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Chapter 4

Liberalization Efforts Prior to 1966

As we pointed out in the preceding chapter, the Indian economy may be characterized as going through Phase II during the 1962–66 period. Export subsidization was steadily and energetically undertaken to reduce the degree and the consequences of the overvaluation of the exchange rate. In addition, the period was characterized by a steady attempt at unifying the import duties which had been increasingly deployed to mop up the import premia on the QR-regime-administered allocations of foreign exchange, and by attempts at streamlining the industrial licensing system so as to reduce, though not to eliminate (in the nature of the case) its adverse effects on efficiency and distributive justice. In many ways, and not just in the matter of export subsidization, this period was one of growing attempts to reduce the adverse impact of Phase I-type policies. Thus, we could well describe our Phase II as a period of partial and halting efforts at liberalization, as contrasted with the preceding period, 1956–61, which witnessed the imposition and consolidation of the QR-regime.

In this chapter, before we proceed to discuss the June 1966 devaluation which constitutes our liberalization episode, and which we analyze intensively throughout Part III of this study, we note the major aspects of these other reforms at removing the worst aspects of the Phase I regime.

INCREASING USE OF TARIFFS

From 1962–63 onward, import duties were used with increasing frequency to mop up the import premia which the QR-regime was generating.[1] Table 4–1

TABLE 4–1

Average Incidence of Import Duties, 1962–67

(Rs. millions)

Item	1962–63	1963–64	1964–65	1965–66	1966–67 (April–May 1966)	June 1966 to March 1967
Total imports	11,315	12,229	13,490	13,940	2,271	16,746
Deduct non-dutiable imports, viz.,						
(i) Food	1,443	1,796	2,821	3,091	644	5,080
(ii) Fertilizers	297	376	329	448	92	875
(iii) Crude petroleum	302	462	272	349	29	335
(iv) Hides and skins–raw and salted	28	34	31	24	2	15
(v) Newsprints	69	69	74	62	10	108
(vi) Books	30	34	41	32	5	36
	2,168	2,771	3,569	4,006	781	6,448
Dutiable imports (estimates)	9,147	9,458	9,921	9,935	149	10,298
Total net import duty revenue	2,347	3,261	4,030	5,473	924	3,926
Average import duty on dutiable imports, %	25.7	34.5	40	55	62	38

SOURCE: Department of Economic Affairs, Ministry of Finance; at request. Reproduced from Bhagwati and Desai, *India*, p. 472.

summarizes this trend, showing that the average import duty (collected on dutiable imports) rose steadily up to the devaluation when, concurrently with the parity change, many duties were revised downward.[2]

The vast majority of these tariff increases were selective and differential, although some reliance was placed on across-the-board increases in duties later in the period. In 1962–63, for example, import duties were raised on some iron and steel items, silk yarn, copra, cars and machine tools. In 1963–64 the budget was used to raise import duties further on machinery, raw cotton, rubber, palm oil, iron and steel manufactures, mineral oils and dyes, among other commodities.

Beginning with the 1963–64 budget, however, the principle of across-the-board rate revisions was introduced. For 1963–64 a *surcharge* was levied on all dutiable articles at a flat rate of 10 percent of the existing import duty. In addition, a genuine across-the-board "regulatory duty" was levied at 10 percent *ad valorem* (unless the additional rate figured at 25 percent of the existing duty worked out higher, in which case this higher rate was applicable).[3]

While the later budgets continued to raise average tariffs, the only major change introduced was through the supplementary budget in 1965–66, when the principle of across-the-board tariffs was further underlined by a major revision in the tariff rates which aimed at reducing the wide range of selectivity and reducing the rates to a smaller number. The broad structure of the nominal tariffs that emerged from these changes is reproduced in Table 4–2. Thus, while import duties were being raised in lieu of the devaluation which was to come only in 1966, attempts were clearly made to introduce more uniformity in the tariff rates. This provided the backdrop to the move toward a formal rate change and greater unification of the exchange rates for different activities, which was to begin with the devaluation.

TABLE 4–2

Average Rates of Nominal Import Duty on Broad Classes of Commodities, after the Supplementary Budget, 1965–66

Item	Percentage Rate of Import Duty[a]
Plant and machinery	35
Agricultural machinery	15
Basic industrial raw materials	40
Processed industrial materials	60
Consumer goods	100

SOURCE: Government of India, Ministry of Finance, Department of Economic Affairs, New Delhi.

a. To these rates we must add the regulatory duty of 10 percent.

REMITTANCES SCHEME

The attempt to bring effective exchange rates to more realistic levels had also been extended to remittances with the National Defense Remittance (NDR) scheme in October 1965.

In principle, this scheme involved an extension of the import entitlement principle to remittances, so that invisibles were brought within the purview of subsidization for the first time. Under this scheme, Indian nationals resident abroad were given import licenses to the value of 60 percent of their remittances to India. Since these licenses were marketable at a premium, in effect the remittances were being subsidized by the full amount of the price at which the licenses could be sold. The remittances were to total approximately Rs. 700 million during the period of the operation of the NDR scheme.

We may note, however, that, in consonance with the bureaucratic restrictions on entitlements for exports, numerous restrictions were built into this scheme as well. The NDR import licenses could, in general, be sold only to producers ("actual users") for certain permissible imports or to general traders who, in turn, were permitted to import, for resale, only those commodities which were specified in Public Notices published from time to time. Again, the NDR licenses once issued to actual users could not be retransferred to other actual users. Furthermore, the list of commodities, once opted for by the actual user in getting his license issued to him against his NDR purchase, could not be changed even if this change was sought within the *overall* list of permissible imports. The bureaucratic nature of such inflexibility, and its economic irrationale, were strikingly highlighted when, with the introduction of liberal import licensing along with the June 1966 devaluation, many actual users who had got sulfur specified on their NDR licenses, in view of its high premium, found sulfur prices tumbling and wished to shift to other imports. The government eventually permitted this to be done, but again with considerable reluctance and restrictions: for example, the sulfur licenses could be converted only into mutton tallow licenses. Bureaucratic notions about "priority," without any demonstrable rationale, had carried over into the operation of the NDR scheme as well.

PARTIAL INDUSTRIAL DE-LICENSING

The reader will recall that, in addition to import licensing, the government also used industrial licensing to regulate the growth of industrial capacity. The end of our period of analysis in this chapter was to be characterized also by partial industrial de-licensing, essentially in the form of exemptions of certain industries from industrial licensing. Thus, in May 1966, eleven industries were formally de-controlled, including iron and steel castings and structurals and cement and pulp. At the same time, the government announced that it would continue to attempt such de-control in regard to industries which did not make substantial (direct) demands on the balance of payments through importation of components and raw materials and which did not encroach on areas sought to be reserved partially or wholly for the small-scale sector.[4]

While all the measures which we have reviewed thus far represented significant shifts toward liberalization of the unduly rigid economic regime, they fell short of restructuring the system on the basis of clear and hard analysis. Nonetheless they did represent significant attempts at loosening up the existing regime. The June 1966 announcement of the devaluation was, in a sense, therefore, the culmination of this entire process of reform in the economic regime of Phase I during Phase II (1962–66) and can be conceived of as the initiation of Phase III, aimed at more significant liberalization *and* rationalization of the trade and payments regime.

NOTES

1. The discussion in this chapter is based on Bhagwati and Desai, *India,* pp. 468–480.

2. Needless to say, we are aware of the well-known difficulties associated with our measure of the tariff level (as well as with alternative measures). We do think, however, that it is an adequate method of underlining the fact that the government increasingly resorted to tariff increases throughout the period.

3. This regulatory duty came into effect only on February 17, 1965.

4. The momentum toward industrial de-licensing was to be carried beyond June 1966 by further exemptions. At the same time, the government was to ease the scope and restrictiveness of industrial licensing for the licensed industries by raising the exemption limit for industrial licensing to units which sought to invest less than Rs. 2.5 million (with some exceptions). Furthermore, in regard to the licensing requirements for "substantial expansion" involving expansion by more than 10 percent of the registered capacity, the government raised this figure generally to 25 percent. Another relaxation, just after June 1966, related to the diversification of production by units licensed for specific products. Subject to qualifications (such as the exclusion of products mainly made in the small-scale sector), 1966 therefore witnessed the grant of permission to diversify production up to 25 percent of the existing capacity. Note that this measure of liberalization also represented a halting and ill-defined move toward a more efficient system. The decision to stop diversification at 25 percent of the originally licensed capacity was based on (1) choice of 25 percent without any clear rationale as to the relevant numbers; (2) a failure to think the problem through and ask why further diversification should not be permitted; and (3) the consequent inability to see that a system under which full diversification was automatically permitted except for a small list of priority outputs (whose production might be required on schedule) and with a small list of prohibited, nonpriority items of manufacture, would have made greater sense, both administratively and in terms of economic efficiency.