value of Various Licenses Issued and Imports under OGL, 1982/83-1983/84 1/

	1982/83	1983/84
	(In millions of rupees)	
Raw material components	53,410	64,870
OGL	6,000	10,000
Automatic permissible items	15,550	18,610
Limited permissible items	15,160	17,180
Canalized items	16,700	19,080
Capital goods	22,000	31,540
OGL	2,000	4,100
REP license	1,000	2,440
Special license for non-REP recipients	--	1,000
Automatic CCIE clearance	--	3,000
Capital goods license	19,000	21,000
Finished consumption goods	5,300	8,200
OGL	1,000	1,100
Special clearance	550	600
Baggage clearance	3,750	6,500
Total	80,710	104,610
	(In per cent)	
Memorandum items:		
Change from preceding period -		
Raw material and components	22.3	21.5
Capital goods	19.9	43.4
Finished consumption goods	10.0	54.7
Total	20.8	29.6

Sources: Data provided by the Indian authorities and staff estimates.

1/ Covers about one half of total imports; excluded are petroleum, fertilizer, foodgrains, edible oil and imports by public undertakings which do not go through the regular licensing channels.

III. India: Fund Relations (As of May 31, 1983)

Date of membership:	December 27, 1945.
Status:	Article XIV.
Quota:	SDR 1,717.5 million.
Fund holdings of rupees:	SDR 4,319.3 million (251.5 per cent of quota), including compensatory financing purchases of SDR 266 million (15.5 per cent), and purchases of SDR 2,700 million (157.2 per cent) under the extended arrangement which include SDR 1,350 million (78.6 per cent) of borrowed resources. Excluding purchases under the Compensatory Financing Facility, Fund holdings were SDR 4,053.3 million (236.0 per cent of quota).
SDR position:	Holdings amounted to SDR 219.8 million, or 32.3 per cent of net cumulative allocation of SDR 681.2 million.
Trust Fund loan disbursements:	SDR 529.0 million.
Direct distribution of profits from gold sales, July 1, 1976-July 31, 1980:	US$149.3 million.
Gold (from distribution):	804,429.4 fine ounces.
Exchange system:	Linked to a basket of currencies within 5 per cent margins. The middle rate as of May 31, 1983 was Rs 16.10 = pound sterling 1.
Last Article IV consultation and discussion of the extended arrangement:	Article IV consultation and EFF review discussions were held during November 1-11, 1982. The staff report (EBS/83/16, 1/20/83) was discussed by the Board on February 18, 1983, and the following decisions No. 7327 - (83/32) and No. 7328 - (83/32) were adopted:

(Continued)

India: Fund Relations (Concluded)
(As of May 31, 1983)

1. The Fund takes this decision relating to India's exchange measures subject to Article VIII, Section 2, and in concluding the 1983 Article XIV consultation with India in the light of the 1983 Article IV consultation with India conducted under Decision No. 5392 - (77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions described in SM/83/28 are maintained by India in accordance with Article XIV, except that the restriction arising under the remaining bilateral payments agreement with a Fund member is subject to approval under Article VIII, Section 2. The Fund encourages the authorities to terminate the bilateral payments agreement with a Fund member as soon as possible and to further simplify the exchange system.

3. The Fund and India have completed the reviews contemplated in paragraph 3(c) of the decision on the program for the second year of the extended arrangement for India (EBS/82/102) and in paragraph 3 of the letter dated June 8, 1982, attached thereto. No new understandings with the Fund are necessary regarding circumstances in which purchases may be made by India under the extended arrangement until June 30, 1983.

IV. Financial Relations with World Bank Group
(As of March 31, 1983)

IBRD/IDA Lending Operations	IBRD	IDA	Total
	(In millions of U.S. dollars)		
Loans/credits fully disbursed	1,568.0	4,364.4	5,932.4
Present commitments 1/			
Agriculture	424.3	3,139.6	3,563.9
Power	940.9	1,921.2	2,862.1
Energy	787.8	--	787.8
Industry	693.5	451.8	1,145.3
Transportation	225.0	474.0	699.0
Water supply and sewerage	--	470.8	470.8
Telecommunication	200.0	272.3	472.3
Other	--	224.1	224.1
Subtotal	3,271.5	6,953.8	10,225.3
Total fully disbursed and present commitments	4,839.5	11,318.2	16,157.7
Repayments	1,211.8	120.4	1,332.2
Total now held by Bank	3,627.7	11,197.8	14,825.5
Total undisbursed (excluding loans and credits not yet effective)	1,896.1	4,045.0	5,941.1
IFC investment now held 2/			118.6

1/ Includes effective loans and credits and those approved as of May 13, 1983.

2/ As of March 31, 1983.