INDIA:Correspondence/Memos 1984-1989
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BOX 103

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ETR FILES
Mr. Leddy

Office Memorandum

cc: Ms. Kelly

TO: The Chairman of the Committee on Liaison with the CONTRACTING PARTIES to the GATT

October 5, 1989

FROM: P.R. Narvekar, PRN Helen B. Junz and T. Leddy

SUBJECT: India--Consultation with the CONTRACTING PARTIES to the GATT

The Fund has been invited to consult with the CONTRACTING PARTIES in conjunction with their forthcoming consultation with India, during the week of October 16, 1989. It is proposed that the Fund be represented at the meeting by Mrs. Helen B. Junz, Special Trade Representative and Director, Office in Geneva.

In accordance with procedures set in EBD/56/102 (8/29/56) the latest Recent Economic Developments paper on India is being transmitted to the CONTRACTING PARTIES. It is expected that the CONTRACTING PARTIES will request the Fund's views with respect to India. It is recommended that, in reply to such a request, the Fund representative should be guided by the attached statement.

Attachment

cc: Mr Boorman
Mr Leddy
Mr Hind
Ms Puckahtikom

I will not raise this issue with M. Qureshi

Office Memorandum

RECEIVED
1989 JUL 17 AM 11:50
ASIAN DEPARTMENT

TO: The Deputy Managing Director — July 11, 1989

FROM: P.R. Narvekar PRN

SUBJECT: India--Bank-Fund Collaboration

Thank you

7/11

cc: PRN
HN
JV

The purpose of this memorandum is to describe in more detail than in my initial memorandum the outline for the World Bank's next annual economic report (Country Economic Memorandum) on India. There has been some change in the outline for the main topic chapter since the last memo I sent to you. Specifically, a section on agricultural policies has been added and some other sections have been consolidated. As in the past, there will also be two other chapters--one dealing with economic developments during the past year and the achievements of the Seventh Plan period (1985/86-1989/90) and the other, with financing requirements as background for the Aid Consortium.

89 JUL 17 PM 3:38
EXCHANGE AND TRADE RELATIONS DEPT.
RECEIVED

The current outline for the main topic chapter envisages sections to address three issues: agricultural policies, trade and industrial liberalization, and public sector finances. On agricultural policies, the intention is to assess policies needed to sustain growth in the post-Green Revolution period. The analysis is to focus mainly on the effects of recent pricing and subsidy policies on both output and the use of inputs. It will also discuss reforms to such policies that would help improve efficiency and growth in agriculture.

There are two large studies now in progress in the Bank examining strategies for trade and industrial liberalization; these are to feed into the chapter on this subject in the report. In addition to summarizing the nature and extent of distortions in the present system, this section will explain how eliminating distortions would boost the growth potential of the economy, and will discuss some rough illustrative estimates (based on a simple growth model) of the possible contribution of structural reform to long-term growth.

The third section will examine prospective effects of large public sector deficits on growth, inflation, and the external position. In addition to scenarios with a 5-10 year time horizon, options for increasing public sector savings through expenditure control or resource mobilization will be examined. This analysis will focus on medium- to long-term growth, investment, and financial strategies as opposed to short- to medium-term stabilization issues.

1989 JUL 11 PM 4:03
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

I have spoken to Mr. Yenal (Chief Economist of the Asia Region) about the Managing Director's concern over the "demonstration effect" of a Bank report on macroeconomic policy. He is eager to work closely with the Fund staff to ensure that our views and concerns are fully taken into account. There is, however, considerable sensitivity about appearing to modify the content or title of the report under pressure from the Fund. In our view, the present outline does not conflict with the Fund's work on India. We have explained to our Bank colleagues the sensitivity about the title, "Macroeconomic Choices for the 1990s"; I believe that making a further issue of the title at this stage is likely to harden resistance to changing it.

Mr. Yenal has informed Mr. Qureshi of the issue. You could therefore raise it with him, although it does not seem necessary. The Bank staff has similarly recommended that Mr. Qureshi need not raise the matter with you. (I understand Mr. Qureshi will be on leave for a month beginning today; Mr. Karaosmanoglu, the Asian Regional Vice President, will be acting in his place.)

cc: Mr. Whittome

c

cc: Mr. Boorman
Mr. Leddy
Mr. Hinds
Ms. Puckahtikom

Office Memorandum

RECEIVED

89 JUN 30 AM 10: 25

EXCHANGE AND TRADE RELATIONS DEPT.

TO: The Managing Director
The Deputy Managing Director

June 29, 1989

FROM: P.R. Narvekar PRN

SUBJECT: India--Bank/Fund Collaboration

The special topic of the World Bank's next annual economic report (Country Economic Memorandum) on India will be "Macroeconomic Choices for the 1990s." (This year's special topic was "Poverty, Employment, and Social Services.") The report is to encompass four main issues: (1) the evolution of the fiscal and external current account deficits that would be consistent with satisfactory growth and external viability; (2) structural reforms required for sustained growth; (3) policies for improving export performance; and (4) ways of increasing public sector savings.

We have participated in the planning discussions and I have discussed the matter with Mr. Karaosmanoglu who has told me that the Fund's views and concerns will be fully taken into account. On our part, we must recognize that with the enormous staff resources devoted to India in the World Bank, they are capable of going much further than we can in the assessment of all issues, including important macroeconomic ones. Our working relations with the World Bank on India--as on other countries--have been excellent, and our colleagues there have informally expressed interest in our participation in a preparatory mission for the report. Owing to manpower constraints, however, it is unlikely that we shall be able to send anyone. Nevertheless, we would not expect any major conflict between our own views and those that are likely to be expressed in the report.

cc: Mr. Karaosmanoglu
Mr. Whittome
Mr. H. Simpson

Office Memorandum

y

TO: Ms. Schadler June 23, 1989

FROM: Thomas Leddy TL

SUBJECT: India: Supplement to Staff Report

The description of the model for India and the medium-term scenarios provide very useful information, but the medium-term scenarios do not seem entirely consistent with the conclusions in the staff appraisal.

a) The staff appraisal notes that "Although the staff projects a manageable current account and stable reserves, there are important uncertainties in this forecast: the strength and breath of export growth; import requirements to sustain rapid export growth; and the flow of non-resident deposits". This statement would seem to be correct only if certain assumptions implying major policy changes are made. The supplement on medium-term scenarios does not include a projection, based on present policies of either the current account or international reserves. The baseline projection assumes that reserves remain equivalent to 2.5 months of imports, and the resulting current account deficit (apart from making certain implicit assumptions on exchange rate policy and import liberalization) would require policy adjustments to reduce the public sector deficit by 5-1/2 percent of GDP by mid 1990s. While the staff appraisal correctly stresses the need for demand restraint, and a significant contribution by the public to sector to increase domestic savings, the extent of the effort required by the public sector only becomes apparent in the medium-time scenarios.

b) Related to the above, the baseline scenario is based on assumptions contained in the five-year plan for growth and inflation. Based on these and other assumptions, the policy adjustment to achieve these targets are derived. While this is a useful scenario, it would also be helpful to include a scenario based on present policies. This would illustrate the consequences of current policies for important variables such as debt and debt service ratios.

c) The baseline scenario assumes that trade and industrial deregulation will be stepped up early in the scenario period. Some doubts must remain on this score. Thus, the implications for growth and other variables of an unchanged stance of trade and industrial policies would also be useful.

Some additional comments on the scenarios are attached.

Finally, given the importance of trade and industrial policy, we would welcome the opportunity to review the Annex to the RED as well as other Annexes.

Attachment

bcc: Mr. Whittome (BF), Mr. Acquah, Ms. Kelly
Ms. Elken

<u>Comments on India--Supplement to Staff Report</u>

1. The supplement is a useful explanation of the framework that the medium-term scenario is based on, but it may create the impression that the framework consists of a more comprehensive model than is actually the case. In fact, it would be more correct to avoid the term "model" and instead to describe the framework as the usual macroeconomic identities with nearly all variables determined exogenously, some of them with reference to an estimated equation, and the remaining ones determined as residuals. This would also help clarify that public saving is only a residual when there is a target for the current account, as in the baseline, but that the current account is the residual when public saving is determined exogenously, as in the sensitivity analysis (the statement on page 3, line 4, should be modified to make it symmetric with the current account description on page 2). The two "blocks"--dealing respectively with balance of payments and the savings and investments of the public and private sectors, could be explicitly shown, so that the reader can clearly identify the relationships between the various variables that are mentioned. It would be useful, moreover, to include the estimated equations in the supplement, as was done in the previous staff report.

2. Furthermore, the important conclusion is drawn that "even with a moderate deterioration in the external environment, the external position would remain manageable provided <u>appropriate</u> economic policies that strengthen the underlying position are adopted," (last sentence on p. 7, continuing to p. 8; emphasis added). It would be useful to spell out some of the appropriate policies.

<u>Page 4, middle and page 5, line 7.</u> It should be made explicit whether a strengthening of domestic competitiveness means a depreciating real effective exchange rate.

<u>Page 1</u>. The only reference to the money demand equation is on this page, but it would be helpful to indicate how it was used to derive the baseline and alternative scenario.

<u>Table 2</u>. Gross domestic savings are projected to increase from 20.8 percent of GDP in 1989/90 to 21.7 percent in 1990/91, which means a corresponding 4.3 percent decline in the ratio of public and private consumption to GDP. Since real GDP is projected to increase by 5.6 percent in 1990/91, real public and private consumption will only increase by about 1.3 percent, implying a per capita decline. The projected savings path may, therefore, be too ambitious. It should also be noted that not too much reliance should be placed on the estimated private savings function (page 3, line 2), given the considerable disagreement in the literature on the effect of growth and population composition on the savings ratio.

Page 6, line 6. 5-1/2 percent rather than 6-1/2 percent.

Table references pages 3 and 4. Reverse order of tables.

Office Memorandum

TO: Ms. Schadler

FROM: Thomas Leddy TL

SUBJECT: India--Draft Staff Report

June 1, 1989

I enjoyed reading this paper, which is very nicely written. A number of comments are attached for your consideration.

Attachment

cc: Mr. Tanzi
Mr. Francotte
Operations Division for General
Resources (TRE)
Mr. Ritchie (IBRD)

bcc: Mr. Acquah
Ms. Kelly
Blue folder

June 1, 1989

India--Comments on Draft Staff Report

1. The report is comprehensive and its policy thrust is appropriate, especially the focus on the medium term and the need for reform and liberalization of what remains a rather highly regulated economy. However, several indications in the text give cause to be somewhat less sanguine about the outlook than is conveyed by the general tone of the report. Among the most important are the following examples:

(i) Industrial decontrol: There is a commitment to prevent "any backtracking" (page 10); yet the emphasis to be placed on "employment creation" and poverty alleviation could act as constraints on progress (pages 19, 20).

(ii) Public sector policies need to generate the equivalent of some 2 percent of GDP of savings, implying a significant fiscal adjustment by the Central Government, the state governments, and the public enterprises sector (page 21). Yet the state governments are suffering from "weak revenue mobilization and expenditure control" and large deficits (totaling some 4 percent of GDP), and consequently a dependency on Central Government budgetary support (page 22). Also, the public enterprises have serious shortcomings that "are unlikely to be solved by administrative needs alone", yet there is no indication of the authorities' reaction to the discussions on possible "reform of" the administrative price system, reducing the reliance of public enterprises on budgetary resources" etc.

(iii) Financial reforms: "The authorities are eager to push reforms further". However, they are constrained by the tradition of providing interest subsidies to certain sectors--farmers, small-scale industry exporters, and the Government (page 23).

(iv) External policies: There is little scope for additional export incentives and therefore there is to be greater reliance on "the liberalization of imports, exchange rate policy, and restraint of demand management" (page 24). Yet "while further increasing the export orientation of the economy was generally embraced by the authorities" there was concern that it would render the economy vulnerable to the foreign trade policies particularly of industrial countries" (page 25). More importantly, there appears to be a strong predispostion to use the exchange system as a tool for balance of payments management, while the staff expects continued maintenance of "the more liberal conditions for imports and a supportive exchange rate policy" (page 28). Incidentally, nothing is said about the adequacy of the prevailing exchange rate.

(v) Finally, there is the external indebtedness problem, which leaves "relatively little scope for increasing the use of foreign savings (loans) without jeopardizing external viability" (page 17); whereas the private savings rate is already relatively high (page 16), implying that the savings-investment balance can only be improved through fiscal retrenchment. On this point, should the report in particular be so felicitious about the budget for 1989/90? The budgeted deficit of 7.3 percent is virtually unchanged from the 1988/89 budgeted level, even as revenue performance is projected to be slightly better. Moreover, little is presented about the public sector deficit which has remained unchanged at about 10 percent of GDP since 1985/86.

In view of all these, it might have been useful to have provided a quantified medium-term scenario indicating the possible adjustment path under unchanged policies, and to highlight the implications for growth and the balance of payments as an alternative to the scenario presented in the report.

2. With respect to the staff appraisal, we would suggest inclusion of the following:

a. An explicit recognition that the Indian trade and industrial system remains highly complex and restrictive despite recent liberalization measures and that access to its market is highly uncertain. In this context I would note that the staff is more forthright in expressing its views on the exchange system (p. 14).

b. The substance of the last paragraph on p. 14 could be restated at the end of the staff appraisal section (page 32) and a sentence added as to why the staff is not recommending approval of the bilateral payments agreements with Fund members and the multiple currency practice, noting that the multiple currency practice constituted by the exchange rate guarantee on interest payments in foreign currency nonresident accounts is new (it was not mentioned in the previous staff reports or Board decisions). There should also be an indication that the details on these exchange restrictions would be provided in the RED.

c. Access to foreign markets by India is important; it could also be stated, however, that this could be facilitated by increased (and more certain) access for other countries to India's market.

d. An explanation of what is necessary for increase transparency (referred to on p. 30). This might refer to a need to reduce the layering of restrictions, to eliminate redundant restrictions, to replace QRs and bans with tariffs, and to simplify the import licensing system.

e. A recommendation to increase competition in final goods markets by substituting tariffs for QRs.

f. On p. 28, second complete paragraph, line 4, the word "expects" is a bit weak. The staff might "urge" the authorities to maintain more liberal conditions for imports and a supportive exchange rate policy.

g. A clearer position on export subsidies would also be desirable. In fact, there may be a case for the staff to recommend a reduction in subsidies.

3. Some other specific comments and questions on the body of the report.

a. On p. 5 it would be useful to include the maximum debt service ratio reached in the early 1980s in the first incomplete paragraph.

b. In the second line from bottom (p. 7), "$60 million" should be replaced by "$60 billion".

c. Should the words "improve inputs" on p. 8 (first paragraph) and p. 9 (second paragraph) be "improve access to inputs"?

d. Section 2.c on external short-term policy issues seems to represent the authorities views (with the exception of the last paragraph pp. 13-14). This might be made more explicit given that staff views on these issues do not appear until much later in the paper in the staff appraisal. It is not clear in the last paragraph of p. 14 whose view is reflected in the sentence "The economic impact of these measures is insignificant." The basis for this view (be it the authorities' or the staff's) might be given.

e. The quantitative restrictions placed on important inputs for low value-added consumer goods are described as "not significant in terms of the main goods of import liberalization" (p. 14). This does not sit well alongside the statement that they were meant "to avert the potential for a weaking of the balance of payments".

f. The Statement on p. 19 that (industrial reform and trade liberalization) "measures" are "now isolated from political pressures" seems inconsistent with the statement on p. 10 that "owing to political constraints in an election year, major changes in structural policies in 1989/90 could not be expected."

g. Page 19-20, the staff might question whether limits on closures and exits of firms in an efficient way to preserve employment.

h. Page 20, first complete paragraph; what are "universal imported inputs"?

i. Page 22-23; the content and outcome of staff discussions with the authorities on the "possibilities for reforming the administrative price system, etc." might be described.

j. Page 24, the word "felt" on line 5 is a little odd; it would make more sense if the word "would" on the following line was changed to "should."

k. Page 24, the nature and extent of "export incentives" could be described (or a reference to the annex to the RED where trade and industrial policies are described could be given); if data are not available this might be made explicit in the staff report or in the RED.

l. Page 25 first incomplete paragraph, last sentence, the increased "vulnerability" of a more "export-oriented" economy may not be a big problem if exports are reasonably diversified both by products and markets.

m. Page 25, last sentence, does the staff have a view on the desirability of liberalizing conditions for foreign direct investment? (These conditions are targeted under Super 301 so the Fund should not appear to support the U.S. approach on this!)

Office Memorandum cc: Mrs. Junz

RECEIVED
89 MAR 10 AM 10: 12
EXCHANGE AND TRADE RELATIONS DEPT.

TO: The Managing Director
The Deputy Managing Director

March 8, 1989

FROM: P.R. Narvekar PRN

SUBJECT: India--1989/90 Budget

The 1989/90 (April-March) Central Government budget, which will be the last before elections due by end-December, was announced on February 28. Its principal objectives are to expand anti-poverty and employment programs, to discourage consumption of luxury goods, to provide relief to middle income taxpayers, to maintain the pace of modernization and growth, and to contain the budget deficit. Major measures directed toward these objectives included the restructuring of existing rural employment programs and the creation of a new employment scheme targeted at the poor (the consolidation of employment programs will increase implementation efficiency); increased excise duties on luxury goods; an increase in the progressivity of income tax rates; and lower import duties on capital goods. Reductions in the growth of expenditure on subsidies and capital outlays and a cut in the absolute amount of defense expenditure contribute to the containment of the deficit.

As expected in an election year, the budget statement included no major structural reforms, while the budget expands popular expenditure programs. Nevertheless, the budget provides for a reduction in the overall deficit from a provisionally estimated 8.4 percent of GDP in 1988/89 to about 7 percent of GDP in 1989/90 (see attached table). The projected deficit coincides with the target discussed with the authorities in January in connection with a possible safety net arrangement. Although capital spending is to decelerate, most of the improvement in the budgetary position is to come from a lower "revenue deficit" which largely coincides with the deficit on current transactions. While these projections indicate the authorities' concern about reducing the deficit, they may be optimistic. Total revenue and grants are budgeted to rise by 1.1 percent of GDP, of which 0.2 percent of GDP reflects the impact of new budget measures. The main source of the revenue increase (excluding budget measures) is a projected 18 percent growth in excise duty collection; based upon past performance, this projection seems optimistic. On the expenditure side, the contribution of lower defense expenditures to the reduction in the deficit is highly praiseworthy. On subsidies, however, it is difficult to see how a sharply lower growth of expenditure can be achieved when there has been no change in policies affecting food and fertilizer subsidies. Finally, the containment of capital spending is a concern in light of the Government's ambitious medium-term growth objective.

Attachment

cc: ETR
FAD
Mr. H. Simpson

Table 1. India: Central Government Operations, 1987/88-1989/90

	1987/88	1988/89 Budget	1988/89 Estimate	1989/90 Budget
	(In percent of GDP)			
Total revenue and grants	11.9	11.5	11.7	12.8
Total expenditure and net lending	20.0	19.2	20.1	19.7
Current expenditure	14.5	14.0	14.6	14.5
Capital expenditure and net lending	5.5	5.2	5.5	5.2
Overall deficit	-8.1	-7.8	-8.4	-6.9
External financing (net)	0.7	0.8	0.6	0.7
Domestic financing (net)	7.4	7.0	7.8	6.2
Of which: Reserve Bank of India	(2.0)	(1.9)	(2.1)	(1.7)
Memorandum item:				
Revenue deficit	-2.7	-2.7	-3.0	-1.8
	(Percentage change)			
Total revenue and grants	11.6	11.8	14.2	21.4
Of which: Income tax	15.9	10.9	13.3	13.6
Excise duties	14.6	3.6	11.9	22.4
Import duties	18.0	15.8	17.4	13.1
Total expenditure and net lending	10.1	11.6	16.5	8.8
Current expenditure	14.4	12.5	17.3	10.0
Of which: Interest payments	28.3	23.0	26.0	20.1
Defense	-3.7	3.0	6.9	-4.0
Subsidies	11.7	16.6	24.0	8.5
Capital expenditure and net lending	0.2	9.4	14.6	5.4
Memorandum item:				
Defense current and capital expenditure	17.8	8.3	10.2	-1.5

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

WITHDRAWAL NOTICE

PROJECT

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DOCUMENT

Series / File	ETR/AI/ETR Files/India Corres
Original box /file No	103/1
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From	hubert neiss
To	MD and DMD
Subject / Title	india safety net
Number of pages	1
Classification	SECRET
Authority	Asia & Pacific Department

COMMENTS

THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC PUBLIC DISCLOSURE REVIEW PROCESS

Entered by bhooten Entered on 10/8/2008

Office Memorandum

TO: Mr. Neiss — August 18, 1988

FROM: Patricia Brenner PB

SUBJECT: India--Some Comparisons with Other Developing Countries

As you requested, attached is a table comparing the share of gross capital formation financed by foreign savings in India with that in several other countries. You had suggested Indonesia, China and Brazil as comparators. I have included several others, for a sample which may be sufficiently wide to suggest that India finances a relatively small proportion of its domestic investment with foreign savings, or, conversely, that India finances more than 90 percent of its investment from domestic effort. You also requested information on India's share in total aid, which is shown in Table 2.

Thinking about questions that could arise at the Board meeting, I have also prepared a table of exchange rate depreciation and export expansion showing India's experience relative to that of the economies of the "dynamic East Asian region." As we stressed in the staff report, India has shown a decided improvement in export performance compared with its own past. However, several other Asian developing countries have done even better. Thus, with the right policy effort it should be possible for India to achieve the export expansion contained in our high-growth scenario, particularly as the "tigers" lose GSP status and provide India with an opportunity to increase its market share.

Attachments

cc: Mrs. Junz (o/r)

SBP TBL tbpdb01(8/18/88)

Table 1. Share of Gross Capital Formation Financed by Foreign Savings 1/

(In percent)

	1984/85	1985/86	1986/87	1987/88	4 year average
India	7.2	10.4	9.8	8.0	8.9
Indonesia	8.2	9.1	21.4	10.0	12.2
China	2/	11.1	6.9	2/	...
Bangladesh	55.7	65.6	59.3	44.4	56.3
Pakistan	31.2	22.2	11.8	17.7	20.7
Sri Lanka	16.3	42.9	40.0	33.8	33.3
Brazil	0.6	1.2	9.8	2.0	3.4
Argentina	24.8	12.1	30.3	41.5	27.2
Chile	78.7	60.5	46.6	25.4	52.8

1/ Foreign savings defined as current account deficit of the balance of payments.

2/ Current account surplus.

SBP TBL tbpdb03(8/18/88)

Table 2. Distribution of Official Development Assistance 1/

(In US$ million)

	1983	1984	1985	1986
Europe	521	413	409	604
Africa	10,364	11,395	12,889	14,305
America	3,431	3,523	4,000	4,421
Middle East	4,120	3,668	3,922	4,023
South Asia	4,490	4,463	4,644	5,941
of which: India	1,741	1,609	1,527	2,059
Far East Asia	11,444	11,808	11,670	15,471
of which: India	670	798	940	1,134
Oceania	1,027	974	900	1,159
LDCs unspecific	3,290	3,073	3,442	3,491
Total, all LDCs	30,078	31,185	33,307	39,451
Memorandum items:				
India as a proportion of ODA to Asia	15.2	13.6	13.1	13.3
India as a proportion of total ODA	5.8	5.2	4.6	5.2

Source: Development Cooperation, 1987 Report of the OECD, Table 18.

1/ Total ODA, net, from DAC countries, multilateral organizations and OPEC.

SBP TBL tb2pdb

Table 3. Changes in Real Effective Exchange Rate and Exports--Several Countries

(In percent)

	Depreciation of REER 1/		Increase in US$ exports, 1987
	Sept. 85-Dec. 87	April 87-April 88	
India	25	16	23
Korea	15	-5 2/	36
Thailand	19	12	17
Hong Kong	20	11	29
Pakistan	29	20	21
Indonesia	45	37	29
Singapore	20	10	25
Philippines	32	14	19
Sri Lanka	21	15	17
Nepal	17	5	41
Bangladesh	14	6	15
Malaysia	24	13	29
Average	23	13	25

1/ Real effective exchange rate data from INS.
2/ Appreciation.

Office Memorandum

TO: Mr. Narvekar August 5, 1988

FROM: Patricia Brenner PB

SUBJECT: India--Illustrative Calculations of Cereal Access

You have expressed an interest in some illustrative calculations of India's potential access for a drawing under the cereal decision. With calendar 1988 as the shortfall year, and based on the mission's estimates for exports and for cereal imports for the five years centered on 1988, India could request an amount equivalent to roughly SDRs 480 million (22 percent of quota), or US$650 million at present exchange rates. This is a mechanical calculation, however, and before a request could be made, several factors would have to be clarified.

A drawing under the cereal decision must be made on the basis of a joint calculation of the export shortfall or excess, and the cereal excess (higher average foodgrain imports), based on the same shortfall year. In addition, the export calculation must be based on at least 6 months of actual data. The amount presented above assumes 6 months of actual exports data (January to June, 1988) that are not yet available, but which the authorities would have to provide. Therefore, a decision would have to be made about the trade-off between availability of actual data, and the amount of a drawing that might be available. A request based on the 12 months ended September 1988, for which we would already have sufficient actual data would not likely generate enough net cereal excess to be worth the effort. In the absence of the requirement of 6 months actual data, given the concentration of foodgrain imports, the "optimum" foodgrain excess year would be fiscal 1988/89. This, however, would require actual exports data for March through September 1988, which would delay the request until the last quarter of 1988. Based on our estimates and projections, a request for roughly SDRs 850 million (39 percent of quota), or US$1.1 million at present exchange rates, might be made on the basis of a 1988/89 cereal excess year.

Within the range of potential access suggested by these illustrative calculations, a drawing would fall within the normal access limit of 42 percent of quota under the new Compensatory and Contingency Financing Facility.

The projections of cereal imports and total exports for 1988/89 and after are based on the mission's projections, converted to

SDRs at the geometric average US$/SDR rate of June 1988 for the period after June 1988. The authorities were reluctant to provide a specific projection of foodgrain imports for 1988/89. They indicated that in the first fiscal quarter, one million tons of wheat and one-half million tons of rice had been imported. They would need to provide a much more detailed projection of foodgrain imports (and exports) before we could proceed seriously.

Attachment

cc: Mrs. Junz
Mr. Neiss
Mr. Hemming
Mr. Shome

NOTE: The net cereal excess is calculated as follows:

1. Determine excess year (12 continuous months)

2. Establish five years centered on excess year

3. Calculate in SDRs:

a. The simple average of foodgrain imports. The difference between cereal imports in the excess year and the average for the five years is the cereal excess.

b. The geometric average of exports. The difference between exports in the center year and the average for the five years is the export shortfall or excess.

c. The net cereal amount is the cereal excess less the export excess or shortfall (i.e., shortfall is added, excess substracted).

Calculation of net cereal excess for center year fiscal 1988/89

(In SDR millions)

	Actual		Mission's Projection		
	1986/87	1987/88	1988/89	1989/90	1990/91
Foodgrain imports	30	19	1,147	--	--
Exports, f.o.b.	8,544	9,669	10,817	12,063	13,415

Average foodgrain imports: 239 million
Center year foodgrain imports less average: 908 million

Geometric average exports: 10,766 million
Center year exports less average: 51 million

Net cereal excess: 857 million

For center year calendar 1988, a similar calculation yields a net cereal excess of about 480 million

Calculation of net cereal excess for center year, calendar 1988

(In SDR million)

	Actual		Mission's Projection		
	1986	1987	1988	1989	1990
Foodgrain imports	42.9	21.7	859.4	287.3	--
Exports, f.o.b.	8,673	9,457	10,426	11,757	13,077

Cereal excess	617
Export excess	136
SDR	481 million

cc. Mr. Aghevli
Mr. Quirk

INTERNATIONAL MONETARY FUND

August 4, 1988

Mr. Neiss:

As discussed.

Attachment

Helen B. Junz

INTERNATIONAL MONETARY FUND

August 3, 1988

Mrs. Junz:

India--Staff Report

Attached please find our comments on India's staff report which I reviewed myself. The comments have been cleared with Mr. Quirk.

Attachment

cc: Mr. Acquah
Mr. Quirk
Ms. Brenner

AMJ
Ana Maria Jul

Comments on India Staff Report

The paper states in a few places that there have been efforts to liberalize trade policies and that the process of liberalization was continued in 1987. Do these trade liberalization efforts include measures affecting imports as well as exports? Measures affecting exports are described on pages 10 and 12, but the only import measure mentioned in the paper refers to a surcharge of 5 percent imposed on the ad valorem auxiliary import duty (page 8, footnote 1). Also, on page 20 it is said that "a new Import-Export Policy for 1988-91 has just been introduced. While the new policy provides for some further liberalization of imports, its main thrust is directed toward extending the range and coverage of incentives available for exporters." If import liberalization measures were introduced in 1987-88 (according to the draft country page for the 1988 Annual Report on Exchange Arrangements and Exchange Restrictions this does not appear to have been the case in 1987), a brief description of these measures should be included. If this was not the case, then the paper should state so, and instead of referring to trade liberalization measures it should label them specifically as measures affecting exports.

Furthermore, given that the measures affecting exports which have been implemented result in budgetary costs (at a time when fiscal trends remain a source of concern) and interest rate subsidies, the report should explain why the staff did not discuss with the authorities an acceleration of the rate of real effective depreciation of the exchange rate, and instead advocates the continuation of the recent slow downward trend in the real effective exchange rate (page 15). Except in the past few months, the exchange rate policy appears to have been passive, with incentives being provided to promote exports while a cumbersome system of trade restrictions was used to contain imports. Also, while the paper links the behavior of exports to exchange rate developments, no reference is made to the impact on imports of these developments.

Page 11, para. 3, lines 5 and 6. According to the paper "the external accounts would show a slight deterioration (in 1988/89), under pressure from increasing foodgrain imports and an SDR 800 million repayment to the Fund." Given that the repayment to the Fund is a below the line item, and that the overall balance of payments surplus for 1988/89 is projected to increase from $0.6 billion to $1.3 billion, wouldn't it be more appropriate to say that gross international reserves are expected to increase only slightly in 1988/89 despite the improvement in the overall balance of payments position because of the repayment to the Fund? Also, I would suggest using "gross international reserves" instead of "official reserves" throughout the paper to avoid any confusion in concepts.

Pages 20-21, last para. This paragraph could be placed at the end of the staff appraisal section (page 24) and a sentence added as to why the staff is not recommending approval of the bilateral payments agreements with Fund members and the multiple currency practice.

Page 25. Paragraph 1 of the proposed decision should read "The Fund takes this decision relating to India's exchange measures subject to Article VIII, Sections 2 and 3, and . . .", because of the multiple currency practice.

INTERNATIONAL MONETARY FUND

August 3, 1988

Mr. Kincaid: (Ms. Junz)

Attached are comments on the India staff report which was reviewed by Mr. Tiwari and discussed with me.

Attachment

cc: Mr. Quirk
Ms. Brenner

Paul A. Acquah

ETR2/CGK/IND--coindstt
August 3, 1988

India--Comments on Draft Briefing Paper

We enjoyed reading this well written brief. But we must note that we were surprised at the complete absence of staff discussion of economic progress in relation to the Seventh Five-Year Plan (1985/86-1989/90). The report should indicate whether the main plan targets of GDP growth, export and import volume growth, and of investment, national savings, and current account deficit will be realized, including whether it is still possible to reverse policy slippages. This discussion could be tied in with the discussion of the high growth scenario.

Regarding Article IV reporting requirements, the report should indicate that India will remain on the standard 12-month consultation cycle, and indicate whether Board approval/disapproval is being sought for maintenance of restrictions and multiple currency practices.

The following comments may also be of use.

Page 2, top. Report should indicate that self-sufficiency was achieved at an economic cost.

Page 3, Table 1. Data on poverty is missing.

Page 4, bottom. Timing of the conclusion of last Article IV consultation discussion should be indicated.

Page 9, bottom. It would be useful to indicate the size of the short-term money market.

Page 12, bottom. Some indications should be provided of the size of the loss in official reserves since recent press reports have reported varying amounts.

Page 17a. Some negative signs in the adjustment column are missing.

Page 18. This page is missing from our copy of the report.

Page 19, top. It would be useful to elaborate on the timetable for expected implementation of enterprise reform, and the envisaged savings to the consolidated budget.

Page 20, middle. A brief description of the main elements of the new Import-Export Policy for 1988-91 together with an indication of the magnitude of the envisaged liberalization in the field of industrial licensing would be useful.

Mrs. Junz
File

Office Memorandum

TO: Mr. Hubert Neiss DATE: August 3, 1988

FROM: Pierre Francotte PF

SUBJECT: India - Draft Report for the 1988 Article IV Consultation

We have the following comments on the draft report:

1. In accordance with standard practice, there should be a sentence at the end of the introductory paragraph indicating that India continues to avail itself of the transitional arrangements of Article XIV, Section 2, as well as a sentence at the end of the staff appraisal recommending that the next Article IV consultation with India be conducted under the standard 12-month cycle.

2. The staff appraisal should also indicate whether approval of the restrictions and multiple currency practice subject to the approval of the Fund is recommended and give the rationale therefor. In accordance with Fund policies, restrictions arising from bilateral payments agreements are not approved because they are discriminatory. As for multiple currency practices, the policy of the Fund is to approve them if they are introduced or maintained for balance of payments reasons, provided they are temporary and being applied while the member is endeavoring to eliminate its BOP problem and provided that they do not give the member an unfair competitive advantage over other members or discriminate among members.

3. Since the description of the exchange restrictions maintained in accordance with Article XIV will appear in the RED rather than in the staff report, we would appreciate it if we could be provided with a copy of the relevant section of the RED before its finalization.

4. Because India's exchange measures include a multiple currency practice subject to approval under Article VIII, Section 3, paragraph 1 of the draft decision should refer to "India's exchange measures subject to Article VIII, Section 2 or 3." (See attached.)

5. Other comments have been written directly on the attached copies of the relevant pages of the draft.

Attachment

cc: Mrs. Junz
Mr. Mathuran
Mr. Hemming
Mr. Liuksila

India: Fund Relations (cont'd.)

B. Nonfinancial Relations

VII. Exchange Rate Arrangements

The Indian rupee is linked to a basket of currencies with 5 percent margins. The intervention currency is the pound sterling. India maintains extensive exchange restrictions which are ~~subject~~ maintained in accordance with ~~to~~ Article XIV. India has restrictions on the making of payments and transfers for current international transactions arising ~~un~~ under the bilateral payments agreements with two Fund members (Poland and Romania)--which are subject to approval under Article VIII, Section 2, and a multiple currency practice arising from a 15 percent tax on foreign exchange provided for travel abroad, which is subject to approval under Article VIII, Section 3.

VIII. Last Article IV Consultation

Article IV consultation discussions were held during May 4-18, 1987. The staff report (SM/87/160, 7/9/87) was discussed by the Board on August 7, 1987, and the following Decision No. 8677-(87/120) was adopted:

1. The Fund takes this decision relating to India's exchange measures subject to Article VIII, Section 2, and in concluding the 1987 Article XIV consultation with India, in light of the 1987 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/87/178 are maintained by India in accordance with Article XIV, except that the restrictions arising under the remaining bilateral payments agreement with two Fund members are subject to approval under Article VIII, Section 2. The Fund encourages the authorities to terminate the bilateral payments arrangements with two Fund members as soon as possible and to further simplify the exchange system.

IX. Technical Assistance

None has been provided by the Fund during the last three years.

X. Resident Representative/Advisor

None.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to India's exchange measures subject to Article VIII, Section 2 and 3 and in concluding the 1988 Article XIV consultation with India, in the light of the 1988 Article IV consultation with India conducted under Decision No. 5392-(77/63), adopted April 29, 1977 as amended (Surveillance over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions described in SM/88/... are maintained by India in accordance with Article XIV, with two exceptions. The restrictions arising under the remaining bilateral payments agreements with two Fund members are subject to approval under Article VIII, Section 2. The 15 percent tax on foreign exchange provided for travel abroad is a multiple currency practice subject to approval under Article VIII, Section 2(a) and 3. The Fund ~~encourages~~ urges the authorities to terminate the restrictive features of the bilateral payments agreements with two Fund members, to eliminate the tax on foreign exchange for travel abroad as soon as possible and encourage them to further simplify the exchange system, which remains complex.

Office Memorandum

TO: Peter Quirk July 25, 1988

FROM: Patricia Brenner PB

SUBJECT: India: Nonresident Accounts

You asked me for a brief description of India's provisions for nonresident accounts. India maintains provisions for nonresident foreign currency (FCNR) deposits, which the Government regards as an attractive alternative to foreign borrowing as a source of foreign exchange. Authorized dealers, mainly commercial banks, maintain FCNR accounts in U.S. dollars and pounds sterling and NRE accounts in rupees for nonresident individuals of Indian origin. An interest rate premium is paid on the latter accounts with respect to the rate payable on domestic deposits. Interest rates on FCNR deposits are changed frequently to maintain a small premium over the respective international deposit rates.

Authorized dealers are required to sell inward remittances under the FCNR scheme to the Reserve Bank of India at a specified rate of exchange. Dealers are authorized to repurchase corresponding amounts at the same rate of exchange when deposits are withdrawn. The authorities pointed out that interest rates on NRE accounts are about 2 percentage points higher than those of FCNR accounts, since in the former case the depositor bears the exchange risk.

In previous reports, the use of separate exchange rates for purchases and rates by the Reserve Bank of proceeds of remittances under the FCNR scheme has been reported as constituting a multiple currency practice involving capital transactions. Following upon our discussion before the mission, I inquired about the treatment of interest under the scheme. It appears that interest would in principle be repatriable at the accounting rate applicable at the time of the deposit. The representatives from the Exchange Control Department insisted, however, that these deposits were in practice maintained "in perpetuity" and that interest simply accrued without ever being withdrawn. Although this would seem implausible for all deposits, the time series shows a continuous increase in the outstanding level of these deposits since 1981.

cc: Mr. Neiss (on return)
Mr. Vittas
Mrs. Junz

WITHDRAWAL NOTICE

PROJECT

Project number	2008-012
Project name	PDR/EXR Front Office (AI)
Project tab number	121
Project box number	2

DOCUMENT

Series / File	ETR/AI/ETR Files/India Corres
Original box /file No	103/1
Date	july 8, 1988
Type	report
From	
To	
Subject / Title	India medium term issues
Number of pages	6
Classification	STRICTLY CONFIDENTIAL
Authority	Asia & Pacific Department

COMMENTS

THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC PUBLIC DISCLOSURE REVIEW PROCESS

Entered by bhooten Entered on 10/8/2008

Mr. Whittome
cc: Mrs. Junz
Mr. Allen
Mr. Watson
Mr. Stuart
I O circulate

Office Memorandum

RECEIVED

88 JUN 15 AM 10: 30

EXCHANGE AND TRADE RELATIONS DEPT.

TO: The Managing Director
The Deputy Managing Director

June 14, 1988

FROM: P.R. Narvekar PRN

SUBJECT: Mr. Sengupta's Speech in India

Attached are press clippings on remarks made by Mr. Sengupta in a seminar held in India last month. In these remarks he (i) cautions that the threat of an external debt trap in India was real, and (ii) provides a critique of adjustment policies recommended by the Fund.

Attachment

cc to Mr Stuart

cc: Mr. Whittome
Mr. H. Simpson

The Economic Times, p.1, May 25, 1988.

Debt trap real: IMF director

— From Our New Delhi Bureau

NEW DELHI, May 24.

The threat facing India that the country may land itself in the external debt trap is real, the International Monetary Fund (IMF) executive director, Dr Arjun Sengupta, has cautioned.

Dr Sengupta, who was the economic advisor to the prime minister before taking up the IMF assignment, told a meeting attended by eminent economists here on Tuesday that if the country continues to resort to international borrowing, it might reach a similar situation being encountered by many developing countries at present. "The danger becomes even more imminent when the distinction between borrowing for production and borrowing for consumption ceases to exist", he remarked.

Dr Sengupta asserted India must stop borrowing for consumption.

Speaking on "IMF adjustment policies — a critical review", Dr Sengupta observed that for quite some time to come, the Fund would face the criticism that it could not draw up adjustment programmes which would ensure both balance of payment equilibrium with growth of the economy. This was because the answer to the question, what produces growth, was yet to be found.

Dr Sengupta admitted that politics were partly responsible for the Fund adopting certain adjustment programmes and policies. But at the same time, no particular set of adjustment policies could be termed as correct measures in the absence of emperical evidence to suggest their effectiveness. Since economists had not provided a concrete answer, opinions ruled the current decision-making in the Fund.

Giving a historical perspective to the entire issue, Dr Sengupta noted that the early years of the Fund witnessed efforts at giving assistance to member nations to tide over their short-term balance of payments difficulties. With the industrial nations ceasing to be the borrowers of the Fund and the developing countries going in for the Fund's assistance in a big way, the basic problem confronting IMF was how to ensure growth while bringing about balance of payments adjustments.

It had been increasingly felt that developing countries with their structural problems could not sustain the desirable balance of payments position without achieving substantial growth in GDP.

However, Dr Sengupta observed that the approach to balance of payments adjustment adopted by the Fund so far had not provided the solutions. The Fund's adjustment policies heavily depended on the proposition that if the money supply and demand difference could be controlled, the balance of payments position could be controlled. The instrument suggested was restrictions on domestic credit and thereby curbs on demand. The assumption was domestic credit did not affect production.

But in actual practice, the domestic credit restrictions did affect production and thereby growth.

The Times of India, p.11, May 29, 1988.

Larger exports for debt service needed

By D. G. GUPTE

THE rising trend in India's debt service ratio has been causing concern. It is estimated that the country's debt service in 1986-87 on external debts on government account, non-government account, IMF drawals and commercial borrowings (including supplier's credits) amounted to about 22 per cent of current receipts. This is likely to increase to 23-24 per cent in 1987-88 because of higher IMF repayments and debt service on commercial borrowings contracted in earlier years.

Dr Arjun Sengupta, executive director of International Monetary Fund, has cautioned that the country may land itself in the external debt trap, if it continues to resort to international

Money & Banking

borrowings. He has asserted that India must stop borrowing for consumption.

Dr Sengupta has brought into focus the rising proportion of exports towards interest element of external loans. In September, 1988, an instalment of Rs 1,000 crores of IMF adjustment credit is due. It would thus appear that the current level of exports to service external debts is expected to rise from 24 per cent to 38 per cent. In this context a substantial increase in exports as a means of meeting debt service cannot be overemphasised.

Mr. Guy

Office Memorandum

TO: Mr. Vittas

May 17, 1988

FROM: Patricia Brenner PB

SUBJECT: India--Draft Paragraph on Trade Issues

Per your request late this afternoon, here are draft paragraphs of material on trade issues that could be included in the pre-briefing for Mr. Sengupta:

In April 1988 the government announced a new Import-Export Policy for 1988-91. A preliminary look at the documents containing the policy suggests that the new policy generally increases export incentives and varies the limitations on imports, although the overall impact on import liberalization is as yet unclear. The staff will discuss the new policy in detail with the authorities and will continue to endorse the policy of replacing import controls with tariffs and gradually reducing the level and dispersion of tariffs. As this is done, compensating subsidies to exporters can be reduced and progress can be made toward ensuring that effective prices for imports and exports are not significantly different. Such a policy is essential to the liberalization of the restrictive industrial and trade systems that have biased production against exports.

The staff believes that if India is to sustain a high rate of economic growth over the medium term, it will be essential to promote export volume growth of 6 to 7 1/2 percent a year. In this regard, the ten to fifteen percent growth of export volume in 1987/88 is noteworthy, and appears to have been related both to the real effective devaluation of the peso between late-1985 and mid-1987 and to the enhancement of export incentive programs. Nevertheless, exchange rate policy during the last twelve months appears to have been less forceful, with only a real depreciation of 3 to 4 percent. The authorities should be careful to assure that exchange rate policy continues to be used actively to support exports, particularly as structural reforms are implemented.

The staff will also inquire as to India's impression of progress in the Uruguay Round of multilateral trade negotiations and its own priorities in the negotiations.

cc: Mrs. Junz

Mr. Whittome

Office Memorandum

TO: The Deputy Managing Director April 26, 1988

FROM: Anupam Basu AB

SUBJECT: Staff Visit--Reserve Bank of India Study on Domestic Financing of Central Government Deficits

During the period April 11-23, 1988, I visited the Reserve Bank of India (RBI) in Bombay to participate in the preparation of a study on the domestic financing of Central Government deficits. My visit was in connection with work which remained to be completed from my last assignment at the RBI on leave of absence from the Fund. I had a very useful discussion with the Governor, Mr. R.N. Malhotra, when I submitted the first draft of the study which was prepared on the basis of extensive consultations with the Deputy Governor, Dr. C.R. Rangarajan, and senior staff of the RBI's Department of Economic Analysis and Policy. Some further work will be needed before the study can be finalized, but this will be completed by the RBI staff. On my part, I have agreed to visit the RBI for a week in August 1988 during my annual leave to finalize the study; the RBI will bear all the expenses. Apart from the timing of the next visit in August 1988, there is no further commitment on the part of the Fund to the RBI.

The basic motivation of the study is the fact that in the 1980s, as a proportion of GDP, the deficit in Central Government operations (excluding interest payments) has been growing more rapidly than the household sector's net financial savings (a large portion of which is held in banks and other financial institutions). The study tries to point out the implications of rapidly increasing the Government's use of resources from a relatively slowly growing pool of financial savings and, alternatively, of relying more heavily on pure monetary financing. The first form of financing seems to suggest a slowdown in the real rate of growth, because government expenditures have lower productivity and the private sector seems to be crowded out. The second form of financing leads to "crowding out" and inflation. The policy recommendation is a combination of a more active interest rate policy and fiscal adjustment, the former to help raise the financial savings ratio and the latter to avoid "crowding out" and a continued rapid rise in the public debt ratio.

cc: Mr. Whittome
Mr. Narvekar
Mr. Brau

C+M

RESERVE BANK OF INDIA
EXCHANGE CONTROL DEPARTMENT
CENTRAL OFFICE

Section IV

Question IV.8 - Please provide a chronological list of all changes in the exchange and trade control regulations and in other aspects of the exchange and trade system since December 31, 1985. Please describe any changes introduced or contemplated in policies with respect to foreign collaboration arrangements in industry, including royalty payments and purchases of technology and in the regulations and incentives for foreign direct and portfolio investment.

Answer - The answer to this question is given in three parts as under:

(A) Chronological list of changes in the exchange and trade control regulations and in other aspects of the exchange and trade system since December 31, 1985.

(B) Changes introduced or contemplated in policies with respect to foreign collaboration arrangements in industry including royalty payments and purchase of technology.

(C) Changes introduced or contemplated in the regulations and incentives for foreign direct and portfolio investment.

(A) Chronological list of changes in the exchange and trade control regulations and in other aspects of the exchange and trade system <u>since December 31, 1985</u>

The information pertaining to trade control regulations and system is obtainable from the Chief Controller of Imports and Exports, Ministry of Commerce, Government of India, New Delhi.

Information regarding changes in the exchange system and Exchange Control is furnished below -

14.3.86	Returning Indians Foreign Exchange Entitlement Scheme (RIFEES)	1. Hitherto non-residents of Indian nationality or origin returning to India for permanent settlement were entitled to avail of foreign exchange upto 25 per cent of the total amount of foreign exchange repatriated to India and balances held in their Non-resident (External) Rupee accounts and Foreign Currency Non-resident (FCNR) accounts at the time of transfer of residence. The limit for the foreign exchange entitlement under the Scheme has been raised from 25 per cent to 50 per cent of the total amount of foreign exchange repatriated to India by the applicant and balances held in his Non-resident (External) Rupee/FCNR accounts.

7.4.86 2. Under the Foreign Travel Scheme (FTS) Indian residents were eligible to undertake

Foreign Travel under <u>Special Travel Schemes</u>

visits to any country (other than Nepal and Bhutan) once in two calendar years and were entitled to draw foreign exchange upto the equivalent of US $ 500 per capita. Similarly, under the Neighbourhood Travel Scheme (NTS) Indian residents were eligible to visit any country in the group of eight neighbouring countries (viz. Bangladesh, Burma, Malaysia, Maldive Islands, Mauritius, Pakistan, Seychelles Islands and Sri Lanka) once in two calendar years and to draw foreign exchange upto the equivalent of US $ 250 per capita. The following changes have been introduced in the Special Travel Schemes with effect from 7th April 1986.

(i) FTS as well as NTS will be available once in three calendar years instead of once in two calendar years.

(ii) FTS and NTS will be mutually exclusive. A traveller visiting any country/ies in the NTS group on his way to other countries covered by FTS would be eligible for release of exchange under FTS only.

(iii) Minor children upto the age of twelve will be eligible to draw exchange at half the normal FTS/NTS quota.

24.7.86 3.(a) The Reserve Bank has issued a notification under the Foreign Exchange Regulation Act, 1973

Hospitality to non-residents on visits to India and surrender of unspent foreign exchange by travellers on return to India

in terms of which it has granted general permission to any person resident in India to make payments in Indian rupees towards hospitality extended to any person resident outside India who is on a visit to India, upto a maximum of Rs. 2,000/- during the course of a single visit.

(b) The Reserve Bank has issued another notification under the Foreign Exchange Regulation Act, 1973 in terms of which any person resident in India who had acquired foreign exchange under general or special permission of the Bank for travel abroad is permitted to surrender the unspent foreign exchange brought back to India by him, to a bank authorised to deal in foreign exchange against payment in rupees (i) within 60 days from the date of his return if the value of foreign exchange brought back does not exceed US $ 200 or its equivalent and (ii) within 30 days of his return if the value of such foreign exchange exceeds US $ 200 or its equivalent. Earlier such unspent balances were required to be surrendered to authorised dealers immediately on the travellers' return to India.

28.7.86 — Release of foreign exchange for travel abroad

4.(a) The Reserve Bank has enhanced the scales for release of exchange for travel abroad for practical and specialised training and medical treatment. Details of the enhanced scales are as under:

Purpose	New scales for release of exchange
(i) Practical training (upto 12 months)	US $ 900 per month
(ii) Specialised training	US $ 100 per day for the first month and US $ 75 per day for the balance period
(iii) Medical treatment:	
a) Initial remittance towards medical expenditure	Upto US $ 7500 subject to accounting. Higher amount can be released if estimate of expenditure from the overseas hospital specifies it.

b)	Pre and post-hospitalisation stay abroad of patients	US $ 100 per day upto 2 months.
c)	Attendants accompanying patients	US $ 75 per day upto 2 months.
(iv)	Incidental expenses where no per diem amount is released	US $ 15 per day subject to minimum of US $ 150 and maximum of US $ 900.
(v)	Travel to Bilateral Group countries (i.e. USSR, German Democratic Republic, Romania, Czechoslovakia and Poland)	Indian travellers visiting these countries are issued rupee travellers cheques encashable in the respective countries. However, free foreign exchange will be released upto 20% of the traveller's exchange entitlement or US $ 100 whichever is more.

(b) Reserve Bank now considers requests from consultants/specialists holding post-graduate qualifications ~~and having to their credit minimum experience of 3 years,~~ for release of exchange for undergoing advanced training specialised medical fields like heart surgery, neurology, oncology, etc. at reputed overseas institutions upto a maximum period of 6 months. This facility is distinct from the facility of undertaking study tours abroad which is already available to leading consultants/specialists.

29.7.86 5. The following changes have been introduced in the relevant regulations with effect from 29th July 1986 -

Remittance/Retirement facilities to Indian/foreign nationals

(a) Persons of Indian nationality or origin who had settled down abroad permanently before the introduction of Exchange Control in India will henceforth be entitled to release of foreign exchange upto Rs. 1 million in one lump sum towards transfer of their Indian assets including bequests, legacies and inheritances as well as balances held in the applicants' ordinary non-resident accounts. The balance, if any, left over after availing of the lump sum remittance of Rs. 1 million will be allowed to be remitted abroad in annual instalments not exceeding Rs. 0.25 million each.

(b) Foreign nationals leaving India on retirement for settlement abroad will be allowed, on their retirement from India, an initial remittance upto Rs. 0.5 million and subsequent annual instalments of Rs. 0.25 million on account of transfer of their capital assets. In addition, they would be eligible to remit the value of their entire current assets.

(c) Persons who were never resident in India will be eligible for remittances towards legacies, inheritances and bequests subject to a ceiling of Rs. 0.5 million for the initial remittance, the balance, if any, being remittable in annual instalments not exceeding Rs. 0.25 million each.

(d) Foreign born-widows of Indian nationals will be eligible to transfer abroad their capital assets plus current income in India upto Rs.0.5 million in one lump sum and upto Rs. 0.25 million each towards the subsequent annual instalments.

1.8.86 6. Reserve Bank has granted general permission to Indian companies to incur hotel expenses

Expenditure on official visits to India of non-resident directors of Indian companies	upto Rs. 3,000/-

per day for a period upto 5 days on account of their non-resident directors in connection with the latter's visits to India for official business like attending board meetings etc.

11.8.86 7. As from August 1986 Reserve Bank has allowed firms/companies holding valid blanket permits under the RBI or ITC Schemes to obtain and use international credit cards to facilitate business visits abroad of their representatives. Applications for the facility have to be submitted to the Central Office of the Bank's Exchange Control Department.

International Credit Cards

11.8.86 8. The Export-Import Bank of India (EXIM Bank) has concluded an agreement with the Bank of Jamaica on 31st October 1985 for making available to the latter, a line of credit of Rs. 50 million. The credit is available for import into Jamaica from India of certain capital and engineering goods including spares. The last date for opening of letters of credit for contracts to be eligible for finance under the line of credit is 30th April 1987 and the last date for making disbursements by EXIM Bank is 31st October 1987.

Exim Bank Line of Credit to Bank of Jamaica

4.9.86 9. Reserve Bank has granted a licence to deal in foreign exchange to Bank of Bahrain and Kuwait B.S.C. in terms of Section 6 of the Foreign Exchange Regulation Act, 1973. The bank has been permitted to undertake all types of foreign exchange transactions in all permitted currencies subject to usual conditions and obligations.

Authorised Dealer in Foreign Exchange

6.1.87 10. Till January 1987, Reserve Bank bought Pound sterling, US dollar, Deutsche mark and Japanese yen on spot as well as forward basis. Sale of foreign currency by Reserve Bank was restricted to Pound sterling on spot basis. With a view to making US dollars available to authorised dealers to meet their merchant commitments in that currency, Reserve Bank has started selling US dollars for spot delivery to authorised dealers with effect from 2nd February 1987. The facility is subject to the following main conditions:-

Sale of US dollars by Reserve Bank to Authorised Dealers

i) Reserve Bank will sell a minimum of US dollars 2,50,000 and higher amounts in multiples of US $ 25,000/-. There will, however, be no ceiling on such sales.

ii) The US dollars to be purchased from Reserve Bank should be only for covering sales of US dollars for specific merchant transactions or commitments in that currency such as remittances to be made on account of imports, dividends, profits, royalty, technical know-how fees, etc. from India in conformity with existing Exchange Control Regulations.

Indo-Nicaraguan Credit Agreement dated 11th September 1986 for **Rs. 125 million**

30.12.86 11. The Government of India have signed on 11th September 1986 an agreement with the Government of the Republic of Nicaragua under which the former will make available to the latter a line of credit of Rs. 125 million. The credit will be available for export from India of certain specified goods of Indian manufacture and services. The export contracts to be financed under the credit agreement must be signed and relative letters of credit established by 30th September 1987. The terminal date for drawals under the credit is 30th September 1988.

(B) Changes introduced or contemplated in policies with respect to foreign collaboration arrangements in industry including royalty payments and purchase of technology

Government of India have introduced a revised procedure for approval of foreign collaboration agreements with effect from 2nd August 1985. The important changes which have been introduced through the revised procedure are the following -

(a) Foreign Collaboration Agreements will not be taken on record by the Government of India but will be filed with Reserve Bank of India(RBI). The date of receipt of a collaboration agreement in the concerned Regional Office of the Exchange Control Department of RBI will be taken as the date of filing of the agreement with RBI.

(b) In the Government approval letter, the following clause will be added.

> "This approval letter is made a part of the foreign collaboration agreement to be executed between you and the foreign collaborator and any provision of the same agreement which is not covered by the said letter or is at variance with the provisions of that letter shall be void and be not binding on the Government or Reserve

Bank of India. If a question arises as to whether a provision in this agreement is or is not covered by the Government approval, the parties hereto agree that the decision of Government in the Department of Industrial Development shall be final".

(c) The foreign collaboration approval letter will form part of the foreign collaboration agreement.

(d) The revised procedure is applicable only to approval letters issued by the Government of India on or after 2nd August 1985. Information regarding changes in the policy on technology transfer is obtainable from Government of India who formulate and administer the policy.

(C) Changes introduced or contemplated in the regulations and incentives for foreign direct and portfolio investment

The process of liberalisation and simplification of procedures relating to investment in India by non-resident Indians(NRIs) and Overseas Corporate Bodies owned to the extent of at least 60% by NRIs (OCBs) continued during 1986. The following is a summary of major changes introduced in this area:

(1) Government of India issued a Notification under Section 19(6) of Foreign Exchange Regulation Act, 1973 on 10th June 1986 in terms of which sale/transfer of shares of Indian companies on non-repatriation basis through stock exchanges in favour of an individual and/or company or other corporate body incorporated under any law in force in India (excluding companies with more than 40% non-resident interest) will not require Reserve Bank's clearance under Section 19(5) of FERA, 1973. In terms of another Notification issued by Government of India on 10th June 1986 transfer of shares of Indian companies by NRIs with repatriation rights through stock exchange in India in favour of a person who is a citizen of India or a person of Indian origin, whether resident in India or outside India or in favour of a company (excluding a FERA company) will not require RBI's permission provided (a) shares had been purchased under the Portfolio Investment Scheme, (b) shares are held for a period of not less than one year prior to transfer, (c) shares are sold in stock market through the

same designated bank through whom they were purchased and (d) the sale proceeds are paid to the designated bank.

(2) Under the Portfolio Investment Scheme the validity of general permission granted by RBI to designated banks for purchase of shares on behalf of NRIs has been raised from 3 to 5 years.

(3) In order to eliminate delays in submission to RBI of inward remittance certificates evidencing receipt of funds from abroad, it has been decided to introduce with effect from 1st April 1987 a separate series of NRE cheques which would enable the bankers to the new issues to issue a consolidated bank certificate without calling for any certificate from the paying banks.

(4) Under the 40% Scheme, private limited companies engaged in manufacturing/industrial activity and/or hotels of 3 star and higher ratings, hospital projects, etc. are now being permitted to issue shares to NRIs upto 40% of the new issue without any monetary ceiling thereon. Earlier there was a ceiling of Rs. 4 million on such issues to NRIs.

(5) NRIs are now permitted to participate in the revival of sick industrial units by making investments with full repatriation rights either by purchasing equity shares from the existing shareholders or by way of subscription to new equity issue of the Indian sick company upto 100%. Repatriation of capital would, however, be permitted after a minimum period of 5 years taking into account the future payment liabilities of the company.

(6) Indian companies engaged in shipping/ computer software/oil exploration were not hitherto allowed to issue shares to NRIs with repatriation rights. NRIs were also not permitted to invest in Medical Diagnostic Centres. These fields have since been thrown open for NRI participation with repatriation benefits under the 40% Scheme.

(7) With effect from 29th November 1986 NRIs have been granted general permission to (a) subscribe to Memorandum and Articles of Association (MA & A) and take up shares of the company for the purpose of its incorporation upto upto a face value of Rs. 10,000/- and (b) the company to issue, shares as above to such NRIs subject to compliance with certain conditions. NRI promoters can

thus now subscribe to the MA & A and take up shares upto face value of Rs. 10,000/- without approaching RBI for prior permission.

(8) Designated banks are allowed to repatriate from India the sale proceeds of shares/debentures held by NRIs to credit such funds to the seller's NRE/FCNR accounts to the extent of cost of acquisition of investment or sale proceeds whichever is less. The excess amount (if any) representing capital gains is permitted to be repatriated/credited to NRE/FCNR account after submission of No Objection Certificate/Tax Clearance Certificate from Income-tax Authorities. With a view to reducing the time lag, Authorised Dealers have been given powers to deduct tax @ 20% on the long term capital gains (in case of individual NRIs) and remit the balance sale proceeds or credit them to the NRI's NRE/FCNR account in India immediately.

(9) General permission has been granted to Indian companies with more than 40% non-resident interest to acquire or hold any immovable property in India which is necessary for or incidental

considered in case of import of
high technology in specialised fishing
and post harvest operations like
processing and marketing of fish and
fishery products.

INDIA

Briefing for Management
Meeting with Indian Delegation

1. Biographical sketch of Mr. N.D. Tiwari, Minister of Finance and Commerce:

Mr. Tiwari, with whom you met during the Annual Meetings, took over the Finance portfolio from the Prime Minister in July 1987. He previously held other portfolios, including Planning, Industries, and External Affairs, and served as Chief Minister of Uttar Pradesh, India's largest state.

2. Recent Developments and Fund Relations

Economic performance in 1987/88 (April-March) was dominated by one of the worst droughts on record. GDP, however, is estimated to have increased by 1.5 percent despite a 10 percent decline in agriculture. Inflation has risen to about 10 percent. The fiscal deficit, about 9 percent of GDP, was only slightly higher than original projections as revenue measures were taken to meet drought-related expenditures. The current account deficit remained about 2 percent of GDP; the strength of exports largely compensated for drought-related imports. Gross official reserves fell to four months of imports, and the external debt service ratio was steady at about 22 percent.

Staff discussions for the next Article IV consultation are to begin in late May. India has sizable repurchase obligations to the Fund over the next several years.

2. Topics for Discussion

a. You may wish to compliment the Government on its handling of the drought. The macroeconomic ramifications have been relatively mild owing to policy initiatives before the drought--in particular, renewed efforts to contain the fiscal deficit and the introduction of monetary targeting--and structural changes that have rendered industry more drought-proof. Large foodgrain stocks and a sizable effective depreciation of the rupee since late 1985 cushioned the impact on the external sector. However, the rebuilding of foodgrain stocks could weaken the budgetary and external positions.

b. The 1988/89 Central Government budget, which appears to have been influenced by the need to hold parliamentary elections by end-1989, envisages another deficit of about 9 percent of GDP. Concessions to agriculture to mitigate the effects of the 1987 drought are financed largely by discretionary revenue measures. However, it is of concern that the recent increase in the current deficit, mainly reflecting higher spending on defense, interest, and subsidies, will not be reversed and that the share of capital expenditure will once again fall. Financing needs will continue to place pressure on money growth.

c. Exports picked up sharply in 1987/88 owing to promotion measures and a 25 percent real effective depreciation of the rupee between late-1985 and mid-1987. During the remainder of 1987, however, the real effective depreciation tapered off to about 3 percent. Medium-term prospects for exports and overall growth depend critically on further import liberalization, industrial deregulation, and a reduction in the public sector deficit. As reforms are carried out, the exchange rate should be used actively to support exports.

India: Summary Data 1/

	1984/85	1985/86	1986/87	1987/88 Est.	1988/89 Proj.
Growth (percent change)					
Real GDP	3.8	4.9	4.1	1.5	5.0
Real domestic demand	3.6	4.5	4.7	--	--
Inflation (percent change)					
GDP deflator	6.4	6.9	7.0	10.0	8.0
WPI (end of year)	7.6	3.8	5.1	10.0	8.0
Terms of trade (change in percent)	-2.1	6.1	13.0	2.5	--
Central government budget 1/					
Revenue (percentage change)	17.2	23.4	12.7	12.4	12.0 2/
Expenditure (percentage change)	23.7	26.1	15.4	9.2	11.7 2/
Central budgetary savings (percent of GDP)	-1.5	-1.5	-2.7	-2.9	-2.9 2/
Overall deficit (percent of GDP)	7.7	8.9	9.6	9.0	8.8 2/
Foreign borrowing (percent of GDP)	0.7	0.6	0.7	0.9	0.9 2/
Money and credit 3/ (percentage change)					
Total domestic credit	19.2	17.2	17.2	14.6 4/	...
Of which: net credit to government	20.8	19.6	21.8	18.7 4/	...
Broad money (M3)	18.7	16.1	18.8	16.4 4/	...
Interest rate (one to two year deposits)	8.0	8.5	8.5	8.5	...
Balance of payments (bn. $)					
Exports 5/	8.8	9.4	10.5	12.5	13.7
Imports 5/	-14.4	-17.2	-16.9	-19.0	-21.0
Of which: Oil 5/	(4.6)	(4.1)	(2.3)	(2.8)	(2.8)
Current account	-2.9	-5.3	-4.0	-4.2	-4.8
Current account (percent of GDP)	-1.7	-2.6	-1.9	-1.8	-1.8
Of which: interest payments	-1.3	-1.5	-1.7	-1.8	-2.0
Overall balance	0.2	0.8	0.7	0.6	1.1
Reserves (end of year)					
Gross official reserves (mn. $)	6,434	7,073	7,200	6,910	...
(In months of imports)	5.4	4.9	5.1	4.1	...
Net official reserves (mn. $)	2,502	2,783	2,908	3,523	...
External debt (end-of-year stock)					
Medium- and long-term, nonmonetary (bn. $)	26.3	32.1	36.7	41.2	46.2
Short-term, nonmonetary (bn. $)	0.3	0.3	0.3	0.4	0.4
Use of Fund credit	3.9	4.3	4.3	3.4	2.4
Monetary liabilities	--	--	--	--	--
Total (percent of GDP)	17.7	18.7	19.9	19.7	18.9
Debt service (bn. $)	2.3	3.0	3.8	4.4	4.7
(percent of current earnings)	15.3	19.0	22.1	21.9	21.5
Use of Fund resources (mn. SDRs)					
Purchases	200	--	--	--	--
Repurchases and Trust Fund repayment	133	250	536	809	909
Fund holdings of currency (Percent of quota)	257.6	248.6	224.3	197.2 6/	...
Exchange rate					
Exchange rate regime	Linked to a currency basket				
Real effective index 7/ (1980 = 100, end of period)	100.8	87.6	77.0	74.5 8/	...
Nominal effective index 7/	106.4	93.0	80.5	75.9 8/	
Rs/US$ (end of period)	12.43	12.29	12.93	13.08 9/	...
Quota (mn. SDRs)	2,208				

1/ Fiscal year ending March.
2/ Budget estimates.
3/ Last Friday of March basis.
4/ For 1987/88, change as of February 12, 1988 over February 13, 1987.
5/ Net of crude oil exports.
6/ February 1988.
7/ 1980 = 100, end of period.
8/ January 1988.
9/ February 1988.

SUR/87/86

CONFIDENTIAL

August 14, 1987

The Acting Chairman's Summing Up at the Conclusion
of the 1987 Article IV Consultation with India
Executive Board Meeting 87/120, August 7, 1987

Directors commended the Indian authorities for the strong economic performance of the past three years. Although unfavorable weather had resulted in only a modest rise in agricultural production, real GDP growth had remained robust. The manufacturing sector had continued to derive strength from earlier reform measures. The rate of inflation had been moderate.

Directors welcomed the recovery in exports and the improvement in the external current account. The upturn in exports was related to the various export promotion measures as well as the depreciation of the rupee in real effective exchange rate terms. While no major changes in import liberalization had been introduced over the past year, determined efforts had been made to ensure the full implementation of earlier initiatives. The substantial increase in imports of capital equipment has been affected by these initiatives.

Directors noted that the overall balance of payments position remained manageable and that India continued to enjoy ready access to international capital markets. However, Directors expressed some concern about the continued rise in external debt service payments which, though not high by international standards, had reached some 22 percent of current receipts.

Directors agreed that the short-term outlook for growth appeared favorable. While there was some concern relating to current weather conditions, real GDP was expected to increase by 5 percent in 1987/88, in line with the Seventh Plan target. The rate of inflation was also projected to be about the same as last year and the external current account deficit to remain about unchanged in relation to GDP despite a sizable further increase in imports.

Directors focused their attention on the prospects for sustaining the current pace of economic expansion over the medium term without jeopardizing external viability. In this context, they endorsed the cautious external debt policy adopted by the authorities, which ruled out large-scale commercial borrowing. Future growth would, therefore, have to rely on continuance of policies to mobilize domestic resources, improved export performance and structural reforms over a broad front, and also on flows of concessional assistance. Given the high savings and investment ratios in the Indian economy, Directors observed that greater efficiency in resource use would be a major stimulant of growth.

Directors believed that the public sector deficit remained high. They endorsed the authorities' commitment to limit this year's central government deficit. In view of the tax reforms already implemented, the bulk of fiscal adjustment would have to come from restraint on current expenditures, including in particular subsidies. In addition, Directors attached considerable importance to strengthening the financial position of public enterprises. Progress in this area had been slow, and while the emphasis on improving operating efficiency was appropriate, the implementation of selective price adjustments was also viewed as necessary.

A number of Directors thought that the authorities' recent focus on slowing the rate of monetary expansion had been appropriate. In these circumstances, fiscal restraint would permit the private sector to retain sufficient access to bank credit. The potential problem of crowding out the private sector could be avoided provided that conditions in the capital market improved. The efficiency of the financial system would be enhanced through more market-oriented instruments and interest rate policies, and reduced emphasis on direct credit by the Reserve Bank. While commending the steps already taken in these areas, Directors encouraged the authorities to continue their efforts to deregulate and broaden the financial system.

Directors stressed the critical importance of accelerated export expansion if the higher growth scenario were to materialize. In this regard, vigorous action was needed to overcome the antiexport bias of the trade system. The authorities were urged to proceed with the replacement of quantitative import restrictions with tariffs, and also a gradual reduction of the average level and dispersion of tariffs. Speakers generally believed that it was fundamentally in the interest of India to maintain the momentum toward a more outward-looking, competitive economy, to strengthen the vitality of the private sector, and to improve the efficiency of the public sector. Flexible exchange rate policy was seen as a supportive element in the export promotion strategy and a means of reinforcing the necessary trade reforms.

Directors recognized that considerable progress had already been made in deregulating industry and reducing distortions in resource allocation. However, it was felt that considerable scope existed for further deregulation. Directors urged the authorities to implement industrial and trade reforms in tandem in order to reduce the risk of encouraging the development of inefficient industries. A number of Directors supported the staff recommendation of the need for adopting a clear timetable for the implementation of specific deregulation measures to give assurance to investors and facilitate the reallocation of resources. In this regard, Directors also underscored the need for provision of generous concessional assistance to India and improved access to world markets for its exports.

In conclusion, Directors believed that, with policies to mobilize additional domestic and external resources and to enhance efficient use of capital, the Indian economy could achieve a growth rate well above the historical rate for a long period ahead, without encountering balance of payments difficulties.

It is expected that the next consultation with India will be held on the standard 12-month cycle.

Office Memorandum

Mr. Whittome
cc: Mr. Brown
my file

TO: The Managing Director

SEP 28 1987

September 28, 1987

FROM: P.R. Narvekar PRN

SUBJECT: India

I now understand that the Indian authorities do not intend to pursue the possibility of emergency assistance from the Fund at this time. The "at this time" proviso is precautionary rather than implying any intention at this stage to make a request a bit later.

In speaking of the drought in your meeting with the Indian delegation tomorrow morning, you may nevertheless wish to say, guardedly, that you would have been prepared to consider sympathetically any request to help India in these circumstances. Such a statement, however guarded, is likely to receive very favorable mention in the Indian press.

cc: The Deputy Managing Director
Mr Whittome
Mr. Brown
Mr. Simpson

Condit — India meeting

longer time frames

MD = need for contingencies — clearly accepted

intelligent condit. (strong but intelligent) — Dom. Reps.

(fewer, realistic points)

re-introd Fd in exch rates indust. ctries

Malhotra — poor countries other than debt distressed have to be kept in view

Sengupta — Fund progras affect Bank shares of India

(poverty index)?

Q skewed because slanted toward creditors

Fund: growth/oriented adj. — go by progras

— some thg based on need into Q distrib. (suitable way)

— no unilateral moves

— condit. review

5-100

502765

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RESERVE BANK OF INDIA
CENTRAL OFFICE
SECRETARY'S DEPARTMENT
CENTRAL OFFICE BUILDING
POST BAG NO.10007
BOMBAY-400 023.

TELEGRAMS:
"RESERVBANK"

TELEPHONE
2861602/0604

Ref.No.SYD.BD/ 4883 /B.3-86/87.

April 1, 1987
Chaitra 11, 1908(Saka)

Mr.Jacques de Larosiere,
Managing Director,
International Monetary Fund,
19th and H Streets, N.W.,
Washington D.C. 20431.

RECEIVED
INTERNATIONAL
MONETARY FUND
1987 APR 20 PM 3 31
COMMUNICATIONS
DIVISION

Dear Sir,

We advise that Shri P.R. Nayak who has been appointed as Deputy Governor of the Bank for a period of five years has assumed charge with effect from the forenoon of 1st April 1987.

Yours faithfully,

(S.S. Karnik)
Joint Secretary

ORIG: ASD
CC: MD
DMD
MR. SENGUPTA
FAD
SEC
ETR
STA.
MR. BOUTER
IMF INST(RM#4-120)
MR. R. BROWN

kw

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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MR. BIMAL JALAN
SECRETARY, BANKING AND
CHIEF ECONOMIC ADVISER
ECOFAIRS
NEW DELHI, INDIA 110001

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MR.SENGUPTA
ETRD

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ON MARCH 4 I CABLED YOU AS FOLLOWS:

QUOTE PURSUANT TO OUR TELEPHONE CONVERSATION, I WOULD LIKE TO PROPOSE THE FOLLOWING SCHEDULE FOR THE UPCOMING ARTICLE IV CONSULTATION MISSION.

MAY 2: MISSION ARRIVES
MAY 4-8: NEW DELHI (CONSULTATION DISCUSSIONS)
MAY 11-13: BOMBAY (DISCUSSIONS WITH THE RBI)
MAY 14-18: NEW DELHI (DISCUSSIONS AND CONCLUDING SESSION)

THE QUESTIONNAIRE HAS ALREADY BEEN SENT AND I WOULD APPRECIATE YOUR RESPONSE TO THE PROPOSED SCHEDULE AT YOUR EARLIEST CONVENIENCE.

I WOULD GREATLY APPRECIATE IT IF THE ANSWERS COULD BE PROVIDED UPON THE MISSION'S ARRIVAL. UNQUOTE

SINCE I HAVE NOT YET RECEIVED A REPLY TO THIS MESSAGE, I PRESUME IT WAS LOST INTRANSIT. I SHALL APPRECIATE HAVING YOUR REACTION TO THE PROPOSED SCHEDULE AT YOUR EARLY CONVENIENCE.

BEST PERSONAL REGARDS, NARVEKAR, INTERFUND

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E AUTHORIZED BY NAME (TYPE): P.R. NARVEKAR AUTHORIZED BY NAME (TYPE): (**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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G SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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DR. BIMAL JALAN
SECRETARY, BANKING AND
CHIEF ECONOMIC ADVISER
ECOFAIRS
NEW DELHIA, INDIA 110001

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MAY 14-18: NEW DELHI (DISCUSSIONS AND CONCLUDING SESSION)

I WOULD APPRECIATE YOUR REACTION TO THE ABOVE AT YOUR EARLIEST CONVENIENCE.

THE QUESTIONNAIRE HAS ALREADY BEEN SENT AND IT WOULD BE MOST HELPFUL IF THE ANSWERS COULD BE PROVIDED UPON THE MISSION'S ARRIVAL.

BEST PERSONAL REGARDS

NARVEKAR

INTERFUND

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DRAFTED BY NAME (TYPE): B.B.AGHEVLI:cjf EXT.: 7177 DEPT.: ASD DATE: 3/4/87

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SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

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Office Memorandum

TO: Mr. Browne June 26, 1987

FROM: Eduard Brau

SUBJECT: India--Staff Report for the 1987 Article IV Consultation

This report proves very nicely that a short but comprehensive staff report on a major country can be produced. The use and reference to charts is very skillful.

The general analysis and conclusions of the report seem to me appropriate. Nevertheless, there are a few areas where you may wish to consider the nuances. One concerns exchange rate policy and recent export performance. I would readily agree on the urgent need for continued flexibility in exchange rate policy. The appraisal (page 20) portrays the recent depreciation as re-enforcing a plethora of special export incentives intended to neutralize the bias against exports in India. Perhap the matter should be portrayed slightly differently in the sense that insufficient trade regime liberalization cum exchange rate adjustment has prompted the need for such incentives. The latter are now described in a somewhat positive fashion, while budgetary costs, distortions in financial markets, etc. created by such measures are not directly addressed. It is clear that a further depreciation would be needed in the event of significant trade reform/liberalization, and in relation to a sustainable current account position based on vigorous export performance. However, if the trade regime were to remain unchanged, the relevance of only a small depreciation in relation to export competitors is not clear. Since key Asian competitor countries of India have closely followed the U.S. dollar, comparisons to competitors may lead to recommendations of ever accelerating depreciations. Thus, the need for exchange rate flexibility should be focused directly on current account and trade liberalization concerns.

Is the report perhaps a little too upbeat about recent performance on the export side, given the plethora of special incentives apparently necessary to help produce an increase in volume, and also given the past habitual large downward revision of tentative figures in this area?

On page 4 and elsewhere, it is said that the huge public sector deficit in India does not "crowd out" the credit needs of the private sector. This is not clear from Chart 4 and from a priori reasoning. Certainly, the manyfold and tight encumbrances on India's financial system are <u>designed</u> to preferentially finance the public sector, and real lending rates are substantially above inflation. (Incidentally, a chart on interest rates would be helpful.)

The following specific comments may also be useful:

Page 2, lines 8-9: Reference is made to the present Government. Since no reference is made in the paper to a major change in policy following the assumption of power by the present Government, it is not clear what the significance of this statement is. Wouldn't it be better to put the last sentence more neutrally, e.g., "these reforms have since been carried much further"?

Page 3, line 14: Over which period did gross capital formation average 24 percent of GDP?

Page 3, last line: A sentence to explain why there is a "lack of opportunities to fully exploit economies of scale" would be helpful to the reader.

Page 5, lines 6-7: It is stated that the real effective exchange rate remained broadly unchanged, with a reference to Chart 6 which shows some substantial changes. The period should be clarified.

Page 5, lines 13-14: The report might mention somewhere the size of the stock of nonresident deposits.

Page 6, lines 11-14: Some explanation for the growth rates of industrial production and services and the expectation of continuation of these growth rates would be useful.

Page 10, lines 6-8: It is not entirely clear from the summary description in this sentence why the extention of the maximum interest rates from 30-year to 20-year bonds constitutes an increased role of market forces. Some clarification would be desirable.

Page 10, 4 lines from bottom: Should there not be some caution about the unreliability of tentative export data?

Page 13: What is the definition of the authorities' "binding foreign exchange constraint," or, stated differently, do they explicitly endorse the broad figures on gross commercial borrowing included in the scenario projections? Alternatively, could the report refer to a public statement by the authorities on their policy with respect to comnmercial borrowing?

Page 14, lines 5-7: Exchange rate policy is not mentioned. Is this mainly for presentational reasons?

Page 18, last sentence, second full paragraph: Exchange rate policy might be mentioned.

Page 19,, bottom paragraph: While agreeing broadly with the necessity of sustaining public investment, I do find it hard to believe that all of it is efficient. If we endorse the current level of public investment, should we not qualify this by the word "efficient"?

Page 21, middle paragraph, last sentence: Exchange rate policy might be mentioned.

Finally, in Chart 1, the panel on the agricultural production index does not have an indication of the base year for the index.

INTERNATIONAL MONETARY FUND

June 25, 1987

Mr. Brau:

India--Staff Report

The attached comments were prepared by Mr. Hansen and myself.

Gerard Belanger

CGK/IND--coindlh
June 25, 1987

India--Comments on Draft Staff Report for Article IV Consultation

The report is remarkably short, yet comprehensive. On a presentational point, the report draws heavily on references to charts, which is useful. However, the charts in general cover a long period 1976/77-1992/93 and it is not always clear which period the statements in the text refer to.

A first general comment concerns exchange rate policy. There is no doubt that a significant depreciation of the rupee against the U.S. dollar would be needed as part of an integrated industrial and trade liberalization policy. The case for further depreciation (as suggested by references to the need for continued flexibility), following the recent relatively large slide, is not so clear, however, in the absence of progress toward liberalization of the present trade and industrial control regime. The "skillful management" of the exchange rate (page 20) since early 1985 has involved essentially depreciating the rupee along with the U.S. dollar. Since a similar policy has been followed by several other Asian countries over the same period, it is not surprising that the rupee has not depreciated much relative to the currencies of competitors. Asian currencies depreciated in real effective terms by 18.3 percent, on average, from the first quarter of 1985 through the third quarter of 1986 (SM/87/29, page 7; also, in contrast with the currencies of many other developing countries Asian currencies had not, at least on average, appreciated along with the U.S. dollar during the preceding period). Comparisons to competitors, for India and other countries which are all following the same policy of depreciating with the U.S. dollar, could only lead to recommendations of ever accelerating depreciations. We would suggest that exchange rate analysis be refocused more sharply on the needs in relation to a sustainable current account and trade liberalization (which, incidentally, the real depreciation should already facilitate).

Second, we wonder whether the staff report is not too upbeat regarding the economic situation of India. The rebound of exports this year and the expected continuation of high growth rates seem to be the result to a large extent of special export incentives. Perhaps such incentives are necessary to neutralize the bias against exports in India, but is this the proper way to go about this? What are the budgetary costs and distortions of financial markets created by such measures?

Third, in the discussion of monetary policy on page 4 of the report and again in the staff appraisal, it is claimed that there is no "crowding out" of private industry. It is not clear that this is so clearcut from Chart 4 which shows a reduced share for the commercial sector in total credit. Also, it is stated on page 4 that bank deposit and lending rates were kept substantially above inflation, implying that the large demand for credit by the public sector and the extension of credit to the priority sectors (presumably at subsidized rates) have resulted in lending rates for credit to private industry which are higher than would otherwise have been necessary. As a separate point, it would be useful to have an interest rate chart to support the argument that deposit and lending rates are significantly positive in real terms. The only reference to interest rates in the paper is the rate for one-year term deposits mentioned in Annex I, and compared with the consumer price index shown in the same Annex this rate is not significantly positive in real terms.

Other points

Page 2, lines 8-9. Reference is made to the present Government. Since no reference is made in the paper to a major change in policy following the assumption of power by the present Government, it is not clear what the significance of this statement is. Wouldn't it be better to put the last sentence more neutrally, e.g., "these reforms have since been carried much further"?

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FOR MR. GARRY PURSELL

ONE. AS DISCUSSED, NEPAL TECHNICAL ASSISTANCE MISSION ON TARIFF REFORM WILL STOP OVER IN NEW DELHI ON ITS WAY TO KATHMANDU. MESSRS. BLEJER, ROBINSON AND MYSELF WILL ARRIVE IN DELHI ON FEBRUARY 22 AND WILL DEPART ON FEBRUARY 25. INSTEAD OF TOM MAXWELL, IT IS NOW DONALD KEESING WHO WILL PARTICIPATE IN THE MISSION FROM THE WORLD BANK. HOWEVER, DUE TO OTHER COMMITMENTS KEESING WILL JOIN THE MISSION IN KATHMANDU ON MARCH 7.

TWO. WHILE IN DELHI, WE WOULD LIKE TO HAVE MEETINGS WITH YOURSELF AND INDIAN OFFICIALS. I WOULD SUGGEST THAT WE MEET WITH YOU ON MONDAY MORNING, FEBRUARY 23 IN YOUR OFFICE. I AGREE WITH YOUR SUGGESTION THAT THE INDIAN OFFICIALS WE SHOULD MEET ARE PRIMARILY THOSE FAMILIAR WITH ISSUES RELEVANT TO NEPAL IN THE CUSTOMS OFFICE. DON KEESING ALSO SUGGESTED THAT WE MIGHT WANT TO MEET WITH OFFICIALS IN THE MINISTRY OF FOREIGN AFFAIRS DEALING WITH TRADE ISSUES CONCERNING

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SPECIAL INSTRUCTIONS

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AUTHORIZED BY NAME (TYPE): G. SZAPARY AUTHORIZED BY NAME (TYPE):

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SEC. 48 REV 1 11-18-82

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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INTBAFRAD
NEW DELHI (INDIA)
FOR MR. GARRY PURSELL
PAGE - 2 -

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NEPAL. HOWEVER, I LEAVE IT TO YOU TO DECIDE WHOM WE SHOULD MEET. I WOULD APPRECIATE IT IF YOU COULD SET UP THESE MEETINGS FOR MONDAY AND TUESDAY.

THREE. WE ARE STAYING IN THE TAJ MAHAL HOTEL. MY LAST DAY IN WASHINGTON IS WEDNESDAY, FEBRUARY 18. IF YOU HAVE A SCHEDULE OF MEETINGS BY THAT TIME, I WOULD APPRECIATE IT IF YOU COULD TELEX IT. OTHERWISE, PLEASE LEAVE A MESSAGE AT THE HOTEL.

THANK YOU AND BEST REGARDS.

SZAPARY
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TELEGRAMS:
"RESERVBANK"

RESERVE BANK OF INDIA
CENTRAL OFFICE
SECRETARY'S DEPARTMENT
CENTRAL OFFICE BUILDING
POST BAG NO.10007
BOMBAY-400 023.

TELEPHONE
2861602/0604

ORIG: ASD

CC: MD
DMD
MR.SENGUPTA
ETR
SEC
TRE
MR.DANNEMANN
MR.BOUTER
MR.R.BROWN
FAD

Ref.No.SYD.BD/3476/B.3-86/87

February 11, 1987
Magha 22, 1908(S)

Mr.Jacques de Larosiere,
Managing Director,
International Monetary Fund,
19th H Streets, N.W.,
Washington D.C.20431.

Dear Sir,

We have pleasure in advising that Shri A. Ghosh and Dr. C. Rangarajan have been re-appointed as Deputy Governors of the Bank for a further period of five years with effect from January 21, 1987 and February 12, 1987 respectively.

Yours faithfully,

(T.K.K. Bhagavat)
Secretary

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DIVISION

1986

Office Memorandum

cc ASD o/c
ETR

OK
RDE
Nov. 24, 1986

TO: The Deputy Managing Director November 18, 1986

THROUGH: The Director of Administration

FROM: Charles S. Gardner

SUBJECT: Mr.Mohammed to Represent Fund at Meeting in New Delhi

We wish to amend our travel schedule to add Mr. Mohammed's visit to New Delhi, India to represent the Fund at the 29th Congress of the International Chamber of Commerce from February 11 to 13, 1987. As noted in Mr. Mohammed's memorandum of October 30 to the Managing Director (copy attached), Mr. Mohammed would be stopping in New Delhi en route to the Fund Seminar to be held in Abu Dhabi from February 16 to 18.

1986 NOV 20 AM 9:35
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

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EXCHANGE &
TRADE RELATIONS

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Attachments

MISSION # 87170202
PROGRAM # 730 (discretionary travel)

RECEIVED
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DY. DIR. ADM.

INTERNATIONAL MONETARY FUND

November 24, 1986

TO : Mr. Aghevli:

FROM: Eduard Brau EB

India Seminar

Bijan,

The attached comments were prepared in this department and I hope you will find them useful. While I suspect I know the reason for the particular treatment of exchange rate policy in this paper, I nevertheless think that its inclusion under the heading "Export Promotion" is rather awkward. Exchange rate policy is thus treated in a highly partial manner, and not integrated with the issue of appropriate pricing of traded goods generally, nor with the issue of reduction of effective protection of domestic manufacturing. Given the importance of the matter, not only in India, it may be useful to promote a more integrated view of the key role of exchange rate policy in the structural changes sought in these economies.

Attachments

Office Memorandum

November 21, 1986

Attached are some specific comments on the text of the paper "Growth and Adjustment: Experiences of Selected Subcontinent Countries (India, Pakistan, Sri Lanka, and Bangladesh)." The following are a number of more general observations.

The paper focuses mainly on performance relative to target during the programs supported by the EFFs approved for the four countries in the period 1979-1984. As such it reads rather like part of a background paper to a conditionality review. There are, for example, explanations given for deviations from program targets in terms of exogenous developments and the degree of policy implementation. By implication there were also clear questions of the appropriateness of program design (e.g., whether exchange rate policy and trade liberalization were sufficient to achieve the export growth objectives). Some of the conclusions are unobjectionable and include the disappointment of the continued weakness in export performance (page 25) and the importance of adopting a comprehensive approach in undertaking structural adjustment (page 26); these conclusions, however, beg the question of why the problems were not tackled more fully in the programs under discussion. In general, the balance of the paper seems a little odd. A more complete description of the experience of growth and adjustment for the whole period from 1979, and less emphasis simply on the years covered by EFF arrangements, would perhaps be more appropriate. I wonder also whether the role of the Fund in the adjustment process needs to be given such prominence; the policy problems have existed for these countries under programs adopted with or without the Fund's support. Moreover, some of the really important policy issues are not touched upon. The appropriate mix of adjustment and financing, for example, and the implications for growth of maintaining a prudent borrowing policy while delaying structural reforms are not discussed. Indeed, external debt management policies and indicators of external debt or debt service are nowhere mentioned. There is no explicit attempt to ask whether the amount of targeted adjustment was sufficient or whether in retrospect the policies were insufficient to achieve the stated objectives. These themes could perhaps be developed in Section VI, along with a judgment about whether the growth that has been achieved is sustainable.

A particular problem of emphasis is the highlighting of the extended Fund facility. We would not want to imply that the EFF either has been (especially in Sri Lanka) or is the only type of use of Fund resources to accompany a program of growth-oriented adjustment. Fund support for policies of structural reform can also be given in the form of a SBA or SAF arrangement. It would seem, however, to be deviating from the subject too much to discuss conditionality under various facilities, nor would it seem an appropriate forum to consider a review of the EFF itself. One way of de-emphasizing the EFF would be to drop Table 1 and to include data on outcomes versus targets in periods covered by SBA programs and, where available, for other years.

Finally, there is an awkwardness in trying to generalize from the experience of only four countries, especially when the time period under consideration differs. Is it helpful, for example, to say that "generally, the average economic growth during the program period was broadly in line with program targets" (page 8) when Table 2 shows that three countries achieved the target, but Bangladesh clearly did not? One wonders whether a case study approach might not have been easier to adopt.

Attachment

CGK/IND:coind1

Comments on "Growth and Adjustment: Experiences of Selected Subcontinent Countries (India, Pakistan, Sri Lanka, and Bangladesh)

Page 2. It is difficult to reconcile the "more than half" (lines 10/11) with the figures of SDR 7.3 billion (Table 1) and SDR 24 billion (footnote to page 1).

Page 2 (footnote). The references to access are incomplete and somewhat misleading. Are they relevant to the subject at hand? Stand-by arrangements have often been of more than 12 months' duration and frequently cover an economic program period of more than one year. Maximum access limits have changed several times since 1979 with the introduction of the supplementary financing and (in 1981) enlarged access policies. Access has not been limited to the ordinary resource limits of 100 and 140 (+25 percent) under the credit tranches and 1974 extended Fund facility decision, respectively. In particular, we should avoid implying that access is necessarily higher under programs supported by an EFF rather than an SBA (see the chart on page 4a, EBS/86/180, illustrating this point). Under present access policy with annual, triennial, and cumulative limits, the principal guiding considerations in determining the appropriate amount of access are the member's balance of payments need and the strength of its adjustment effort. (The longer repayment period, however, is a clear feature of EFFs, but is not mentioned in the footnote.)

Page 5, (first sentence of last paragraph). It appears from Table 2 that a higher rather than lower current account deficit was targetted in all cases. This requires some explanation.

Page 6, lines 10-12. How important was the issue of slow disbursements of development aid? This might usefully be referred to later.

Pages 5-8. This section, which discusses various aspects of policies included in the programs (except external debt management), could usefully describe the medium-term context of the external and internal objectives and justify the targeted path. What was considered to be a viable position, and when was it considered attainable?

Page 6, line 14. If "most" means three out of four programs, which is the exception?

Page 8, last line. "Lower than targeted inflation" would be preferable to "relative financial and price stability."

Page 9, line 1. The description of a larger-than-anticipated improvement in India's current account deficit is somewhat exaggerated. "Better than expected outturn" would be more appropriate, using the language of the 1985 staff report. In the initial program, the current account was targeted to worsen slightly by 0.2 percent of GDP from 2.1 percent in 1980/81 to 2.3 percent in 1983/84. Subsequent revisions to the base year data meant that the outturn showed a marginal improvement of 0.1 percent of GDP from 1.6 percent of GDP in 1980/81 to 1.5 percent in 1983/84.

Page 9, paragraph 2. Though drought affected India's agricultural output in 1982/83, a combination of good weather and productivity gains led to a record harvest in 1983/84. Since agricultural output exceeded targets for the program period, was the weather not a beneficial factor on average over the three-year period? Higher than expected oil prices also contributed to the problems of Sri Lanka.

<u>Page 13, line 2</u> However, the delay in raising domestic flour prices in 1979/80 proved costly to Sri Lanka.

<u>Page 15, line 3</u>. The increased flexibility of exchange rate policy should not be exaggerated. The exchange system in India has not changed, and the application of the existing system did not prevent a slight appreciation. In Bangladesh the more frequent exchange rate adjustments from September 1980 to end-1981 failed to compensate for relative inflation, while there had been a devaluation in 1975 and a steady real effective depreciation until 1980 (SM/82/41, p.13).

<u>Page 16, paragraph 3</u>. The 'most' could perhaps be better spelt out, since in the first sentence it seems to mean India, Pakistan, and Bangladesh. (In Sri Lanka, expenditure rose dramatically above targets in 1979 and 1980); and in the third sentence seems to mean 'all.'

<u>Page 18, section 4a</u>. Is it possible to say how much the gain in agricultural output (and thereby total output) had to do with technological change; and how much with specific measures introduced under the programs?

<u>Page 19, lines 17-18</u>. According to EBS/85/27, page 12, India's total public savings exceeded the target, though the composition was different. Is there a definitional problem? (See also SM/86/56, Supplement 1).

<u>Page 24, first sentence of conclusion</u>. "External adjustment" would need to be defined carefully, since the targets seemed to imply higher (or no change in) current account deficits than in the pre-program period.

Page 24, second sentence of conclusion. (also page 18, second paragraph). Was the weather really "recurrently" adverse, or even adverse on balance for each country?

Page 25, first main paragraph. This could usefully be turned around to say that growth performance was relatively good despite the failure to make much progress on many aspects of structural reform. This could then lead to a discussion of whether the economic growth performance can be sustained in the absence of further structural reform.

Office Memorandum

To: Mr. Brau

November 21, 1986

From: John Hicklin J.H.

Subject: India Seminar

Attached are some specific comments on the text of the paper "Growth and Adjustment: Experiences of Selected Subcontinent Countries (India, Pakistan, Sri Lanka, and Bangladesh)." The following are a number of more general observations.

The paper focuses mainly on performance relative to target during the programs supported by the EFFs approved for the four countries in the period 1979-1984. As such it reads rather like part of a background paper to a conditionality review. There are, for example, explanations given for deviations from program targets in terms of exogenous developments and the degree of policy implementation. By implication there were also clear questions of the appropriateness of program design (e.g., whether exchange rate policy and trade liberalization were sufficient to achieve the export growth objectives). Some of the conclusions are unobjectionable and include the disappointment of the continued weakness in export performance (page 25) and the importance of adopting a comprehensive approach in undertaking structural adjustment (page 26); these conclusions, however, beg the question of why the problems were not tackled more fully in the programs under discussion. In general, the balance of the paper seems a little odd. A more complete description of the experience of growth and adjustment for the whole period from 1979, and less emphasis simply on the years covered by EFF arrangements, would perhaps be more appropriate. I wonder also whether the role of the Fund in the adjustment process needs to be given such prominence; the policy problems have existed for these countries under programs adopted with or without the Fund's support. Moreover, some of the really important policy issues are not touched upon. The appropriate mix of adjustment and financing, for example, and the implications for growth of maintaining a prudent borrowing policy while delaying structural reforms are not discussed. Indeed, external debt management policies and indicators of external debt or debt service are nowhere mentioned. There is no explicit attempt to ask whether the amount of targeted adjustment was sufficient or whether in retrospect the policies were insufficient to achieve the stated objectives. These themes could perhaps be developed in Section VI, along with a judgment about whether the growth that has been achieved is sustainable.

A particular problem of emphasis is the highlighting of the extended Fund facility. We would not want to imply that the EFF either has been (especially in Sri Lanka) or is the only type of use of Fund resources to accompany a program of growth-oriented adjustment. Fund support for policies of structural reform can also be given in the form of a SBA or SAF arrangement. It would seem, however, to be deviating from the subject too much to discuss conditionality under various facilities, nor would it seem an appropriate forum to consider a review of the EFF itself. One way of de-emphasizing the EFF would be to drop Table 1 and to include data on outcomes versus targets in periods covered by SBA programs and, where available, for other years.

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Attachment

cc: Mr. Johnson

MASTER.

Office Memorandum

TO: Mr. Brau

November 19, 1986

FROM: Bijan B. Aghevli BBA

SUBJECT: India Seminar

The attached paper, which has been prepared by Mr. In-Su Kim, will be presented by Mr. Neiss and myself at the Seminar on "Adjustment and Economic Growth--the Asian Experience" to be held in Bombay, December 8-10, 1986. I would appreciate any comments you may have by the end of the week.

Attachment

INC - sh6in (11/19/86)

Growth and Adjustment:
Experiences of Selected Subcontinent Countries
(India, Pakistan, Sri Lanka, and Bangladesh)

I. Introduction

During the late 1970s and early 1980s, the international economy experienced the re-emergence of serious payments imbalances, primarily reflecting the sharp increases in oil prices and the concomitant decline in commodity prices. These imbalances were particularly pronounced in the non-oil developing countries, which suffered not only from the marked deterioration in their terms of trade, but also from the ensuing recession in the industrial countries and the sharp rise in international interest rates. The total current account deficit of non-oil developing countries widened from about SDR 100 billion during 1976-78 to SDR 260 billion during the subsequent three years. The severe external payments difficulties facing these countries led to a substantial increase in the number of adjustment programs supported by Fund resources. 1/

An important accompanying development to the increase in Fund-supported programs was the growing emphasis on the need for structural adjustment to strengthen productive capacity and foster growth potential. In view of the substantial size of payments imbalances and the apparent persistence of the shift in the terms of trade, the adjustment

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1/ The number of Fund-supported programs (under upper credit tranche stand-by and extended arrangements) increased from 54 (a total commitment of SDR 8 billion) during 1976-78 to 88 (SDR 24 billion) during 1979-81.

strategy was generally reoriented such that demand-oriented policies were supplemented by more comprehensive structural or supply-oriented polices that were aimed at improving resource allocation, promoting domestic investment and savings, and strengthening external competitiveness. 1/ This shift in the adjustment strategy was reflected in a marked increase in member countries' recourse to extended arrangements with the Fund, which were designed to provide medium-term assistance to cope with structural imbalances. 2/ Among the countries that entered into such arrangements were four subcontinent countries, India, Pakistan, Sri Lanka, and Bangladesh, which together accounted for more than half of the total commitment of Fund resources during 1979-81 (Table 1).

This paper focuses on the design and implementation of the growth-oriented adjustment programs adopted by the four subcontinent countries. It examines the effectiveness of the programs in achieving key domestic and external objectives both during and after the program

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1/ The distinction between demand-oriented policies and supply-oriented polices is made for presentational convenience. In reality, major policy measures, such as fiscal, monetary, pricing, and exchange rate policies, cut across the distinction between demand and supply.

2/ The extended fund facility was established in 1974 to assist member countries to overcome balance of payments problems caused by structural rigidities, which are associated primarily with cost and price distortions. The key thrust of programs under extended arrangements is to promote the efficient use and allocation of resources and expand capacity output through structural measures such as reducing price distortions and increasing domestic investment and savings. In view of the much longer time period required for the implementation of structural measures, the extended arrangements cover a period of up to three years, with financial support amounting to the equivalent of 140 percent of a member's current quota. This compares with a maximum financial support of up to 100 percent of quota and a program period of only up to one year under standard stand-by arrangements.

INC - sh6inatl

Table 1. Arrangements of Subcontinent Countries Under The Extended Fund Facility, 1979-81

Country	Date of Agreement	Original Expiration Date	Date of Cancel-lation	Amounts 1/ Committed	As percent of Quota 2/	Drawn
Sri Lanka	Jan. 1979	Dec. 1981	--	260	(219)	260
Pakistan	Nov. 1980	Nov. 1983	--	1,268	(445)	1,079
Bangladesh	Dec. 1980	Dec. 1983	June 1982	800	(351)	220
India	Nov. 1981	Nov. 1984	May 1984	5,000	(291)	3,900

1/ In millions of SDRs.
2/ Based on the size of quota at the time of the inception of the programs.

period. The performance of key economic and financial variables is discussed mainly in terms of targets set under the programs, and an attempt is made to analyze the impact of both policy and exogenous variables on actual developments.

The paper is organized as follows: section II provides a brief overview of economic difficulties faced by the subcontinent countries prior to the adoption of the adjustment programs; section III discusses the objectives and policy design of these programs; section IV reviews the extent of policy implementation and the performance of key economic variables in the countries during the program period; section V presents a brief overview of economic and policy developments during the post-program period, and the concluding section provides a summary of major findings and issues for discussion.

II. Background to the Extended Adjustment Programs

The adjustment effort of the four subcontinent countries was initiated in the late 1970s and prior to the introduction of the extended arrangements with the Fund. Except for India, these efforts, which had been designed to counter poor economic performance and a deteriorating external position, were supported by stand-by arrangements with the Fund. In Sri Lanka, significant policy reforms were implemented in 1977-78 to revitalize the economy which had suffered from pervasive government controls and cost-price distortions. Major corrective measures included: the reduction of administrative controls; the establishment of realistic relative prices through reduction of consumer subsidies; the introduction of major tax and interest rate reforms; and the unification of the exchange rate system at a depreciated level. In Pakistan, adjustment efforts were undertaken in 1977/78 to narrow the fiscal imbalance and reduce cost-price distortions that had led to inefficiency in key economic sectors and depressed private sector confidence and investment. In Bangladesh, a stabilization program was adopted during 1979/80 to promote price stability, improve the financial position of the public sector, and strengthen production particularly through adequate producer prices for key agricultural products.

Notwithstanding the progress made in achieving economic adjustment, the four countries continued to be plagued by a number of deep-rooted structural problems that required sustained reform efforts over the medium term. While the extent of these problems varied across the countries, a number of common factors are identifiable. Economic growth in most countries was still hampered by inefficiencies in key economic sectors, industrial and infrastructure bottlenecks, and pervasive cost-price distortions arising from infrequent adjustments in both administered prices and the exchange rate in the face of domestic inflation. These impediments to growth were compounded by adverse weather, which disrupted agricultural production and, in the case of India, also interfered with power generation. Fiscal conditions remained weak because of low and inelastic revenue in the face of rapidly rising government expenditure that was propelled by increasing social and development needs. The fragile fiscal position was a primary source of excessive monetary expansion, which placed the four countries under inflationary pressure. Weak production bases, together with inadequate producer incentives, continued to constrain the countries' export capacities. At the same time, domestic demand pressures gave rise to strong import demand, which was suppressed through tight exchange and import controls at the expense of economic efficiency. These strains on the domestic economies and on the balance of payments positions were intensified by the marked deterioration in the terms of trade and the subsequent slowdown in export markets.

III. Policy Design of Extended Adjustment Programs

The principal adjustment strategy adopted by the countries under review was to strengthen productive capacity and promote economic expansion in a context of financial and external stability. It was thought that higher economic growth would be realized through measures to raise both domestic investment and savings and to improve the efficiency of production and resource allocation; the latter was to be achieved primarily through the correction of cost-price distortions, the relaxation of restrictive industrial regulations, and the liberalization of trade policies. These policies were to be accompanied by restrained financial policies aimed at maintaining price stability and thus facilitating structural adjustment.

In view of the relatively long gestation period of structural programs, the improvement in the external current account position was expected to materialize only gradually. Underlying the supply-oriented adjustment strategy was the recognition that there was substantial scope for export growth and import substitution in these economies through the removal of structural imbalances and bottlenecks. The strategy was also in conformity with the urgent developmental needs of providing employment for the growing labor forces and alleviating poverty. The adjustment programs were, to varying degrees, incorporated into development plans.

All of the adjustment programs envisaged a substantial step-up in domestic investment. In view of the major role of the public sector in these countries, the Government was expected to take the lead in expanding investment. In general, public sector investment programs were to be reviewed and reoriented in close consultation with the World Bank with the objectives of improving infrastructure, exploiting opportunities of comparative advantage, and avoiding projects with excessively long gestation periods. Substantial resources were to be allocated to the agricultural sector, to the energy sector, and to the industrial sector. Most programs foresaw a broadened role for private investment through the adoption of policies conducive to liberal industrial and import licensing arrangements and to foreign collaboration.

The increase in domestic investment was to be financed mainly by a step-up in domestic resource mobilization so as to avoid disruption in financial stability and excessive recourse to external finance. The major burden for resource mobilization was placed on the public sector. The government budget was expected to generate larger savings through tax reforms, reductions in subsidies (particularly for food, fertilizer, and petroleum products), and restraint in wage outlays. Substantial savings were also to be generated by nonfinancial public enterprises primarily through flexible pricing policies and the rationalization of their operations, including privatization in some cases. The programs also generally stressed the need for encouraging private savings through flexible interest rate policy, widening of the range of financial instruments, and strengthening of financial intermediation.

The programs recognized that the alleviation of cost-price distortions was essential for improving resource allocation and stimulating production. Substantial upward adjustments were to be made to procurement prices, particularly for those agricultural commodities that were considered to have potential for export and import substitution. More flexible adjustment of administered prices for industrial outputs was also perceived to be important for reducing distortions. Furthermore, increased financial incentives were deemed necessary to improve the profitability and external competitiveness of the export sector, which had been adversely affected by heavy indirect taxes and inflationary pressures. To this end, exchange rate policy was expected to be used actively in accordance with developments in domestic and external prices.

A crucial element of the adjustment programs was the liberalization of restrictive industrial regulations and import policy which had been pervasive. In order to encourage private sector production and facilitate modernization, the programs called for the simplification of licensing approval procedures and for the easing of regulatory restraints on capacity utilization and expansion (India). The liberalization of import policy was aimed primarily at ensuring increased access to raw materials and intermediate goods so as to alleviate supply bottlenecks and improve international competitiveness. Imports of capital goods were also to be liberalized in order to improve the efficiency of domestic production and investment. The program with Pakistan envisaged a shift from quantitative restrictions to tariffs for regulating imports and protecting domestic industry.

Notwithstanding the emphasis on structural measures, prudent demand management remained a principal element of the adjustment programs, as financial and price stability were viewed to be a fundamental prerequisite for successful economic adjustment. A major policy objective was the strengthening of the budgetary position through measures to increase revenue and restrain expenditure. The programs sought a substantial reduction in the overall budget deficit and a corresponding decline in government recourse to bank borrowing. At the same time, the growth of liquidity and domestic credit was to be contained to moderate inflationary pressures while supporting economic growth and private sector activity.

IV. Performance Under the Adjustment Programs

1. Overview

The performance of the four economies with respect to growth, inflation, and external adjustment was uneven: India and Pakistan broadly achieved the original objectives of the programs, while Sri Lanka and Bangladesh were less successful. Generally, the average economic growth during the program period was broadly in line with program targets (Table 2). In the case of India and Pakistan, a favorable growth outcome was accompanied by relative financial and price

INC - sh6intbl 11/19/86

Table 2. Selected Economic Indicators 1/

(In percent)

	Pre-program	Program annual average: Targets	Program annual average: Outcome	Post-program annual average 2/
India				
Real GDP growth	7.8	4.8	5.3	4.0
Inflation (WPI)	18.2	9.3	6.1	6.4
External current account/GDP	-1.6	-2.1	-1.6	-1.4
Pakistan				
Real GDP growth	7.3	5.7	6.5	5.3
Inflation (CPI)	10.7	10.0	8.4	8.0
External current account/GDP	-4.5	-4.6	-3.3	-4.2
Sri Lanka				
Real GDP growth	5.8	6.0	6.0	5.1
Inflation (GDP deflator)	7.8	11.7	18.1	15.5
External current account/GDP	-5.5	-10.8	-14.9	-10.4
Bangladesh				
Real GDP growth	3.5	7.2	3.7	3.1
Inflation (CPI)	18.5	11.5	14.4	10.2
External current account/GDP	-11.5	-12.9	-10.6	-8.1

1/ Dates for pre-program, program, and post-program periods are defined as follows:

	Pre-program period	Program period	Post program period
India	1980/81	1981/82-1983/84	1984/85-1985/86
Pakistan	1979/80	1980/81-1982/83	1983/84-1984/85
Sri Lanka	1978	1979-1981	1982-1984
Bangladesh	1979/80	1980/81-1981/82	1982/83-1984/85

2/ Partly preliminary.

stability and a larger-than-anticipated improvement in the external current account deficit. In contrast, Sri Lanka suffered from both intensified inflation and a marked deterioration in its current account balance. In the case of Bangladesh, program objectives in terms of both growth and inflation were not met and the current account deficit was reduced only through a drastic cut in the issuance of import licenses. The extended arrangement with Bangladesh became inoperative during its first year, as it became clear that the situation was not conducive to undertaking fundamental structural reforms; the authorities renewed their adjustment efforts subsequently when they entered into another financial arrangement with the Fund in 1982/83.

The path and pace of adjustment in these economies were influenced significantly by unanticipated deviations of both exogenous and policy variables from the programs' original assumptions. Recurrent droughts adversely affected growth in India (1982/83), Sri Lanka (1979), and Bangladesh (1980/81). The task of adjustment was further complicated by the prolonged international recession and by a precipitous decline in export prices that reinforced emerging fiscal difficulties (Sri Lanka and Bangladesh). On the other hand, all four countries benefited from stronger-than-expected private transfers, particularly from oil exporting countries; also, adjustment in India was facilitated by more moderate increases in oil prices.

The extent of policy implementation also varied across the four programs. On average, implementation with regard to structural measures, especially those related to the strengthening of tax revenue, mobilization of private savings, and relaxation of industrial and import controls, was weaker than envisaged. Also, measures taken to promote exports were generally modest, with exchange rate policy playing relatively little role in improving the profitability and international competitiveness of the export sector. On the positive side, significant progress was made in the area of pricing policy: incentives to agricultural producers were raised, subsidies were reduced, and the financial position of public enterprises was improved. The extent of price adjustments, however, fell short of eliminating certain costly subsidies and of mobilizing sufficient resources for investment in some cases. Financial policies were generally restrained in India and Pakistan, but they turned out to be expansionary in Sri Lanka and Bangladesh.

2. Implementation of structural policies

a. Public sector investment and savings

Public investment in India, Pakistan, and Bangladesh was constrained by lower-than-expected public sector resources. In India, revenue shortfalls limited the scope for investment in a number of important sectors, including electric power, irrigation, coal, and the railways. Nevertheless, substantial progress was made in expanding capacity in these sectors. Both India and Pakistan made notable progress in expanding investment in the oil and gas sectors. Pakistan and Bangladesh also reoriented their public investment toward more quick-yielding projects, although the magnitude of the reallocation was less than originally planned. Sri Lanka also attempted to reorient the pattern of its public investment, but it was less successful as priority continued to be accorded to capital- and import-intensive projects with long gestation periods (particularly housing and urban development programs) at the expense of more efficient and quick-yielding projects (tree crops). More generally, inadequate control over public investment in Sri Lanka resulted in excessive investment which proved to be unsustainable.

Progress in public sector resource mobilization was below expectation in all the countries. The generation of higher budgetary savings was thwarted by the continued low buoyancy of the tax systems and increases in current expenditure. The tax reform intended to broaden the tax base did not materialize in Pakistan, Sri Lanka, and Bangladesh, and tax exemption remained high. Efforts to contain the subsidy burden were strengthened in most countries. The rising import cost of petroleum products was mostly passed on to consumers and the prices of food and fertilizer were raised substantially. In Sri Lanka, a large increase in key issue prices (wheat flour and rice) led to a reduction in government subsidies, but much of this reduction was offset by a sharp increase in wages and salaries and interest payments. 1/ In the other three countries, the extent of price adjustment with respect to food and fertilizer was relatively limited, resulting in a substantial budgetary burden. 2/

1/ A significant reduction in food subsidies was partly offset by an increase in subsidies under a food stamp program, which replaced a food rationing scheme. Nevertheless, total subsidies for food were relatively stable in nominal terms during the program period.

2/ Total subsidies on food and fertilizer in India and Pakistan amounted to 12 percent of central government revenue and 6 percent of consolidated central and provincial government revenue, respectively, in the last year of the program period. The fertilizer subsidy also rose substantially in Sri Lanka during the third year of the program period.

The record of public enterprises in mobilizing resources was mixed. In India, sizable adjustments of administered prices for industrial products and public services were implemented, providing a large portion of additional resources required for public investment. 1/ However, limited adjustments made to electricity tariffs and irrigation charges constrained resource mobilization at the state government level. The oil sector played a major role in mobilizing domestic resources in India; prices of domestically produced crude oil tripled, although they still remained below international prices during the program period; oil price adjustment also contributed to some extent to resource mobilization in Pakistan. In Sri Lanka and Bangladesh, resource mobilization by public enterprises was constrained by inadequate price adjustments. In general, the financial position of public enterprises remained weak in the four countries, because of limited progress in the rationalization of their management and operations.

b. Pricing policy

Pricing policy was an integral element of the structural adjustment programs. Procurement prices for key crops were raised substantially in most countries to offset increases in production costs and to strengthen financial incentives for producers. As already mentioned, flexible pricing policies were also pursued with respect to major consumer goods

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1/ The bulk of these adjustments were introduced in the first year of the program period. The size of the price adjustment amounted to about 45 percent for coal, 18-38 percent for steel and iron, 20 percent for aluminum, 16 percent for cement, and 60 percent for fertilizer. Also, railway and postal tariffs were raised substantially.

and industrial products, in an effort to reduce subsidies and mobilize increased resources. In India, progress was made in strengthening the market mechanism: official controls on steel prices were lifted and a dual pricing system was introduced for the cement industry. While the degree of price adjustment for certain commodities was limited, the increased flexibility in pricing policy marked an important step toward reducing cost-price distortions in all four countries.

c. Industrial and import policies

Liberalization of industrial regulations was relatively slow in most of the countries. In the case of India, a number of measures were taken to ease industrial regulations, but their immediate impact was limited. These measures included: a relaxation of constraints on capacity utilization; an easing of restrictions on industrial location; the exemption of investment in export capacity from industrial licensing requirements, anti-monopoly regulations, and reservation policies for small-scale industry; an extension of various concessions to 100 percent export-oriented units and industries with high export potential; and liberal access to foreign collaboration. In Pakistan, the intended deregulation of industrial policies and labor reforms was postponed.

A central feature of the adjustment programs, particularly those adopted by India and Pakistan, was the liberalization of the import system. 1/ In both countries, import liberalization was largely implemented as envisaged in the programs, but its overall effect was gener-

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1/ In Sri Lanka, imports were liberalized as part of the reforms in 1977-78.

ally modest. In India, liberalization measures focused on easing exporters' access to imports, including imports of capital goods and technology. As a result, the effective restriction of licensing on access to imports under the least restrictive licensing category was virtually eliminated. However, licensing continued to impose an effective constraint on imports under the more restricted import categories. In the case of Pakistan, major measures included: the abolishment of licensing ceilings on most nonconsumer goods; the conversion from a positive import list to a negative list scheme; an increase in the ceilings on items that continued to be subject to licensing; and a reduction of imports that had been banned to protect domestic industry. Some steps were also taken to rationalize the tariff system, but the comprehensive tariff reform envisaged in the program was not implemented. In Bangladesh, import controls were tightened in response to a sharp deterioration in the trade deficit and the consequent shortage of foreign exchange.

d. Export promotion

In most programs, the objective of promoting exports was pursued primarily through the liberalization of industrial regulations and import controls. In addition, steps were taken to offset the incidence of heavy indirect taxes and improve the profitability and external competitiveness of the export sector. Major measures taken to this end included special tax benefits for export-oriented industries (India), reduced taxes on primary commodity exports (Sri Lanka), the improvement and extension of cash compensation and duty drawbacks (India and

Pakistan), and the increased provision of export rebates (Pakistan); the latter almost tripled over the program period.

Exchange rate policy was conducted more flexibly in the four countries in order to avoid erosion of external competitiveness. After a sharp appreciation during the first year of its program, Pakistan severed the link between its currency and the U.S. dollar during the second year in an effort to restore export competitiveness. Sri Lanka also allowed its currency to depreciate substantially in the second year of the program to offset an appreciation that had occurred in the first year. Notwithstanding the increased flexibility in exchange rate policy, external competitiveness improved only in Pakistan and Bangladesh, which were successful in achieving a moderate depreciation in real effective terms. The currency of India appreciated slightly in real effective terms over the program period. In Sri Lanka, despite a relatively large nominal depreciation, the rupee appreciated significantly in real effective terms because of high domestic inflation.

3. Financial policies

a. Fiscal policy

The extent of fiscal adjustment among the four countries varied. In India and Pakistan, the overall budget deficit in relation to GDP came relatively close to the target, although fiscal restraint faltered during the latter part of the program (Table 3). In Sri Lanka, however, fiscal policy was quite expansionary, reflecting expenditure overruns and revenue shortfalls. The overall deficit was contained below the

Table 3. Financial Indicators

(In percent)

	Pre-program	Program annual average: Targets	Program annual average: Outcome	Post-program annual average 1/
India				
Overall budget deficit/GDP 2/	6.6	6.5	6.8	8.8
Revenue (including grants)/GDP	10.0	11.0	10.7	11.6
Expenditure/GDP	16.5	17.5	17.6	20.4
Current expenditure/GDP	(10.6)	(11.9)	(11.4)	(13.5)
Credit expansion	22.3	18.3	17.5	16.9
Liquidity growth	18.3	14.7	15.6	17.2
Real effective exchange rate	2.9	...	1.7	-5.6
Pakistan				
Overall budget deficit/GDP 3/	6.2	4.8	5.8	7.0
Revenue (excluding grants)/GDP 4/	16.3	16.6	16.3	16.8
Expenditure/GDP	23.1	22.6	22.7	24.3
Current expenditure/GDP	(15.0)	(14.0)	(15.0)	(17.9)
Credit expansion	15.1	17.2	16.1	18.6
Liquidity growth	17.6	14.1	15.6	11.8
Real effective exchange rate	-2.2	...	-1.9	-2.3
Sri Lanka				
Overall budget deficit/GDP 2/	13.8	10.9	17.5	13.4
Revenue (excluding grants)/GDP	26.2	20.0	20.1	19.0
Expenditure/GDP	40.0	31.0	37.6	32.4
Current expenditure/GDP	(27.6)	(18.1)	(21.2)	(17.3)
Credit expansion	18.4	36.0	39.4	7.3
Liquidity growth	27.5	25.8	31.0	20.7
Real effective exchange rate	--	...	8.9	6.3
Bangladesh				
Overall budget deficit/GDP 2/	12.2	10.6	9.0	9.8
Revenue (including grants)/GDP	9.8	...	9.0	8.6
Expenditure/GDP	22.0	...	18.0	18.4
Current expenditure/GDP	(6.2)	(...)	(5.6)	(6.7)
Credit expansion	39.7	28.7	28.3	23.2
Liquidity growth	34.3	15.7	15.7	33.5
Real effective exchange rate	2.6	...	-7.4	4.7

1/ Partly preliminary.
2/ For the central government.
3/ For the consolidated public sector.
4/ Excludes surpluses of autonomous public enterprises.

Note 1: For the definition of dates for pre-program, program, and post-program periods, see footnote 1 of Table 2.

Note 2: Throughout the Tables, dashes (--) indicate that the figure is zero, and dots (...) indicate that data are not available.

target in Bangladesh at the expense of a large cut in development expenditure. The deterioration in the fiscal position in these two latter countries diverted the authorities' attention from structural adjustment to demand management.

Revenue performance came close to targets in most countries, although there was relatively limited progress toward broadening the tax base, reducing tax exemptions, and improving tax administration. In Pakistan and Bangladesh, the continued heavy dependence on import duties, together with sluggish import expansion, resulted in a low buoyancy of revenues. In India, increased tax concessions offered to stimulate industrial activity and private savings weakened tax buoyancy. In Sri Lanka, progress in reducing dependence on export taxes was relatively modest.

Total expenditure was also broadly in line with the program targets in most countries, reflecting a reduction in subsidies and an unanticipated retrenchment in capital expenditure. In both Pakistan and Bangladesh, development outlays had to be curtailed substantially in order to limit the overall deficit in the face of a stagnation in revenues. However, pressure on expenditure remained strong in most countries, partly owing to still large subsidies on food and fertilizers (India, Pakistan, and Bangladesh) and continued increases in wages/salaries and interest payments (Sri Lanka). In Sri Lanka, capital expenditure grew significantly in the second year of the program as a result of ambitious investment programs and lack of effective fiscal control.

b. Credit and interest rate policies

Monetary conditions in the subcontinent countries were critically affected by fiscal developments. India and Pakistan were generally successful in limiting the growth of domestic credit to program targets, although in the case of Pakistan the credit ceilings for the third year were exceeded as a result of the widening fiscal deficit. Credit to the private sector grew roughly in line with program targets in both countries. In Sri Lanka and Bangladesh, the deterioration of fiscal operations led to a strong expansion of credit--in the case of Bangladesh, excessive credit growth during the first year of the program was offset by a significant tightening of credit policy in the subsequent year. In both countries, credit to the private sector was sharply reduced during the course of the program so as to restore monetary stability. The average growth of liquidity for the program period as a whole was generally higher than envisaged in all four countries. In India and Pakistan, the rapid expansion was attributable partly to more favorable than expected developments in the external sector, particularly during the third year.

Interest rate policy was used more actively in most countries to encourage private financial savings. Key deposit rates at commercial banks were raised by 5 percentage points to 20 percent in Sri Lanka, by 5-6 percentage points to 12-15 percent in Bangladesh, and by 1.5 percentage points to 8-11 percent in India. Despite these adjustments, interest rates remained below or barely higher than the domestic inflation rate in these countries. In India, interest rate measures were supplemented by a number of other measures, including an increase in the rates of return on debentures and government securities, tax concessions on interest income, and a widening of financial instruments. Interest rate policy was inactive in Pakistan, reflecting the pursuit of an interest-free financial system in accordance with Islamic principles.

4. Economic outturn

a. Production, investment, and prices

The favorable growth performance achieved by India, Pakistan, and Sri Lanka was generally associated with higher agricultural production. The resilience of agriculture reflected the effects of policies to increase the area under irrigation and to stimulate the spread of modern production techniques and inputs, particularly fertilizer; the use of the latter was encouraged by low pricing policies and by strengthening field service support (India and Pakistan). Notwithstanding recurrent adverse weather, substantial progress was made in India, Pakistan, and Bangladesh toward self-sufficiency in foodgrain production, which contributed to import substitution.

Industrial developments were also generally encouraging. Manufacturing registered a strong expansion in Pakistan, owing to new capacity for import substitution, fuller capacity utilization, and improved import availability. The growth of India's manufacturing sector remained well below program targets, reflecting the impact of the world recession and continued domestic controls. However, performance in basic industries and infrastructure generally improved, and bottlenecks were reduced substantially. The production of crude oil and gas increased robustly in both India and Pakistan, leading to a substantial reduction in oil imports in the former. 1/

Domestic investment relative to GDP was below targets in both India and Pakistan (Table 4). Public investment in these countries was lower than targeted because of limited resource mobilization by the public sector; in addition, private investment in India was constrained by weak domestic and external demand in the aftermath of the oil price increases and by uncertainties over the relaxation of industrial regulations and import controls. Sri Lanka was successful in achieving the program growth target, but at the expense of excessive expansion in public sector investment; private investment in the country also remained buoyant, aided by monetary and fiscal concessions and a low pricing policy for imported capital goods.

Despite the importance attached to domestic resource mobilization, savings fell short of program targets in all four countries. Shortfalls were registered by both the public and private sectors in the case of India. Private savings fell in relation to GDP during the program period in India and Sri Lanka because of drought-induced declines in agricultural income, a sharp fall in the terms of trade (Sri Lanka), the lingering adverse income effect of higher energy prices, and weak policy

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1/ In India, the self-sufficiency rate of crude oil production rose from 40 percent in the pre-program period to more than 60 percent by the last year of the program period. This significant increase, however, was attributable partly to a low production level in the base year owing to unrest in Assam. In Pakistan, the share of domestic crude oil in total crude oil consumption rose from 11 percent to 13 percent during the program period.

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Table 4. Savings and Investment

(In percent)

	Pre-program	Program annual average: Targets	Program annual average: Outcome	Post-program annual average 1/
India				
Gross national savings/GDP	22.2	24.0	22.3	22.9
Public	(4.0)	(4.8)	(4.5)	(3.6)
Private	(18.2)	(19.2)	(17.8)	(19.3)
Gross capital formation/GDP	23.8	26.1	23.9	23.7
Public	(11.4)	(12.9)	(11.7)	(12.5)
Private	(12.4)	(13.2)	(12.2)	(11.2)
Pakistan				
Gross national savings/GNP	11.9	12.8	12.8	12.0
Gross domestic savings/GNP	5.9	7.6	5.9	4.9
Gross fixed capital formation/GNP	15.6	16.0	14.3	14.3
Public	(10.5)	(...)	(8.9)	(8.6)
Private	(5.1)	(...)	(5.4)	(5.7)
Sri Lanka				
Gross domestic savings/GDP	15.5	16.8	14.2	17.8
Public	(-1.3)	(1.1)	(-1.7)	(0.2) 2/
Private	(16.8)	(15.7)	(15.9)	(17.6) 2/
Gross fixed capital formation/GDP	20.0	28.3	29.0	28.4
Public	(7.2)	(14.7)	(16.0)	(4.8) 2/
Private	(12.8)	(13.6)	(13.5)	(23.6) 2/
Bangladesh				
Gross national savings/GDP	4.5	...	2.4	4.9
Gross domestic savings/GDP	3.0	...	--	1.0
Gross capital formation/GDP	13.6	...	13.0	13.0
Public	(7.8)	(...)	(7.3)	(6.4)
Private	(5.8)	(...)	(5.8)	(6.6)

1/ Partly preliminary.
2/ Because of changes in the classification of the public and private sectors, data series are not comparable with the previous period.

Note: For the definition of pre-program, program, and post-program periods, see footnote 1 of Table 2.

initiatives. In most of the subcontinent countries, workers' remittances continued to be an important factor contributing to national savings.

Inflation subsided broadly in line with program targets in India and Pakistan, as restrained financial policies, improved supplies, and a substantial moderation in international inflation more than offset the upward adjustment of administered prices. In Sri Lanka, however, the rapid expansion in domestic credit, combined with a sharp increase in international oil prices, gave rise to strong inflationary pressures, and the program targets were exceeded by a wide margin. Inflationary pressures were also strong in Bangladesh.

b. External developments

The cumulative current account deficit over the program period was substantially smaller than targeted in the cases of India and Pakistan (Table 5). The current account deficit was also kept below target in Bangladesh, primarily through a substantial tightening of import license issues. In contrast, the current account deficit in Sri Lanka exceeded the program target because of higher imports and poor export performance.

The smaller-than-expected current account deficits in India and Pakistan were due to stronger net services and private transfers and, in the case of India, also to a significant reduction in imports. Oil imports accounted for about 60 percent of the import savings over program projections in India, while they remained roughly unchanged at the 1980/81 level in Pakistan. The growth of non-oil imports was also more

Table 5. Balance of Payments

	Pre-program	Program average Targets	Program average Outcome	Post-program average 1/
India (in billions of SDRs)				
Exports	6.6	9.5	7.6	8.6
Imports	12.3	15.4	13.2	13.3
Services and private transfers	3.0	2.3	3.1	2.2
Current account	-2.7	-3.6	-2.5	2.5
Overall balance	-0.4	-2.1	-1.4	0.3
Official reserves	6.1	...	4.9	5.4
Export volume growth (percent)	-0.4	6.3	1.2	3.1
Import volume growth (percent)	15.6	2.3	1.3	1.4
Pakistan (in billions of US$)				
Exports	2.4	3.2	2.6	2.5
Imports	4.9	6.2	5.6	6.0
Services and private transfers	1.4	1.5	2.0	2.1
Current account	-1.1	-1.5	-1.0	-1.4
Overall balance	0.2	-0.4	--	-0.5
Official reserves	0.6	...	1.9	0.8
Export volume growth (percent)	...	...	...	...
Import volume growth (percent)	...	...	...	...
Sri Lanka (in billions of SDRs)				
Exports	0.7	0.9	0.8	1.1
Imports	0.8	1.2	1.4	1.8
Services and private transfers	--	--	0.1	0.2
Current account	-0.1	-0.3	-0.5	-0.5
Overall balance	0.1	--	-0.1	0.1
Official reserves	0.3	...	0.3	0.5
Export volume growth (percent)	...	...	-1.6	5.3
Import volume growth (percent)	...	...	5.7	6.5
Bangladesh (in billions of US$)				
Exports	0.7	0.9	0.7	0.8
Imports	2.4	2.8	2.5	2.4
Services and private transfers	0.2	0.1	0.4	0.5
Current account	-1.5	-1.8	-1.4	-1.1
Overall balance	-0.2	-0.3	-0.2	0.1
Official reserves	0.3	...	0.4	0.4
Export volume growth (percent)	...	12.2	9.4	1.0
Import volume growth (percent)	...	-1.5	2.2	5.7

1/ Partly preliminary.

Note: For the definition of pre-program, program, and post-program periods, see footnote 1 of Table 2.

sluggish than expected in these countries, largely because of the improved domestic availability of key agricultural commodities and industrial inputs. The increase in workers' remittances in India accounted for three quarters of the improvement in the current account deficit relative to program projections. In the case of Pakistan, the combined contribution made by private transfers and net services was more than the improvement in the current account. Sri Lanka also experienced larger-than-expected private transfers.

Exports were considerably below expectation in all four countries. The cumulative shortfall in export earnings largely offset the gains achieved in lowering imports in India and Pakistan. In most countries, the average growth rate of export volume was below that achieved by non-oil developing countries (about 4 percent) during the corresponding period. The disappointing export growth performance reflected the severe international recession, the limited progress made in alleviating domestic impediments to export development, and a deterioration in external competitiveness.

V. Developments in the Post-Program Period

Despite stepped-up efforts under the programs, the extent of structural adjustment achieved during the program period was generally limited. This was partly attributable to the intensity of structural imbalances prior to the inception of the programs, but also to the gradual approach adopted by the countries and the lags before certain adjustment policies become effective. In order to sustain the structural adjustment efforts, further follow-up measures were introduced in most countries during the post-program period.

In India, significant liberalization measures were taken during 1985 in the areas of industrial licensing, import policy, tax reform, and the financial system. The coverage of anti-monopoly legislation was reduced considerably through a substantial increase in the asset limit and the exemption of a large number of industrial groups from restrictions on capacity expansion. In addition, most of the exempted industries were delicensed and large companies were permitted to diversify their operations. Import policy adopted a liberal stance to allow improved access to industrial machinery through the removal of licensing requirements, simplification of procedures, and the reduction or elimination of tariffs. For a wide range of materials and components, monopoly imports by public corporations were terminated. In the area of tax policy, the structure of direct tax was rationalized, with a substantial reduction in tax rates and an increase in the exemption limit for personal income tax, in order to create an environment to foster private sector growth and reduce tax evasion. Steps were also taken to alleviate rigidities in the interest rate structure through an increase in interest rates on government securities. Complementary action is now under consideration with regard to further financial sector reform.

In Bangladesh, an adjustment program was reinstated in 1982/83 and supported by a new stand-by arrangement. Under the program, progress was made in strengthening the fiscal position through an increase in taxes, reduction of subsidies (particularly on fertilizer and foodgrains), and adjustment of key administered prices (electricity, natural gas, and petroleum products). At the same time, exchange rate policy was conducted more flexibly and a more liberal import policy was pursued with a view to improving the efficiency of the economy, especially that of the export sector. Adjustment efforts were stepped up in 1985/86 under the support of another stand-by arrangement, in order to deal with a re-emerging deterioration in the balance of payments and weakening in growth performance. The focus of the program continued to be placed on the mobilization of domestic resources, tightening of monetary policy, and further liberalization of the trade and payments system supported by flexible exchange rate management.

In Pakistan, the authorities continued to pursue flexible pricing policies with respect to petroleum and gas, which contributed to a significant increase in petroleum production and to the containment of petroleum subsidies. However, further progress toward structural adjustment in key areas, including tax reform, liberalization of import controls, and export promotion, was sluggish.

The pace of structural adjustment in Sri Lanka was slowed by the deterioration in national security and by a marked boom in export prices of key primary commodities in 1983/84. However, the authorities recognize that continued efforts are necessary to overcome the long-standing structural weaknesses in the economy, especially diminishing growth potential of the narrowly-based export sector, a weak budgetary process that fails to establish priorities and control government spending effectively, and the poor performance of public enterprises.

The first step in a phased program of tariff reform to improve efficiency was undertaken in late 1984.

Notwithstanding the further steps taken by a number of countries, continued adjustment efforts remain essential, particularly in the areas of export development, economic efficiency, and public finance. During the post-program, export volume growth remained generally low, partly reflecting slow improvement in economic efficiency. With the exception of Sri Lanka, the fiscal deficit widened, as expenditure rose rapidly in the face of stagnant revenues; in the case of Sri Lanka, a substantial decline in the fiscal deficit resulted from a large cutback in current expenditure. The poor management and operations of public enterprises remained a major source of low productivity and financial instability.

VI. Conclusion

The principal objective of the adjustment programs adopted by the four subcontinent countries was to seek external adjustment through the strengthening of production and investment with the support of restrained demand management. Under the programs, most countries were successful in achieving targeted economic growth, despite the deepening of the international recession and recurrent adverse weather. In India and Pakistan, satisfactory growth was accompanied by a moderation in inflation and a substantial improvement in the balance of payments. In Sri Lanka and Bangladesh, however, progress toward price stability and external viability was thwarted by expansionary financial policies and the marked deterioration in the terms of trade.

Notwithstanding the generally favorable growth performance, the extent of structural adjustment achieved in key areas during the program period was below expectations. Public sector resource mobilization was constrained by modest progress in improving the tax bouyancy and by rising current expenditure. The smaller-than-expected resource availability limited public investment below targets in India, Pakistan, and Bangladesh, and the reorientation of public investment was less than satisfactory in Sri Lanka. The response of private investment and savings to a number of initiatives offered by the Government was generally less encouraging.

The most disappointing development for all the subcontinent countries was the continued weakness in export performance. The growth of exports remained heavily constrained by low productivity and inadequate financial incentives. Although there appears to be further scope for external adjustment through efficient import substitution, the strong development of the export sector will be crucial for achieving external viability over the medium term. This suggests that the focus of further structural adjustment should be placed particularly on liberalizing industrial and import controls and on improving the profitability and external competitiveness of the export sector.

The experience of the subcontinent countries shows that restrained financial management plays a major role not only in improving the balance of payments but also in facilitating structural adjustment. As indicated by the cases of Sri Lanka and Bangladesh, the lack of financial stability made it difficult for the authorities to focus their attention on structural adjustment. In addition, financial instability tended to nullify the effect of structural measures and to reinforce distortions, especially in investment patterns, savings, and relative prices. These experiences reaffirm that prudent demand management is essential for the effective pursuit of structural adjustment. In view of the dominant role of fiscal operations in affecting financial stability in the subcontinent countries, success in demand management policy will require bold actions to reform the tax systems and limit the excessive expansion in current expenditure.

One generalization that can be made on the basis of the experience of the four countries is the importance of adopting a comprehensive approach in undertaking structural adjustment. Policy measures aimed at alleviating only part of pervasive distortions tend to be relatively ineffective and, at times, even counter-productive. Progress toward structural adjustment would be successful only if major constraints were removed through continuous adjustment efforts. This point underscores the importance of sustaining the momentum of economic adjustment that was initiated under the adjustment programs. In this context, it is encouraging that continued efforts were made by most of the subcontinent countries during the post-program period.

my file

Office Memorandum

To: Mr. Neiss

March 21, 1986

From: John Hicklin J.H.

Subject: India: Medium-term Scenario, with Oil Price Assumption of $15/bbl

As requested, I attach (Table 1) a modified version of the Scenario III presented in the Staff Report, with an oil price assumption of $15 per barrel in 1986/87, instead of $20 per barrel.

The detailed assumptions of the revised Scenario, called Scenario IV for convenience, are shown in Table 2. The world oil price is assumed to remain constant at $15/bbl in 1986-87 before rising in line with the world price of manufactures. Relative to Scenario III, the average nominal oil price is, therefore, $4.17 lower over the Seventh Plan period, and $5.21 lower over the four years 1986/87-1989/90. With no change assumed in oil consumption or production, the oil bill is reduced by 25 percent for the four years 1986/87-1989/90. Using the same rule of thumb as before, the percentage reduction in transfer and non-resident deposit inflows (12.5 percent) is assumed to be half that of the reduction in the oil price (25 percent). Given the constraints that commercial borrowing is limited to $2 billion per year, and that the overall balance is unchanged related to Scenario III (with no change in assumptions on the level of reserves or Fund purchases), import volumes are treated as the residual. Imports can increase to the extent that the current account deficit does not fall as a result of the lower oil prices by more than the amount needed to offset the reduced non-resident deposit inflows. The severe constraint on import volume growth still exists, with the implications for the attainment of the GDP targets of the Plan in the absence of policies to boost exports. Total import volumes would grow by only 4.4 percent over the Plan period (compared with 3.8 percent in Scenario III and 5.8 percent assumed in the Plan), and non-bulk imports would grow by 4.1 percent (compared with 2.9 percent in Scenario III, 6-7 percent assumed in the Plan and 10 percent in the World Bank draft CEM). The benefit of the further reduction in the oil price would largely be felt in 1986/87, with non-bulk imports rising by 9.3 percent (rather than 4.8 percent in Scenario III), but the implications of maintaining the prudent borrowing policy in the absence of better export performance would still be very severe for the last three years of the Plan period. Given the lower transfer receipts, the debt service ratio rises a little in Scenario IV relative to Scenario III.

cc: Mr. Brau
Mr. Browne
Mr. Schulz
Mr. Hemming
Mr. Tiwari (o/r)

Table 1. India: Scenario IV - Medium-Term Projections, 1983/84-1989/90

(In millions of U.S. dollars)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Trade balance	-5,693	-4,467	-5,366	-4,740	-4,719	-4,524	-5,338
Exports, f.o.b.	(8,667)	(8,931)	(8,750)	(9,756)	(10,569)	(11,528)	(12,574)
Percent change	3.4	3.0	-2.0	11.5	8.3	9.1	9.1
Imports, c.i.f.	(-14,360)	(-13,398)	(-14,116)	(-14,495)	(-15,288)	(-16,052)	(-17,259)
Percent change	-0.2	-6.7	5.4	2.7	5.5	5.0	7.5
Invisibles balance	2,922	2,310	2,324	1,618	1,644	1,501	1,571
Nonfactor services	(1,089)	(832)	(902)	(856)	(941)	(1,036)	(1,139)
Net investment income	(-727)	(-866)	(-1,008)	(-1,084)	(-1,163)	(-1,401)	(-1,441)
Transfers	(2,560)	(2,344)	(2,430)	(1,846)	(1,866)	(1,866)	(1,873)
Current account	-2,772	-2,157	-3,042	-3,122	-3,075	-3,022	-3,114
Capital account	2,343	2,357	3,239	3,605	3,672	3,695	3,751
Net aid	1,602	1,410	1,548	1,764	1,911	2,069	2,341
Loans	(1,308)	(1,107)	(1,249)	(1,472)	(1,619)	(1,777)	(2,049)
Disbursements	1,905	1,652	1,852	2,208	2,399	2,573	2,857
Amortization	-596	-546	-602	-736	-780	-796	-808
Grants	(293)	(303)	(299)	(292)	(292)	(292)	(292)
Commercial borrowing, net	533	930	1,051	1,524	1,533	1,370	1,108
Disbursements	(794)	(1,259)	(1,445)	(2,000)	(2,000)	(2,000)	(2,000)
Amortization	(-261)	(-330)	(-394)	(-476)	(-467)	(-630)	(-892)
Bilateral arrangements	194	164	41	--	--	--	--
Nonresident deposits	558	609	699	567	578	655	702
Other capital	-543	-756	-100	-250	-350	-400	-400
Overall balance	-428	200	197	483	598	672	637
Monetary movements	428	-200	-197	-483	-598	-672	-637
Net use of Fund credit	(1,305)	(67)	(-207)	(-476)	(-782)	(-906)	(-779)
Gross reserves (- = increase)	(-877)	(-267)	(10)	(-7)	(184)	(234)	(142)
Memorandum items:							
Current account/GDP	-1.5	-1.2	-1.5	-1.4	-1.3	-1.2	-1.1
End-year reserves (US$ mn.) 1/	6,167	6,434	6,424	6,431	6,247	6,013	5,871
End-year reserves (in months of imports, c.i.f.)	5.2	5.8	5.5	5.3	4.9	4.5	4.1
Debt service payments (US$ mn.)	2,103	2,366	2,713	3,261	3,643	4,197	4,369
Debt service ratio 2/	14.0	16.1	18.4	21.1	21.9	23.4	22.5
World oil price (US$/barrel)	28.55	28.00	24.99	15.00	15.18	15.86	16.58
Terms of trade (% change) 3/	10.0	0.8	-1.3	11.1	0.7	0.7	0.4

Sources: Indian authorities; and staff estimates.

1/ Gross reserves, including gold holdings valued at SDR 35 per troy ounce.
2/ As a proportion of current receipts.
3/ Ratio of average value indices.

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Table 2. India: Comparison of Scenarios III and IV

		1985/86	1986/87	1987/88	1988/89	1989/90	7th Plan Average	1986/87-1989/90 4-year av.
World oil price ($/bbl)	Scenario III	24.99	20.00	20.23	21.14	22.09	21.69	20.87
	Scenario IV	24.99	15.00	15.18	15.86	16.58	17.52	15.66
Oil bill ($ million)	Scenario III	3,425	2,895	3,092	3,413	3,767	3,318	3,292
	Scenario IV	3,425	2,171	2,321	2,561	2,827	2,661	2,470
Transfers ($ million)	Scenario III	2,450	2,133	2,155	2,155	2,163	2,211	2,152
	Scenario IV	2,450	1,866	1,886	1,886	1,893	1,996	1,883
Nonresident deposit inflows ($ million)	Scenario III	699	648	661	749	802	712	715
	Scenario IV	699	567	578	655	702	640	626
Total import volumes (percent change)	Scenario III	9.3	4.3	2.1	0.8	2.9	3.8	2.5
	Scenario IV	9.3	6.6	2.2	1.1	3.2	4.4	3.3
Nonbulk import volumes (percent change)	Scenario III	10.7	4.8	0.4	-2.4	1.4	2.9	1.0
	Scenario IV	10.7	9.3	0.8	-1.7	2.0	4.1	2.5
Current account ($ mn.)	Scenario III	3,042	3,203	3,157	3,116	3,214	3,146	3,173
	Scenario IV	3,042	3,122	3,075	3,022	3,114	3,075	3,083
(Percent GDP)		(1.5)	(1.4)	(1.3)	(1.2)	(1.1)	(1.3)	(1.2)
Debt service ratio (percent of current receipts)	Scenario III	18.4	20.8	21.6	23.1	22.3	21.2	22.0
	Scenario IV	18.4	21.1	21.9	23.4	22.5	21.5	22.2

ETR File

Office Memorandum

March 17, 1986

MEMORANDUM FOR FILES

Subject: World Bank Draft CEM

1. Table 1 (attached) summarizes the World Bank's estimates of foreign exchange sources and uses in their "base case" for the Seventh Plan period, and compares this with Scenario I from the Staff Report. The most important differences in assumptions relate to the oil price and to import volumes. The World Bank base case assumes oil prices to be $20 in 1986/87 (similar to Scenario II and III assumptions), and the total import bill to remain as if oil prices were to rise in line with the Plan assumptions, with growth in non-bulk import volumes calculated as a residual. In current prices, the total import bill is very similar in the two scenarios, though the higher World Bank export projection, with the same export volume growth as in Scenario I, implies higher export prices and, therefore, more beneficial terms of trade movements over the Plan period. Gross inflows of commercial (i.e., private) borrowing and of aid are very similar, though the split between IDA and World Bank disbursements differs from that projected by the Indian authorities. Partly reflecting the higher reliance on IBRD than on IDA funds, the World Bank projections of net factor payments and of amortization are higher than in Scenario I.

2. Mr. Ecevit confirms that the definition of the debt service ratio used in the CEM draft is the same as used by the Fund, i.e., payments inclusive of interest payments on non-resident deposits as a ratio of total current receipts. On this basis, the debt service ratio rises from 18.4 percent in 1985/86 to about 22 percent (p.152) in 1989/90, (compared with 18.0 percent in 1985/86 to 21.2 percent in 1989/90 in Scenario I.) The debt service ratio quoted in the CEM on pages 133-134 is on a different basis.

3. The statement on page 137 that the lower oil price assumption than in the Plan is "likely to save about $2.5 billion" in the oil import bill over the Plan period is apparently an average constant price figure. The equivalent current price figure cumulated over the five years of the Seventh Plan is $6.2 billion, which compares with a figure of $6 billion implied in the calculation used in the sensitivity analyses (and in moving from Scenario I to Scenarios II and III) in the Staff Report. The calculations consistent with the Staff Report are attached.

4. The World Bank's concept of gross reserves excludes gold holdings, which are included in the definition used in the Staff Report.

5. There is a significant difference between the estimates of the average export volume growth during the Sixth Plan. The World Bank report (p.140) shows an annual average of 3.8 percent; the Staff Report's estimate is of less than 2 percent. The major reason for the difference relates to the 1980/81 growth estimate, as described in Mr. Brown's memorandum for files of March 7. In current prices, however, the levels of both exports and imports between 1980/81 and 1984/85 are identical, reflecting the decision to use the same definition of trade values (balance of payments basis, excluding crude oil exports) and the similar projections for 1984/85. Though the export and import levels differ slightly from those in the Staff Report for 1985/86, the World Bank's estimate of the current account deficit in 1985/86 of $3,039 million is very close to the Staff Report estimate of $3,042 million for Scenarios I and III.

6. The World Bank report (p.136) refers to estimates of elasticities of non-bulk imports with respect to GDP, during both the Sixth and the Seventh Plans. Estimates consistent with the data used in the Staff Report imply an elasticity of non-bulk imports with respect to GDP of 1.9 during the Sixth Plan (compared with the World Bank's estimate of 1.6); and of 1.2 during the Seventh Plan (compared with the World Bank estimate of 1.4, or 1.3 if the Staff Report GDP figure of 5.3 percent is used instead of the World Bank's 5.0). Because of the sharp fall in imports in 1984/85, the elasticity of non-bulk imports with respect to GDP over the first four years of the Sixth Plan is much higher than for the whole Plan period. The World Bank indicates an elasticity of 2.7, against an estimate consistent with the Staff Report of 3.2. The draft CEM points to the serious concern over the low non-bulk import growth assumptions for the Seventh Plan and the implications for growth, and in the World Bank's modified version of the Seventh Plan Scenario the part of the import bill saved by the lower oil prices is assumed spent on non-bulk imports. This would raise the growth of non-bulk imports from nearly 7 percent per annum to 10 percent, and total imports from 5.8 percent to 7.3 percent per annum, with a corresponding rise in the implied non-bulk import elasticity to 1.9 - 2.0. I have made a rough calculation of the effects on non-bulk import growth, if a similar scenario to that used by the World Bank had been prepared using the Staff Report's Scenario I as a base. Similar results would have been obtained, with non-bulk imports growing by 9.3 percent over the Seventh Plan period, and total imports by 7 percent, with an elasticity of non-bulk imports with respect to GDP of 1.8.

7. The major differences between the Bank's Scenario and the Staff Report's Scenario III are the lower export and aid disbursement assumptions of the latter, together with assumed policy response of limiting gross commercial borrowing to $2 billion per annum. The consequences for non-bulk import growth, which is the residual for both the World Bank and Scenario III, are quite different. The World Bank assumes a growth in non-bulk imports of 10 percent per annum, whereas Scenario III has an increase of only 3 percent. The Staff Report makes

clear that the lower import growth in Scenario III would not be consistent with the GDP growth target of 5.3 percent per annum, but the precise impact on GDP is much more difficult to assess, and depends in part on the success of the import substitution policies.

J. Hicklin

John Hicklin
Economist
Stand-By Policies Division, ETR

cc: Mr. Neiss
Mr. Brau
Mr. Browne
Mr. Schulz
Mr. Hemming
Mr. Tiwari

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Table 1. India: Foreign Exchange Sources and Uses
During the Seventh Plan
(in billions of U.S. dollars)

	Fund Scenario I	World Bank Table 5.7 (revised)
Foreign exchange requirements	119.0	120.2
Imports	102.6	102.5
Goods	(88.7)	(89.2)
Services (Non-factor)	(13.9)	(13.2)
Factor payments (Net)	6.5	7.7
Amortization	9.8	10.6
Increase in reserves	0.2	-0.6
Foreign exchange sources	119.0	120.2
Exports	76.9	81.8
Goods	(58.2)	(61.9)
Services (Non-factor)	(18.7)	(19.9)
Private transfers and remittances (net)	12.5	10.5
Official grants	1.5	1.5
Direct investment	...	0.4
Medium- and long-term borrowing - official	13.7	13.9
Official concessional		
IDA	(5.8)	(3.5)
Bilateral)	(5.1)	(3.8)
Multilateral)		(0.2)
Official nonconcessional		
IBRD	(2.8)	(5.8)
Bilateral	...	(0.6)
Medium- and long-term borrowing - private	11.8	11.5
NR deposits	4.1	2.9
Other capital including errors and omissions	-1.5	-2.3

Working Table JH1. India: Details of Oil Price Simulations

	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	7th Plan Average	1986/87-1989/90 4 Year Average
Scenario I								
Oil price ($/bbl)	28.00	25.86	28.32	29.34	30.66	32.04	29.24	30.09
Oil bill ($m)	3,203	3,544	4,099	4,485	4,950	5,464	4,508	4,750
Transfers and non-resident deposits ($m)	2,973	3,149	3,267	3,332	3,436	3,509	3,339	3,386
Transfers	(2,364)	(2,450)	(2,500)	(2,550)	(2,550)	(2,560)	(2,522)	(2,540)
Non-resident deposits	(609)	(699)	(767)	(782)	(886)	(949)	(817)	(846)
Current account ($m) (% of GDP)	-2,157 (-1.18)	-3,042 (-1.52	-3,530 (-1.58)	-3,859 (-1.56)	-4,404 (-1.61)	-4,797 (-1.58)	-3,926 (-1.57)	-4,148 (-1.58)
Gross commercial borrowing (%m)	1,259	1,445	2,227	2,453	2,735	2,909	2,354	2,581
Debt service ratio	16.14	17.98	19.57	20.39	21.61	21.15	20.14	20.68
Simulation A (-$1/bbl, no transfer effect)								
Oil price ($/bbl)	28.00	25.86	27.32	28.34	29.66	31.04	28.44	29.09
Oil bill ($m)	3,203	3,544	3,954	4,332	4,789	5,293	4,382	4,592
Transfers and non-resident deposits ($m)	2,973	3,149	3,267	3,332	3,436	3,509	3,339	3,386
Change from Scenario I								
Oil price ($/bbl)	--	--	-1.00	-1.00	-1.00	-1.00	-0.80	-1.00
Oil bill ($m)	--	--	-145	-153	-161	-171	-126	-158
Transfers and non-resident deposits ($m)	--	--	--	--	--	--	--	--
Current account ($m) (% of GDP)	--(--)	--(--)	+145 (.07)	+165 (.07)	+189 (.07)	+213 (.07)	+142 (.06)	+178 (.07)
Debt service ratio	--	--	--	-.07	-.13	-.30	-.10	-.13
Gross commercial borrowing($m)	--	--	-145	-165	-189	-237	-147	-184
Simulation A (-$1/bbl, net effect)								
Oil price ($/bbl)	28.00	25.86	27.32	28.34	29.66	31.04	28.44	29.09
Oil bill ($m)	3,203	3,544	3,954	4,332	4,789	5,293	4,382	4,592
Transfers and non-resident deposits ($m)	2,973	3,149	3,212	3,276	3,381	3,457	3,295	3,332
Transfers	(2,364)	(2,450)	(2,458)	(2,507)	(2,509)	(2,522)	(2,489)	(2,499)
Non-resident deposits	(609)	(699)	(754)	(769)	(872)	(935)	(806)	(833)
Change from Scenario I								
Oil price ($/bbl)	--	--	-1.00	-1.00	-1.00	-1.00	-.80	-1.00
Oil bill ($m)	--	--	-145	-153	-161	-171	-126	-158
Transfers and non-resident deposits ($m)	--	--	-55	-56	-55	-52	-44	-55
Current account ($m) (% of GDP)	-- (--)	-- (--)	+104 (.05)	+119 (.05)	+141 (.05)	+164 (.05)	+106	+132
Debt service ratio	--	--	+.04	-.01	-.05	-.17	-.04	-.05
Gross commercial borrowing ($m)	--	--	-91	-106	-127	-165	-98	-122
Simulation B (WEO oil price no transfer effect)								
Oil price ($/bbl)	28.00	24.99	20.00	20.23	21.14	22.09	21.69	20.87
Oil bill ($m)	3,203	3,425	2,895	3,092	3,413	3,767	3,318	3,292
Transfers and non-resident deposits ($m)	2,973	3,149	3,267	3,332	3,436	3,509	3,339	3,386
Change from Scenario I								
Oil price ($/bbl)	--	-0.87	-8.32	-9.11	-9.52	-9.95	-7.55	-9.23
Oil bill ($m)	--	-119	-1,204	-1,393	-1,537	-1,697	-1,190	-1,458
Transfers and non-resident deposits ($m)	--	--	--	--	--	--	--	--
Current account ($m) (% of GDP)	--	+119 (.06)	+1,215 (.55)	+1,501 (.61)	+1,782 (.65)	+2,094 (.69)	+1,342 (.51)	+1,648 (.63)
Debt service ratio	--	--	-.06	-.60	-1.32	-2.82	-0.96	-1.20
Gross commercial borrowing ($m)	--	-119	-1,215	-1,501	-1,802	-2,317	-1,391	-1,709
Simulation B (WEO oil price, net effect) 1/								
Oil price ($/bbl)	28.00	24.99	20.00	20.23	21.14	22.09	21.69	20.87
Oil bill ($m)	3,203	3,425	2,895	3,092	3,413	3,767	3,318	3,292
Transfers and non-resident deposits ($m)	2,973	3,149	2,781	2,816	2,904	2,965	2,923	2,867
Transfers	(2,364)	(2,450)	(2,133)	(2,155)	(2,155)	(2,163)	(2,211)	(2,152)
Non-resident deposits	(609)	(699)	(648)	(661)	(749)	(802)	(712)	(715)
Change from Scenario I								
Oil price ($/bbl)	--	-0.87	-8.32	-9.11	-9.52	-9.95	-7.55	-9.23
Oil bill ($m)	--	-119	-1,204	-1,393	-1,537	-1,697	-1,190	-1,458
Transfers and non-resident deposits ($m)	--	--	-486	-516	-532	-544	-416	-519
Current account ($m) (% of GDP)	--	+119 (.06)	+856 (.39)	+1,083 (.44)	+1,326 (.49)	+1,595 (.52)	+996 (.38)	+1,215 (.46)
Debt service ratio	--	--	-.33	-.03	-.60	-1.64	-.39	-.57
Gross commercial borrowing ($m)	--	-119	-737	-962	-1,209	-1,591	-924	-1,125

1/ As reflected in Scenarios 2 and 3.

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India file

Office Memorandum

TO: Mr. Neiss — February 10, 1986

FROM: Eduard Brau

SUBJECT: India--Staff Report 1986 Article IV Consultation

This is a comprehensive report that puts India's adjustment needs in a clear perspective. You have indicated that the medium-term scenarios are being revised and I look forward to seeing them.

Rather than write a lengthy note, I am attaching copies of the pages of the draft where I have made comments.

My main impression is that the overall assessment of the liberalization actions to date is somewhat too glowing. While these actions are potentially significant and should be praised, there is as yet little evidence of actual, as opposed to potential, effects. Moreover, past experience has shown that the impact of administrative reforms is often diluted considerably by remaining constraints in other areas (in this case especially the lack of concurrent financial liberalization), or by offsetting policy changes; at the same time, I have substantial doubts as to how effective liberalization can be in the absence of more significant exchange rate action. My other main suggestion, therefore, relates to some strengthening of the commentary on exchange rate policy.

Attachments

cc: Mr. Hicklin

in their policy of import liberalization, industrial deregulation, and public sector resource mobilization to enhance the efficiency of the economy and strengthen its export potential. In this respect, Directors stressed the importance of moving to a more liberal regulatory environment, both in the areas of industrial licensing and import control, allowing industry greater access to modern technology and establishing conditions which afforded adequate incentives to improve industrial efficiency.

in concluding the 1985 Art IV consult. with the Indi

too strong

The major policy initiatives that have been taken during the past year to carry forward the process of economic liberalization and structural reform are in the direction recommended by earlier ~~in line with~~ the Executive Board ~~'s expressed views~~.

2.

The measures have concentrated on reducing administrative controls over industrial production and investment, import liberalization, tax reform, and greater financial discipline in the public sector. The primary objective is to created an environment for faster growth with balance of payments viability during the period of the Seventh Plan (1985/86-1989/90). A substantially improved industrial and export performance and a strengthened public sector savings effort are seen as crucial elements in this endeavor.

2. <u>The Sixth Plan outcome</u>

During the period of the Sixth Plan (1980/81-1984/85), the annual average rate of growth of real GDP exceeded 5 percent. 1/ However, if

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1/ All macroeconomic statistics are reported on a fiscal-year basis (April-March) unless otherwise stated.

remain below the average of 7 percent projected in the Seventh Plan. The growth of import volumes of 5-6 percent would be broadly consistent with the income elasticity assumed in the Plan, with some progress expected in substitution in both agricultural and industrial sectors. Helped by the expected fall in oil prices, the terms of trade could improve despite the continued weak outlook for primary commodity exports. The decline in the trade deficit would be offset mainly by the increase in interest payments. The debt service ratio is expected to rise to 19.5 percent.

Gross external aid flows are expected to rise by 16 percent, including an element to reflect the slower pace of disbursements in the two preceding years. Increased capital inflow would also take the form of higher commercial borrowing, which could exceed $2 billion in gross terms. The authorities did not place a rigid limit on new borr. contracts ~~commitments~~ and would review the situation at least every six months. Borrowing would not be undertaken to increase gross official reserves.

III. Liberalization and Reform Policies

The promotion of efficiency and international competitiveness throughout the economy, and particularly within the industrial sector, is a fundamental part of the government's strategy to attain faster economic growth. In the past, excessive administrative regulation of industry and trade reduced competition, inhibited the ability of entrepreneurs to respond to changes in domestic and external demand, hampered the adoption of new technology, and discouraged attention to product design and quality control. The high degree of protection accorded to producers by industrial and import regulations enhanced the profitability of the domestic market relative to exports. Progress was made in reducing distortions in resource allocation under the Fund extended arrangement during 1981-84. Recently, the Government has strongly accentuated the trend toward liberalization and reform in a number of areas, particularly industrial licensing, import liberalization, tax reform and financial reform. 1/ These actions have already changed the business climate decisively. It is difficult to quantify their longer-term impact at this stage, particularly since the detailed administrative changes needed for their implementation have in some cases not yet been formulated fully. (Some quantitative indicators are provided in Table 3.) The staff would, nevertheless, agree with the authorities that these policies represent, in addition to a consolidation of earlier achievements, a more determined approach to the implementation of market-oriented policies that is in accord with the views expressed by Executive Directors during the 1985 Article IV consultation discussions. It is equally clear, however, that further important steps in all areas will be necessary to realize the authorities' goal of a substantially more efficient economy.

a more careful assessment is warran[ted] for these reasons

1. Industrial policy

Since 1951, in order to ensure that growth and development objectives are consistent, licenses have been required for public and private

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1/ Details are contained in the Supplement to Recent Economic Developments, Annex 2.

somewhat less attention than those in other areas in the recent past. The main issues now under consideration are appropriate methods of conducting monetary policy to secure adequate financing of the public sector without endangering price stability, stimulate savings, and encourage industrial and export growth. A committee on the working of the monetary system appointed by the Reserve Bank addressed these issues in a recently published report, and its recommendations are expected to be considered by the Government in early 1986.

The authorities view financial liberalization as a necessary complement to the recent liberalization and reform measures, but indicated that the large size of public sector financing is a complicating factor. Observed relationships between money, output, and prices in India over the past two decades could provide a basis for targeting a range of monetary growth, but this range would have to be coordinated with prospective public sector financing needs. Market-related yields had been introduced on government securities to promote sales to the nonbank public. The staff team discussed the possibility of greater reliance on flexible interest rate policy and reduced quantitative lending controls which could improve the allocation of private sector credit. It could also increase the importance of open market operations as an instrument of monetary control, and this would give the Reserve Bank greater flexibility in the use of cash and liquidity ratios and of refinance facilities. The authorities indicated that the impact of such changes on the Government's conduct of fiscal policy would need to be carefully examined.

yes

well above the long-term historical trend--to be achieved by efforts to promote industrial output, while continuing agricultural expansion (Table 4). It is to be supported by a rise in public and private investment averaging 6 percent annually in real terms and an acceleration of export volume growth to 7 percent annually. 1/ The strategy for industrial development focuses on increased access to technology, a greater degree of liberalization, tax incentives, and a larger supply of imported inputs. According to the World Bank, these development targets are feasible, but the authorities recognize that ~~they~~ the targets are optimistic. Their position is that the Five-Year Plan expresses the government's development strategy but is not a rigid framework, and that annual targets will be adjusted, in the light of evolving circumstances, in order to maintain internal and external financial stability. In this context, the principal medium-term issues discussed with the authorities were public sector savings, external borrowing strategy, and export promotion.

if buttressed by strong policy efforts

1/ A World Bank staff assessment of the investment program is contained in the Supplement to Recent Economic Developments, Annex 1.

Table 5. Public Sector Resources Available for Plan Financing 1/

(In percent of GDP)

	Sixth Plan			Seventh Plan	
		Target	Actual		Target 2/
	1980/81	...	3.8	1985/86	(4.2)
	1981/82	...	5.1	1986/87	(5.2)
	1982/83	...	5.5	1987/88	(5.9)
	1983/84	...	5.0	1988/89	(6.6)
	1984/85	...	4.4	1989/90	(7.5)
Total Plan period		6.9	4.8		6.0
Central Government		1.5	0.9		-0.3
States		2.6	1.6		1.6
Public enterprises		2.8	2.2		4.7

1/ Defined as current revenue less non-Plan current expenditure (which is all current expenditure apart from maintenance on investment projects) for Central and State Governments, and operating surpluses of public enterprises).

2/ Implied annual targets were derived from Seventh Plan data prepared in 1984/85 prices on the assumption of a 5 percent annual rate of price increase.

2. External borrowing strategy

The scope for commercial borrowing was discussed on the basis of illustrative scenarios intended to show the implications of the planned development strategy and of various external assumptions on the balance of payments, commercial financing needs, and debt service obligations. 1/ In the first scenario, consistent with the Seventh Plan, gross commercial borrowing averages $2.5 billion a year (about $2 billion on a net basis) with a debt service ratio of 20 percent (Table 6

1/ The details of the scenarios are presented in Annex II.

to what?

and Chart 7). This situation would be manageable. all ~~Nevertheless,~~ The balance of payments situation would worsen during the Plan period, and would become more difficult beyond 1989/90, when commercial debt service payments would increase substantially. ~~However,~~ only if ~~the staff team pointed out that the Plan scenario rests on~~ the optimistic Plan assumptions of annual increases of 7 percent in export volumes and 15 percent in aid disbursements are realized.

Alternative assumptions for exports and aid were suggested by the staff. A 4 percent growth was assumed for export volume, broadly in line with the long-term historic trend but still significantly higher than export growth during the past few years. 1/ Aid disbursements are assumed to rise by 10 percent, approximately the same rate realized during the previous Plan period. On account of these changes in assumptions, gross commercial borrowing requirements and the debt service ratio would rise rapidly, leading to an unsustainable external situation. The authorities felt that the alternative assumptions were on the pessimistic side. Export performance would be higher than the past trend as a result of the liberalization and reform measures and other policies to stimulate industrial development and competitiveness. It was recognized that full achievement of the export target during the Seventh Plan might not be possible, given the weak performance in the first Plan year. Nevertheless, taking into account the time needed to redirect resources to the export sector, it was still expected that

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1/ Export performance during 1950-84 is reviewed in the Supplement to Recent Economic Developments, Annex 5.

od beyond ?

cent. The balance of payments position in the years beyond the Plan would come under increased strain. The Government would face the choice between higher commercial borrowing than it presently plans and considers prudent, or a slower pace of development than targeted. The authorities emphasized that if the medium-term balance of payments trends indicated the possibility of debt servicing difficulties, as in this scenario, there was no doubt that slower growth would have to be accepted.

The implications of limiting commercial borrowing to the Plan assumptions are indicated in the third scenario. In this scenario, the assumptions of the second scenario are retained, except for commercial borrowing, which is assumed to be constrained to $2.4 billion annually, corresponding to the Plan assumptions. This limitation would allow an annual import growth of 4.5 percent in volume, compared with 6 percent projected in the Plan (Table 6 and Chart 7). The impact of this import constraint on growth--basing the estimate on an elasticity of 1.2 with respect to GDP 1/--would be a reduction by over 1 percentage point. Accordingly, under this scenario, economic growth would probably be constrained to an average annual rate of about 4 percent. This constraint would, however, be alleviated by a further downward revision of oil import prices.

debt service after 1990 ?

1/ This is the elasticity implied by the Plan projections. The historical elasticity has been somewhat higher, around 1.3 to 1.5.

Table 6. Summary of Medium-Term Balance of Payments
Scenarios, 1985/86-1989/90

bad one IV

	Scenarios I 1/	II	III
	(Annual averages)		
Export volume growth (%)	6.8	4.0	4.0
Import volume growth (%)	5.8	5.4	4.5
Current account ($ bn.)	4.0	4.2	3.6
(% of GDP)	(1.6)	(1.7)	(1.6)
Gross aid disbursements ($ bn.)	3.0	2.7	2.7
(% change)	(15.0)	(10.0)	(10.0)
Gross commercial borrowing ($ bn.)	2.4	3.1	2.4
(% change)	(19.0)	(28.0)	(20.0)
Debt service ($ bn.) → not informative	3.8	3.8	3.8
		(1989/90)	
Gross commercial borrowing ($ bn.)	3.0	4.4	3.1
Debt service ratio 2/ (% of current receipts)	21.2	23.6	22.9

histor

2.4

2

after 1989/

1/ Assumptions consistent with the Seventh Plan.
2/ The estimate for 1985/86 is 18.0.

will continue to need to observe

The above scenarios indicate that the Government's prudent limits for commercial borrowing ~~are needed~~ to ensure continued balance of payments viability. ~~but also that following such a prudent borrowing policy is likely to reduce the scope for growth if external developments are less favorable than those in the Plan.~~ Various developments could, of course, change the assumptions implicit in these scenarios and this would allow for different outcomes. The most important of these assumptions relate to export and non-oil import prices, oil prices, world demand, and world

No

2

Table 7. Sensitivity of Medium-Term Balance of Payments to Key Assumptions, 1985/86-1989/90

	Assumptions: Scenario I (Annual average percent change)	Assumptions: Scenario III (Annual average percent change)	Change in Variable	Average Annual Change in Current Account ($ mn.)
Oil prices	2.8	-0.8		
($/bbl., average)	(29.4)	(25.4)	-$1/bbl.	+100
Export prices	3.2	3.2	+1% point	+400
Non-oil import prices	3.6	3.6	+1% point	-450
World demand	5.5	5.5	+1% point	+400
LIBOR	8.0	8.0	+1% point	-150

3. Export promotion

~~While there are various possible outcomes of the medium-term external scenario, as indicated above,~~ The authorities realize that the key to accelerating growth while maintaining prudent borrowing policies remains an improvement of export performance. In view of the weak performance in the past few years, raising export growth significantly over the next years has, therefore, become urgent and a main focus of policy. In this context, various approaches were discussed to increase the supply of exports and to make exports more competitive, in terms of price as well as in terms of quality and timely delivery. The main focus was on exchange rate policy and import liberalization, which are complementary and mutually reinforcing.

Nevertheless, for many products domestic sales continued to be more profitable than export sales.

a. Exchange rate policy

With respect to price competitiveness, the authorities pointed to the recent depreciation in the real effective exchange rate (Chart 6) and indicated that they would continue to use exchange rate policy in a flexible manner so as to ~~maintain~~ improve India's competitive position and to provide proper incentives to exporters. The staff team viewed this policy stance as an essential part of the export strategy and pointed out that, in the past, faster export growth was generally associated with increased price competitiveness and vice versa. During the period 1950-65, when the real effective exchange rate index appreciated, export volume growth was modest and market shares were continuously lost. After a large devaluation in June 1966, the impact of which was substantially offset by the removal of export incentives and higher taxation, growth accelerated somewhat, but further market shares were lost. By contrast, during 1974-78 when the real effective exchange rate was depreciated substantially, the growth in export volume accelerated sharply and market shares were retained. During 1979-85, with a broadly unchanged real effective rate, the growth in export volume was modest and market shares again eroded. Over the whole period 1950-85, average export volume rose by 3.5 percent annually and India's share of world exports declined from 2 percent to 0.5 percent. The recent depreciation of the real effective rate, combined with liberalization and reform measures, should have a favorable impact on export performance.

2

2

yes, but hint not enough

e rate in pace with lib.?

2

dubious — bop problems are especially acute in some non-industrial countries

straint to Indian exports than for many other developing countries, reflecting greater diversification of sales to non-industrial country markets and a lesser degree of specialization in production. Protectionism would, nevertheless, make the authorities' task more difficult.

V. Staff Appraisal

Economic policy has entered a new phase in India. In the Seventh Plan (1985/86-1989/90), which was approved recently, the Government has set an ambitious program for accelerated development, aiming at substantially higher growth of output and investment than the historical trends. To establish adequate conditions for the realization of these targets, a number of deep-seated structural problems are being addressed more forcefully and efforts directed to modernize the economy. The strategy also gives due consideration to price stability and balance of payments viability and, accordingly, incorporates cautious financial policies and a prudent external borrowing program.

The liberalization and reform measures implemented during the past year are impressive and represent an intensified effort to continue a policy direction initiated during the EFF period. While some time will be needed to assess the full impact of these measures, important steps to follow up in this direction will almost certainly be required, if the strategy of accelerated development is to succeed. This is recognized by the Government, which regards liberalization and reform as a continuing process.

see top p.37

comment: according to pp 20/21 there are proposals/studies with little or no actual reform in place

Yes

Significant scope for further measures indeed exists. In particular, these include delicensing in industry, the simplification of administrative procedures, and import liberalization. A further easing of access to foreign technology and an improvement in the climate for foreign investment will also help in the authorities' efforts to achieve a full-scale industrial modernization. The 1985/86 budget contained a major tax reform package, including tax reductions and simplifications, and this has already had a positive effect on tax collections. A strengthening of tax administration has also contributed to faster revenue growth. In the fiscal area, there is potential for additional improvements as suggested in the Government's proposals on long-term fiscal policy. These include a further rationalization of direct taxes, changes in the incentive system, a restructuring of indirect taxes, and a progressive shift from quantitative import controls to tariffs. Financial liberalization has yet to be ~~fully~~ implemented. Official proposals which aim at a market-related interest rate structure, a better coordination of budgetary and monetary policies, and monetary targeting would contribute to effective demand management. Steps beyond these proposals, including the more extensive freeing of interest rates and the replacement of selective credit controls by general controls, would be needed ~~should also be considered so as to make financial reforms a full complement to the~~ so that the reforms in the other areas are not diluted by inefficient credit allocation.

The Government has also set up a monitoring system for public enterprises and initiated measures to improve their financial performance. Increased public sector resource mobilization is needed to finance the expenditure and a continuation of the intensified revenue collection efforts is needed to guarantee this. In addition, the recent enforcement of budgetary discipline by the States through the restriction of overdraft facilities with the Reserve Bank should remain an effective element of public sector restraint.

The overall external situation has been relatively comfortable. However, this has been achieved because of rising earnings from services and higher capital inflows which financed a widening trade deficit. The cause of the latter is a very weak export performance. Almost one year into the new Plan period, there is no sign of the substantial breakthrough needed to achieve the volume growth envisaged in the Plan. Continuation of present export trends would have serious balance of payments implications and require a modification of the Government's strategy of accelerated growth. The Government's position rightly is that the problem cannot be met by resorting to import controls which would negate the thrust of its current strategy.

e-write comments 2.

The balance of payments scenario consistent with the high export growth and other assumptions in the Seventh Plan provide~~s~~ for commercial borrowing in the range of \$2-3 billion a year. This would represent a sustainable course only within the context of rapid export growth. However, likely shortfalls in projected inflows from exports and possibly also from official aid would widen the financing gap substantially and raise the debt service ratio uncomfortably. In this case, the Government would have to modify its development strategy and opt for lower growth in order to prevent debt servicing difficulties. While such a course would indeed be ~~followed by~~ intended by

how can we know that

no dilemma exists — one not possible without the other

the Government, increased efforts should be made at an early stage to accelerate export growth to enable achievement of strong ~~and thereby avoid the possibility of a dilemma between~~ growth while maintaining ~~and~~ balance of payments viability, ~~at a later stage.~~ This calls for bold action on many fronts aimed at enhancing the range and quality of export products as well as at an improvement in export profitability relative to domestic sales. Implementation of liberalization and reform measures as well as of a more flexible exchange rate policy, combined with financial discipline in the public sector, are key elements of such a policy. Even ~~if~~ though a ~~larger~~ drop in oil prices ~~would~~ alleviates the prospective balance of payments constraint, the urgency remains to implement ~~these~~ the policies which create conditions for accelerated growth and employment opportunities, and for a significantly more competitive economy. The moves to remedy long-standing weaknesses in the economic structure and to revitalize the export sector present a formidable challenge to the Indian authorities. Their efforts should be supported by a lowering of barriers to the entry of exports into foreign markets.

only mention of e-r in appraisal

— over —

VI. Proposed Decision

The following draft decision concluding the 1986 Article IV consultation with India is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to India's exchange measures subject to Article VIII, Section 2, and in concluding the 1986 Article XIV consultation with India, in the light of the 1986 Article IV consultation with India conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

where is this described in this report?

2. The restrictions on the making of payments and transfers for current international transactions described in SM/86/... 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.

INTERNATIONAL MONETARY FUND

February 7, 1986

Mr. Brau:

Attached are comments on the draft staff report for India.

These comments were prepared by Mr. Sheehy.

Attachment

GB

Gerard Belanger

India--Comments on Draft Staff Report

1. Our main comment concerns the overall tone of the draft report, which is substantially more favorable than that for the previous consultation. We wonder if this more positive assessment is fully justified by the recent liberalization measures, which although potentially significant, have yet to bear fruit in many instances. It would be useful in this connection if the report could include additional information or evaluations of the actual (as compared with potential) impact of the reforms on relative prices and sectoral profitability, so as to enable the information on administrative changes to be placed in a broader perspective. Further information, in addition to that provided in Table 3, on the response of economic behavior and developments to the reforms would also be welcome. As our past experience has shown, the impact of administrative reforms often can be diluted considerably by remaining constraints in other areas or by offsetting policy changes.

2. The rapid rise in the external debt service burden (at a time of sharply lower international interest rates) is a matter of considerable concern, particularly in light of the weak export performance and absence of prospects for a major acceleration in export growth. The reference (p. 11) to the greater profitability of domestic sales compared with exports is especially worrisome in this context. The wisdom of continued borrowing at the envisaged level depends crucially on the efficiency with which such resources are used, and in particular on their contribution to improved export earnings. We would suggest that this point be emphasized in the report, and that the discussion of export promotion policies (pp. 33 ff.) focus explicitly on what must be done to eliminate the apparent bias against exports that is inherent in the current structure of incentives. References to the "manageable" debt situation and the "prudent" and "sustainable" borrowing policies of the Government should be altered accordingly.

3. In the absence of financial market reforms to reduce the crowding out of private sector borrowers and improve the efficiency of credit allocation, it is likely that reforms of other policies aimed at increasing the role of the private sector will have a limited impact. We would suggest that this point be emphasized in the report, and that the staff appraisal strike a more forceful note in this respect (pp. 20-21 and 37).

4. The following specific comments may also be useful.

a. Page 8, top. The reference to Chart 3 would be clearer if the two panels of the chart were inverted.

b. Page 12, bottom. We do not understand the implications of adopting agricultural policies that aim to shift the composition of output to accord more closely with the pattern of domestic demand. Should the emphasis not be placed on agricultural efficiency in the broader context, with surpluses aimed at the export market? There is no obvious reason why self sufficiency should be sought for every agricultural crop.

c. Page 19. The discussion of developments in indirect taxation would be enriched if there were some reference to the implications of customs duty changes for the structure of effective protection.

d. Page 20. The tax reform program, as described, sounds more like a tax reduction program. What are the implications of the reform for tax revenues? What other steps are envisaged to improve tax collections?

e. Page 30, footnote. It would be useful to clarify the implications for the scenario of the differing estimates of the elasticity of GDP growth with respect to imports.

f. Page 31, Table 6. A more interesting statistic on debt service might be the average annual increase in debt service or in the debt service ratio under the alternative scenarios.

g. Page 36, top. Quotas and restrictions on trade are generally more important in nonindustrial than in industrial countries. The greater share of Indian exports to nonindustrial countries would thus not necessarily mean that such restrictions are less of a constraint in the Indian case.

INTERNATIONAL MONETARY FUND

CONFIDENTIAL

January 2, 1986

Mr. Finch:

India

With no little prodding, the Asian Department is now taking an appropriate line on exchange rate policy. My own feeling is that Tun Thin is now more venturesome in this area partly because Mr. Sengupta is quite vocal, in internal discussions, in pushing for a more aggressive exchange rate policy.

Attachment

Eduard H. Brau Br

Mr. Tun Thin

Office Memorandum

CC: E.B.

CONFIDENTIAL

TO: The Acting Managing Director December 24, 1985

FROM: Tun Thin T.T.

SUBJECT: India--Exchange Rate Policy

Parallel with the mission's discussions, I had several private meetings (accompanied by Dr. Sengupta and Mr. Neiss) individually with Secretary of Finance Venkataraman, Special Secretary of Finance Bimal Jalan, Deputy Chairman of Planning Commission Manmohan Singh, Advisor to the Prime Minister Montek Singh Ahluwalia, Secretary of Industry Srivastava, and Governor Malhotra of the Reserve Bank of India on prospective balance of payments developments and the problem of external financing in the medium term. I made the point that export performance would be the most important element in maintaining balance of payments viability, and that depreciation was essential to stimulate exports, which have performed disappointingly over the past years. A resumption of export growth was crucial if the government's strategy of accelerated development should not be thwarted by the danger of running into debt servicing difficulties.

The authorities are obviously aware of this issue, but it seems that a concrete strategy is still being evolved. There is a consensus on two points: (1) A depreciation is needed to make exports more profitable relative to domestic sales, and to support import liberalization; and (2) Given the high political sensitivity of this issue, a depreciation has to be a gradual process rather than one-step action. They fear that a more drastic action would upset the present mood of confidence.

The decline of the U.S. dollar since September has resulted in a "painless" depreciation of 6-7 percent, and the real rate is now below the level of 1978-79 which is the lowest in the past decade (from 1970 to 1978-79, the real rate fell by some 25 percent, but appreciated again until mid-1985). However, in view of the poor export performance, I emphasized that a stronger depreciation is needed. While Manmohan Singh and to some extent Governor Malhotra are more inclined to accept a further depreciation, the Finance Secretary and the Prime Minister's advisor-while not disputing the desirability of further softening the rate--take a more cautious attitude.

When I pointed out that the medium-term balance of payments scenario consistent with the Seventh Plan was not sustainable, the Planning Secretary replied that the authorities would be ready to change the Plan targets if necessary to avoid overborrowing and debt servicing difficulties. He admitted that the Plan's export projections were overly optimistic (he argued that unless the Plan targets were set high, the concerned authorities would not act with sufficient vigor), did not dispute that aid disbursements may also turn out to be lower, but he hoped that a further fall in oil prices would ease the strain on the balance of payments. In any event, he expected that, for the coming two years, the balance of payments would remain manageable. Thereafter, however, it was indicated that India might have to approach the Fund.

In the discussions the officials also emphasized that the Government was on a firm course on liberalization and increased resource mobilization as advised by the Managing Director at the time of their cancellation of the EFF program. They asked me to convey to Managing Director that the policies initiated during the EFF period were not only being continued, but further strengthened by the new Government. Mr. Sengupta was very supportive in these discussions and, on his part, underlined the need for further policy action.

cc: The Managing Director (on return)
Mr. Brown

1985

INTERNATIONAL MONETARY FUND

CONFIDENTIAL

January 2, 1986

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cc: The Managing Director (on return)
Mr. Brown

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WASHINGTON, D. C. 20431

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MINISTER NARAYANAN
UNION MINISTER OF STATE FOR
EXTERNAL AFFAIRS
DELHI (INDIA)

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MR. SENGUPTA
ASD
ETRD

START TEXT HERE

I WILL BE VISITING INDIA DURING THE FORTHCOMING CONSULTATION MISSION AND HOPE VERY MUCH THAT I WILL BE ABLE TO MEET WITH YOU. WILL BE ARRIVING DELHI ON TUESDAY DECEMBER 10 ON FLIGHT IC 185 FROM BOMBAY AT 6:50 P.M. AND DEPARTING SUNDAY DECEMBER 15 ON FLIGHT JL482 AT 4:50 A.M. IN DELHI I WILL BE STAYING AT THE TAJ PALACE HOTEL. WARM REGARDS TO YOU AND MRS. NARAYANAN.

TUN THIN

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IN XII

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MR. SURENDAR SINGH
PROTOCOL AND HOSPITALITY OFFICER
DEPARTMENT OF ECONOMIC AFFAIRS
MINISTRY OF FINANCE
NEW DELHI 110011, INDIA

DISPATCHED BY 1985 OCT 23 PM 1:35

RECEIVED OCT 25 1985 EXCHANGE TRADE RELATIONS

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AS DISCUSSED ON THE PHONE THIS MORNING, WE HAVE SENT A CABLE TO MR. BAJAJ DATED OCTOBER 16. IN ADDITION TO THE LIQUIDITY, I WOULD ALSO LIKE TO ASK IF YOUR OFFICE WILL BE ABLE TO ARRANGE FOR A TYPEWRITER IN DELHI AND BOMBAY.

WE HAVE NOT YET BEEN ABLE TO GET HOTEL RESERVATIONS FOR THE UPCOMING ARTICLE IV CONSULTATION MISSION TO INDIA. THE TAJ MAHAL AND THE MERIDIAN IN NEW DELHI ARE NOT AVAILABLE, SO WE HAVE ASKED FOR RESERVATIONS AT THE TAJ PALACE BUT NO NEWS YET. COULD YOU ASSIST US FOR THAT HOTEL OR ANY OTHER THAT YOU MIGHT RECOMMEND. WE NEED THE FOLLOWING ACCOMMODATIONS:

(1) NEW DELHI--(9 NIGHTS) FRIDAY, NOV. 29 TO SUNDAY, DEC. 8; 1 SUITE (MR. HUBERT NEISS, MISSION CHIEF) AND 7 SINGLES (MESSRS. BROWNE, SCHULZ, HICKLIN, HEMMING, TIWARI, IBRD REPRESENTATIVE, AND MISS ALLEN);

(2) NEW DELHI--(3 NIGHTS) TUESDAY, DEC. 10 TO FRIDAY, DEC. 13; 1 SUITE (MR. HUBERT NEISS) AND 8 SINGLES (SAME NAMES AS ABOVE BUT ADD MR. TUN THIN).

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DRAFTED BY NAME (TYPE): TThin EXT.: 7600 DEPT.: ASD DATE: 10/23/85

AUTHORIZED BY NAME (TYPE): Tun Thin AUTHORIZED BY NAME (TYPE): ( )

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SEC. 48 REV 1 11-18-82

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MR. SURENDAR SINGH
NEW DELHI, INDIA
PAGE - 2 -

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(3) JAIPUR: 2 NIGHTS--DEC. 13 AND 14--7 SINGLES (MESSRS. BROWNE, SCHULZ, HICKLIN, HEMMING, TIWARI, IBRD REPRESENTATIVE, AND MISS ALLEN); AND 1 NIGHT ONLY--DEC. 13--2 SINGLES (MESSRS. TUN THIN AND NEISS), ALL AT THE RAMBAGH PALACE IN THE NEW WING.

(4) NEW DELHI: (1 NIGHT) DECEMBER 14--2 SINGLES (MESSRS. TUN THIN AND NEISS); AND 1 NIGHT, DECEMBER 15--7 SINGLES (SAME 7 NAMES AS GIVEN ABOVE).

FOR BOMBAY, WE HAVE 1 SUITE AND 8 SINGLES CONFIRMED AT THE TAJ MAHAL FOR FOR TWO NIGHTS, DEC. 8 AND 9.

THANK YOU VERY MUCH FOR YOUR ASSISTANCE.

DETAILS OF OUR ARRIVAL TIMES WILL BE CABLED TO YOU SOON.

REGARDS.

TUN THIN
DIRECTOR
ASIAN DEPARTMENT
INTERFUND

IF REQUIRED INITIAL BELOW

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C TELEX NO.: CABLE ADDRESS:

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Office Memorandum

cc: Mr. Brau

October 11, 1985

MEMORANDUM FOR FILES

SUBJECT: Meeting of Indian Delegation with Managing Director

After some discussion of broad issues of Fund policies and the world economy, the meeting turned to a review of the Indian economy. The Finance Minister, who led the Indian delegation, said that the 1985/86 budget had been well received. Besides the tax changes introduced in the budget, another important recent change of policy was a move away from discretionary to nondiscretionary controls. Also, the authorities were trying to provide a long-term framework to economic policies: a three-year policy for exports and imports had been laid before Parliament and a long-term fiscal policy for the period of the Plan was being formulated. The new policies had passed two crucial tests: tax collections had increased sharply and inflation had come down. The Managing Director welcomed all these developments.

The meeting, which was also attended by Messrs. Tun Thin, Brau, and Narvekar, lasted about 25 minutes.

PRN

P.R. Narvekar

cc: The Deputy Managing Director
ETR
Mr. Brown

#93748 #93748

TELEGRAMS:
"RESERVBANK"

RESERVE BANK OF INDIA
SECRETARY'S DEPARTMENT
CENTRAL OFFICE BUILDING
POST BAG NO.10007
BOMBAY-400023

TELEPHONE
295602/04

Ref.No.SYD.BD/ 6396 /B.3-84/85

April 30, 1985
Vaishakha 10,1906

ORIG: ASD
CC: MD
DMD
MR. SENGUPTA
ETR
TRE
SEC
MR. DANNEMANN
MR. BOUTER
MR. BAGARES
MR. COLLINS

Mr. Jacques de Larosiere,
Managing Director,
International Monetary Fund,
19th and H Streets, N.W.,
Washington D.C. 20431.

Dear Sir,

We advise that Dr. P.D. Ojha who has been appointed as Deputy Governor of the Bank for a period of five years has assumed charge with effect from the forenoon of 29th April 1985.

Yours faithfully,

(B. Ray)
Secretary

Office Memorandum

To : Mr. Anjaria

February 26, 1985

From : Arne B. Petersen

Subject: India: USTR Response to Questionnaire

The USTR response to the Indian questionnaire is worded too cautiously and takes great pains to stay within the framework of current Indian policies. While describing fairly well the inefficiencies resulting from present policies, the response does not draw the logical conclusion that more sweeping reforms are needed. For example, the section on import liberalization discusses the need to liberalize intermediate goods, especially for export producers, but does not mention the need to open up the domestic market to competition from foreign consumer goods. The discussion of the exchange rate policy pays too much heed to the "complex effects domestically," and falls short of Mr. Dallara's Board statement. Also, the discussion of industrial regulation (bottom of page 3) suggests one more complication (in the form of exemptions for export potential or performance), rather than stressing the need for general liberalization. If it is felt necessary to make recommendations for improvements within the framework of existing policies, I think it should be stressed that this is what is being done; even then, it would be useful to hint at more desirable solutions.

तार
TELEGRAMS } "RESERVBANK"

टेलीफोन
TELEPHONE } ~~xxxxxxxxx~~ 295602

टेलेक्स
TELEX } 011-2455
011-2318

कृपया उत्तर में लिखें।
Please quote in reply.
संदर्भ सं.
Reference No. SYD.BD/ 4605 /B.1-84/85

भारतीय रिज़र्व बैंक
केंद्रीय कार्यालय, सचिव विभाग
बंबई सं. 400 001.

RESERVE BANK OF INDIA

CENTRAL OFFICE
SECRETARY'S DEPARTMENT
BOMBAY NO- 400 001.

#92253

पोस्ट बॉक्स
Post Box } 10007

February 4, 1985.
Magha 15, 1906 शक/Saka

Mr. Jacques de Larosiere,
Managing Director,
International Monetary Fund,
19th and H Streets, N.W.,
Washington D.C. 20431.

Dear Sir,

We advise that Shri A. Ghosh has relinquished charge of the office of Governor of the Reserve Bank of India on February 4, 1985 and that Shri R.N. Malhotra who has been appointed in his place for a period of five years has assumed charge as Governor of the Bank with effect from the same day.

Shri Ghosh who has been reappointed as Deputy Governor of the Bank assumed charge of the office of Deputy Governor with effect from February 4, 1985.

RECEIVED
INTERNATIONAL MONETARY FUND
85 FEB 11 PM 3:57
COMMUNICATIONS DIVISION

ORIG: ASD
CC: MD
DMD
MR. SENGUPTA
ETR
TRE
SEC
MR. DANNEMANN
MR. BOUTER
MS. BAGARES
MR. S. COLLINS

Yours faithfully,

[signature]

(A. Balamitran)
Secretary

तार
TELEGRAMS } "RESERVBANK" 91983

टेलीफोन
TELEPHONE } 268311

टेलेक्स
TELEX } 011-2455
011-2318

कृपया उत्तर में लिखें।
Please quote in reply.
संदर्भ सं.
Reference No. SYD.BD/3922/B.1-84/85

भारतीय रिज़र्व बैंक
केंद्रीय कार्यालय, सचिव विभाग
बंबई सं. 400 001.
RESERVE BANK OF INDIA
CENTRAL OFFICE
SECRETARY'S DEPARTMENT
BOMBAY NO- 400 001.

91983 पोस्ट बॉक्स
Post Box } 406

January 15, 1985

Pausa 25, 1906 शक/Saka

Mr. Jacques de Larosiere,
Managing Director,
International Monetary Fund,
19th and H Streets, N.W.,
Washington D.C. 20431.

RECEIVED
JAN 23 1985
EXCHANGE & TRADE RELATIONS

Orig: ASD

cc: MD
DMD
Mr. Malhotra
ETR
EXR
LEG
RES
SEC
TRE
Mr. Collins
Mr. Dannemann

Dear Sir,

We advise that Dr. Manmohan Singh has relinquished charge of the office of Governor of the Reserve Bank of India on January 14, 1985 and that Shri A. Ghosh who has been appointed in his place has assumed charge as Governor of the Bank with effect from January 15, 1985.

Yours faithfully,

A Balamitran

(A. Balamitran)
Secretary

Rdm/

Mr. Scott January 9, 1985

Eduard Brau

India--Staff Report for 1985
Article IV Consultation

This draft seems to me very thorough and highly readable, as well as convincing on the substance. I have commented in a few places in the attached copy of the report, also making small editorial suggestions, which we could discuss further.

I have one general comment, without making detailed drafting suggestions on it. In the staff appraisal, the staff's position on issues related to efficiency and competitiveness is clearly stated, whereas the authorities' general reactions are not. I recognize that the body of the staff report describes the authorities' views; however, the appraisal should give somewhat more prominence to repeating the authorities' views in general terms. Otherwise, the staff appraisal would end up on the note (which could seem somewhat magisterial) of suggesting to the authorities that the new Plan happily affords them an opportunity to carry out all the suggestions.

Attachment

INTERNATIONAL MONETARY FUND

January 10, 1985

Mr. Brau:

Mr. Bonvicini has reviewed the India staff report, and his comments are attached.

I should note that I have seen reports in the press that the Indians are about to move on some trade liberalizing measures--this may deserve mention.

It would be helpful to have some discussion of restrictive matters in the appraisal in addition to lines 8 and 9 on page 38. In this connection I am not sure that the "further" in the last line of the proposed decision is appropriate, given the apparently limited nature of the measures mentioned (but not described) on pp. 21 and 22.

Att.

Peter J. Quirk

Office Memorandum

TO : Mr. Quirk

FROM : J. Bonvincini

DATE: January 10, 1985

SUBJECT : India - Staff Report

I found this report to contain a comprehensive review of the economic program implemented in support of the extended arrangement and performance under it. The section on policy discussions, on the other hand, seems exceedingly long and lacking specificity in outlining objectives and policies of the authorities. Similarly, the staff appraisal might benefit from some pru~~n~~ning and, especially from a somewhat stronger presentation of the staff's opinion as regards the policy stand of the authorities in a number of areas. It should be pointed out that the staff appraisal does not contain any reference to the staff's assesment of India's exchange and trade system.

cc: Mr. Beacker
Ms. Dillon
Mr. Quirk

Office Memorandum

TO: Mr. Dannemann
Mr. Tanzi
Mr. Brau
Mr. Leddy
Mr. Silard

January 7, 1985

FROM: Douglas A. Scott DAS

SUBJECT: India: Staff Report for 1985 Article IV Consultation

Attached is a copy of the draft Staff Report for the 1985 Article IV consultation with India. I would appreciate receiving your comments by noon, Thursday, January 10, 1985.

Attachment

1984

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THE BOX

DR. C. RANGARAJAN
DEPUTY GOVERNOR
RESERVE BANK OF INDIA
BOMBAY, INDIA

DISPATCHED BY
OCT -5 PM 3 42

MARK XX FOR CODE
(_______) CODE

DISTRIBUTION

CC:ASD
ETRD
Files

DO NOT TYPE HERE

START TEXT HERE

I AM SORRY FOR THE DELAY IN RESPONDING TO YOUR REQUEST FOR THE DATA UNDERLYING THE CHARTS ON THE SIMULATIONS. THIS IS BECAUSE I COULD NOT FIND THE ORIGINAL PRINTOUTS. HOWEVER, I HAVE NOW RERUN THE SIMULATION PROGRAM AND THE RESULTS ARE SLIGHTLY BETTER. HOWEVER, THE CHARTS YOU HAVE NEED NOT BE CHANGED BECAUSE THE DIFFERENCE IS VERY SLIGHT. TABLE 6 OF THE PAPER WHICH PRESENTS THE RESULTS OF THE SIMULATION EXERCISE COULD, HOWEVER, BE CHANGED AS FOLLOWS:

AGGREGATE	- MEAN ABSOLUTE ERROR-	-ROOT MEAN -SQUARE ERROR
M1	0.11	0.15
M3	0.48	0.70

THE DATA UNDERLYING THE SIMULATION CHARTS ARE AS FOLLOWS: (RS.CRORES)

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO.: CABLE ADDRESS:

DRAFTED BY * NAME (TYPE): ALL DETAILS TO BE COMPLETED ON FIRST PAGE PLEASE EXT.: DEPT.: DATE:

AUTHORIZED BY * NAME (TYPE): AUTHORIZED BY NAME (TYPE): * ( )

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log

C. 48 REV 1
11-18-82

*

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THE BOX

DR. C. RANGARAJAN

PAGE -2-

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( ) CODE

DISTRIBUTION

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-	-M1 ACTUALS	-M3 SIMULATED	-M3 ACTUALS	-M3 SIMULATED
1973 Q1	8466		15,703	
1973 Q2	8467	8620	16,146	17,090
1973 Q3	8582	8772	16,698	18,191
1973 Q4	9089	9231	17,332	19,396
1974 Q1	9745	9976	18,305	20,902
1974 Q2	9650	9654	18,487	21,431
1974 Q3	9344	9541	18,747	21,739
1974 Q4	9676	9766	19,290	22,223
1975 Q1	10,165	10,282	20,248	23,064
1975 Q2	10,046	10,077	20,676	23,278
1975 Q3	10,032	10,096	21,238	23,492
1975 Q4	10,335	10,281	21,980	23,840
1976 Q1	11,084	11,131	23,522	24,973
1976 Q2	11,172	11,331	24,500	25,755
1976 Q3	11,600	11,532	25,900	26,461
1976 Q4	12,083	12,118	26,858	27,544

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C. 48 REV 1 11-18-82

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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DR. C. RANGARAJAN

PAGE -3-

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-	M1	M1	M3	M3
-	ACTUALS	SIMULATED	ACTUALS	SIMULATED
1977 Q1	12,910	12,806	28,663	28,901
1977 Q2	12,640	12,717	29,422	29,557
1977 Q3	13,286	13,282	30,826	30,663
1977 Q4	13,795	13,545	32,139	31,570
1978 Q1	14,838	14,768	34,173	33,498
1978 Q2	14,686	14,663	35,117	34,394
1978 Q3	15,737	15,263	37,180	35,717
1978 Q4	16,843	16,310	39,188	37,659
1979 Q1	17,903	17,785	41,383	40,391
1979 Q2	18,216	18,051	43,094	42,217
1979 Q3	18,407	18,739	44,436	44,197
1979 Q4	19,376	19,451	46,245	46,205
1980 Q1	20,309	20,332	48,332	48,424
1980 Q2	19,799	19,784	49,149	49,053
1980 Q3	20,971	20,958	51,600	51,031
1980 Q4	22,397	22,228	54,294	53,572

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C TELEX NO.: CABLE ADDRESS:

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WASHINGTON, D. C. 20431

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DR. C. RANGARAJAN

PAGE -4-

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DISTRIBUTION

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-	-	M1	M1	M3	M3
-	-	ACTUALS	SIMULATED	ACTUALS	SIMULATED
1981	Q1	23,716	23,651	57,248	56,659
1981	Q2	23,392	23,526	58,673	58,255
1981	Q3	24,126	24,937	60,608	61,075
1981	Q4	24,546	24,614	61,706	62,223

HOPE THE ABOVE WILL BE SUFFICIENT TO ENABLE YOU TO FINALIZE THE PAPER. WITH MY BEST REGARDS.

ANOOP SINGH

INTERFUND

DO NOT TYPE HERE

SPECIAL INSTRUCTIONS ... TEXT MUST END HERE

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): A.Singh:sh EXT.: 7321 DEPT.: ASD DATE: 10/5/84

AUTHORIZED BY NAME (TYPE): A.Singh

AUTHORIZED BY NAME (TYPE):

(**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log ______

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

Office Memorandum

cc: Mr Brau
Mr Quirk

TO: Mr. Finch

July 13, 1984

FROM: A. Vasudevan

SUBJECT: India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 13th July 1984:

Spot buying Rs. 100 = pounds 6.7295 (pound 1 = Rs. 14.86)

Spot selling Rs. 100 = pounds 6.6934 (pound 1 = Rs. 14.94)

Middle rate pound 1 = Rs. 14.90."

CC: Mr. Tun Thin
Treasurer's Office

Office Memorandum

cc: Mr Quirk
Mr Brau

TO: Mr. Finch — July 12, 1984

FROM: A. Vasadevan

SUBJECT: India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 12th July 1984:

Spot buying Rs. 100 = pounds 6.7751 (pound 1 = Rs. 14.76)

Spot selling Rs. 100 = pounds 6.7385 (pound 1 = Rs. 14.84)

Middle rate pound 1 = Rs. 14.80."

CC: Mr. Tun Thin
Treasurer's Office

Office Memorandum

cc: Mr Brau
Mr Quirk

TO: Mr. Finch — July 9, 1984

FROM: A. Vasudevan AV.

SUBJECT: India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 9th July 1984:

Spot buying Rs. 100 = pounds 6.7522 (pound 1 = Rs. 14.81)

Spot selling Rs. 100 = pounds 6.7159 (pound 1 = Rs. 14.89)

Middle rate pound 1 = Rs. 14.85."

CC: Mr. Tun Thin
Treasurer's Office

RECEIVED
JUL 9 1984
EXCHANGE & TRADE RELATIONS

cc: Mr Brau
Mr Quirk

Office Memorandum

TO : Mr. Finch DATE: July 6, 1984

FROM : A. Vasudevan A.V.

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 6th July 1984:

Spot buying Rs. 100 = pounds 6.7295 (pound 1 = Rs. 14.86)

Spot selling Rs.100 = pounds 6.6934 (pound 1 = Rs. 14.94)

Middle rate pound 1 = Rs. 14.90."

cc: Mr. Tun Thin
Treasurer's Office

RECEIVED
JUL 6 1984
EXCHANGE & TRADE RELATIONS

cc: MR BRAU
MR QUIRK

Office Memorandum

TO : Mr. Finch

DATE: July 5, 1984

FROM : A. Vasudevan

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

> "We furnish below the rates for our intervention currency pound sterling effective 4th July 1984:
>
> Spot buying Rs. 100 = pounds 6.6622 (pound 1 = Rs.15.01)
>
> Spot selling Rs.100 = pounds 6.6269 (pound 1 = Rs.15.09)
>
> Middle rate pound 1 = Rs. 15.05."

cc: Mr. Tun Thin
Treasurer's Office

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

June 26, 1984

FROM: Duncan Ripley

SUBJECT: India Aid Consortium Meeting, June 19-20, 1984

Mr. Bernier

Prologue

At a meeting with the Indian delegation prior to the Consortium Meeting, Mr. Kaul, the Finance Secretary, indicated that the second half of October would be a suitable time for the next Article IV consultation mission. Precise dates will be communicated from Delhi after the return of the delegation.

Statements by delegations

The written statements of the Indian authorities and the IBRD touched on a number of interesting issues. With regard to the efficiency of investment, the Bank noted that although the share of investment in GDP had increased from 11 to 24 percent over the last 30 years, real GDP growth had averaged only 3.5 percent. The difficulties in increasing direct tax revenue, which accounts for only 3 percent of GDP, were thoroughly reviewed. The authorities were somewhat ambivalent as to whether expenditures should be financed by additional tax revenues, or by tapping private sector savings through borrowing. Techniques for reducing the cascading of indirect taxes are again under study.

The authorities noted that they had increased very substantially their external borrowing on commercial terms, but that such borrowing was inappropriate for investments not directly yielding foreign exchange. The authorities also noted that the EFF had provided short-term funds, whereas they were in need of long-term developmental assistance on concessional terms. They commented a number of times on the deteriorating quality of aid (tied aid, a lower grant component in concessional aid, mixed credits) and the Bank group noted that, particularly with reduced reliance on IDA, the debt servicing burden for India would increase markedly. Both the donor countries and the Indian authorities suggested that measures should be taken to facilitate the transfer of technology.

Generally, the statements of country delegations were much as expected. Most commended the authorities for the good agricultural performance; the deceleration of inflation; the strengthening of the balance of payments and with it the cancellation of the third year of the EFF; and the trend toward liberalization. The performance of exports, and particularly the growth of the industrial sector gave rise to worries. Export growth was seen as crucial to the growth strategy, and it was only through real growth that the pressing problem of poverty could be addressed. (The treatment of poverty in the IBRD reports was applauded by most delegations.) The Bank gave a figure of 8 percent volume growth as the minimum rate consistent with real GDP growth of 5 percent, and a viable external balance. The authorities pointed to specific measures to enhance export incentives, and did not think that the exchange rate was out of line. They did not comment on the profit differential in favor of goods sold on the domestic market.

The authorities were encouraged to focus in the Seventh Five-Year Plan on modernizing existing capacity and increasing capacity utilization. The challenge of increasing efficiency was seen to be particularly great in public sector enterprises.

Financial situation and outlook

It was widely noted that bureaucratic difficulties in donor countries and in India delayed aid disbursements. In 1983 bilateral government disbursements had fallen short of the "indications" given at the consortium meeting by $490 million, whereas previously the indications had generally been regarded as a floor. Additional Bank disbursements had largely filled the gap in 1983. "Indications" of bilateral donors for 1984 had remained constant at $1.2 billion (gross) with the total commitment being increased to $4 billion on account of an increase in the Bank Group contribution (against a total of $3.7 billion in 1983). The grant element, however, would be lower.

cc: Messrs. Tun Thin
Narvekar
Palmer
Collins

Mr. Palmer
Mr. Quirion
cc: Ms. Kelley

Office Memorandum

To: Mr. Tun Thin April 13, 1984

From: W. O. Habermeier

Subject: India

I understand from you that the Managing Director does not favor taking any initiative at this time with the Indian authorities in relation to the intended purchase or to possible early repurchase.

Bearing in mind that India has given up the possibility of using the final SDR 1.1 billion under the extended arrangement, I see no strong reason to raise with the Indians whether they should proceed with the purchase at the end of April. Moreover, we may not have sufficient information to formulate a definitive judgement on the requirement of need; there may have been special factors that caused the increase, and these may be reversed in the near future.

As regards early repurchase, we agreed that this matter would not be raised with the Indian authorities for the time being. We shall examine whether India's gross reserves and balance of payments position is "sufficiently strong" in good time before the next Operational Budget. If the reserves continue to rise we may well come to the conclusion that India's position is sufficiently strong for it to start reversing its indebtedness to the Fund.

In the meantime, I would like to draw your attention to the following in connection with early repurchases.

(i) The early repurchase decision provides for a six months grace period from the end of a quarter in which the last purchase has been made by the member. If the purchase is made at end-April, early repurchase would not start until the quarter starting December 1984, assuming India's position is sufficiently strong.

(ii) Only a very small part of the additional purchase would be reversed in the first quarter (see attachment). Reversal is going to be very slow unless India's reserves rise dramatically.

(iii) Early repurchases under the present decision are not be to carried to the point at which a country's reserves would fall below 250 percent of the member's quota. Based on end-March reserves, and assuming the SDR 200 million is purchased and added to reserves, this limitation means there is only scope for early repurchases of somewhat less than SDR 500 million compared to about SDR 4.0 billion in purchases that will be outstanding at the end of the year.

Attachment

cc: The Deputy Managing Director
Mr. Palmer

India - Calculations in Accordance with Guidelines on
Early Repurchases for a Hypothetical Budget Period*

(In millions of SDRs)

Member	Quota (1)	Amount Outstanding Subject to Repurchases (2)	Gross Reserves 1/ (3)	Change in gross Reserves Over Last Six Months (4)	1.5% of Gross Reserves (5)	5% of Change in Gross Reserves (6)	Calculated Early Repurchase total Col. (5) & Col. (6) (7)	'Credit' for Advance Repurchase (8)	Maturing Obligations (9)	Expected Early Repurchase (10)
India	2,207.7	3,799.8 2/	5,796	432	86.9	21.6	108.5	--	33.3	75.2
		3,999.8 3/	5,996 3/	434	89.9	21.7	111.7	--	33.3	78.4

* Assuming India is considered sufficiently strong for the December 1984 - February 1985 quarterly period.
1/ Data as of March 31, 1984 as provided by the Asian Department.
2/ Assuming no further purchases.
3/ Including a further purchase of SDR 200 million.

cc: Mr. Frisch
Mr. Guitian
Ms. Kelly

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

April 10, 1984

FROM: Tun Thin

SUBJECT: April Purchase Under the EFF

As pointed out in the brief forwarded to you yesterday, India's gross reserves rose by SDR 800 million in the quarter ending March 31 (by SDR 900 million during the 1983/84 fiscal year). This raises the issue of balance of payments need in connection with the end-April drawing of SDR 200 million. This question was touched on informally with some members of the delegation yesterday.

We cannot, of course, challenge representation of need by India if the authorities were to make one. However, I think you may wish to point out to them this afternoon that if they proceed with the drawing, this will increase any early repurchase obligations to which India may become subject.

cc: Mr. Habermeier
Mr. Palmer
Mr. Collins

Mr. Finch

Office Memorandum

TO : The Managing Director
The Deputy Managing Director

DATE: April 10, 1984

FROM : Donald K. Palmer DKP

SUBJECT : India--Balance of Payments Need

The briefing memorandum prepared by the Asian Department contains the surprising information that "Gross reserves increased by SDR 900 million in 1983/84 against a revised program estimate of January for an increase of SDR 150 million." The reference to the "estimate of January" is the staff paper which was discussed by the Executive Board on January 27, 1984; shortly thereafter India purchased SDR 400 million. The briefing memorandum also notes that India is expected to draw SDR 200 million before the extended arrangement is cancelled.

The sharp increase in gross reserves during the January-March quarter raises the policy issue of whether India has a balance of payments need which would support a purchase of the remaining SDR 200 million. An appropriate course would be for the staff of the concerned departments to review this issue and submit a recommendation for your consideration.

cc: Mr. Habermeier
Mr. Tun Thin
Mr. Collins

bcc: Messrs. Finch, Guitian, Kelly

Office Memorandum

TO: Mr. Tun Thin

April 9, 1984

FROM: Duncan Ripley DR

SUBJECT: Brief for the Managing Director's Discussion with the Indian Authorities

Please find attached the requested Brief for your initials.

It has been cleared with Ms. Kelly of ETR, in Mr. Palmer's absence.

Attachment

cc: Ms. Kelly

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

April 9, 1984

FROM: Tun Thin

SUBJECT: India--Visit by the Indian Delegation

Mr. Pranab Mukherjee, Indian Finance Minister is scheduled to call on you at 4:00 p.m., Tuesday, April 10. Other members of the Indian delegation that may be present include, P.K. Kaul, (Finance Secretary), Mr. Jalan (Chief Economic Advisor) and Governor Manmohan Singh of the Reserve Bank of India. We understand that there are no particular issues with respect to India that the delegation wishes to raise.

1. Political developments in India

Elections for the lower house must be held by early 1985. No precise time has been set, but it is probable that they will be scheduled for November. The budget for fiscal year 1984/85 (April-March) that was just introduced is admittedly an election year budget.

The timing of the election may be influenced by developments in the Punjab and adjoining States. There has been increasing violence between radical Sikhs, seeking autonomy or even independence for an extended Punjab, and more moderate Sikhs, and Hindus. A state of emergency in the Punjab has just been declared.

2. Fund relations

Assuming compliance (which is virtually assured) with the performance criteria of the last annual program (ending March 31, 1984) under the EFF, India is expected to draw SDR 200 million at the end of April. As you know, the extended arrangement is to be cancelled following this purchase; the arrangement would have expired in November 1984.

Repayments of the EFF loan are scheduled to begin in May 1985. SDR 231 million is due in FY 1985/86 and SDR 431 million in 1986/87; a peak of SDR 800 million will be reached in 1988/89.

A staff visit is planned for the second half of May to discuss, inter alia, the 1984/85 budget, the trade policy for 1984/85, the monetary program for the coming months and balance of payments developments. A paper is planned for the information of the Board.

3. The Indian economy

Real GDP growth in 1983/84 is estimated at some 6-6 1/2 percent, an outturn that reflects mainly the sharp recovery in agricultural output after a severe drought in 1982/83; the growth of industrial activity appears to have picked up during the course of the year.

Following a remarkably favorable price performance in 1982/83, price developments have recently been less satisfactory and the authorities have become increasingly concerned about inflation. The WPI index has been increasing at about 10 percent per annum while the increase in the consumer price index reached 12 1/2 percent in December 1983. The lagged effects of reduced supplies of some key agricultural commodities following the drought in 1982/83 may explain part of the acceleration of inflation, but more rapid than envisaged monetary growth in the first ten months of 1983/84 was also a factor. This expansion took place notwithstanding a number of restraining measures implemented by the Reserve Bank of India during the course of the year. Monetary expansion has been fueled by a smaller than expected decline in net foreign assets, whereas domestic credit has remained well within the limits of the monetary program.

In response to higher rates of inflation and the prospect of substantially overshooting the target for the 1983/84 budget deficit, the Government issued instructions in January 1984 that public sector expenditures should be drastically cut back in the remaining two and one half months of the fiscal year. In the event, the budget deficit of the Central Government is thought to have exceeded 7 percent of GDP, thus overshooting the budget estimate by more than 1 percentage point; a marginally better outturn (7 percent of GDP) is envisaged in the 1984/85 budget. In the absence of additional supporting measures it seems unlikely that the deficit of the Central Government will be contained at this level. State budgets deficits could also rise significantly.

The labor relations situation has recently deteriorated. Production in the organized jute sector has come to a halt and all major ports have been essentially closed since mid-March.

The balance of payments outcome for 1983/84 is now projected to have been more favorable than earlier expected. [Gross reserves increased by SDR 900 million in 1983/84 against a revised program estimate of January for an increase of SDR 150 million.] The current account deficit is likely to have been below the revised program estimate of 1.9 percent of GDP, but information is partial. Further, unexpectedly large inflows of nonresident deposits may also have contributed to the substantially smaller than projected overall balance of payments deficit.

The real effective exchange rate appreciated by about 1 percent during the 1983/84 program and in February was some three percentage points above the level at the beginning of the EFF.

4. Possible topics for discussion

You may wish to review with the delegation the recent Article IV consultation discussions, and note that the Board welcomed the decision of the Indian authorities to cancel the extended arrangement following the more rapid than expected improvement in the external position. Executive Directors had generally spoken very favorably of India's performance under the extended arrangement. However, the hope was expressed that adjustment efforts would not be relaxed.

While the balance of payments position has indeed improved faster than expected, structural weaknesses persist. The improvement in the current account reflects to a large extent higher domestic oil production which will soon peak, and workers' remittance from the Gulf countries that are expected to weaken. There is clearly a need for a further substantial reduction in the current account deficit if there is not to be a rapid increase in India's debt service burden. Thus the need for a continuing review of export incentives might usefully be stressed.

You may also wish to emphasize the need for cautious financial policies in 1984/85 if inflation is to be kept under control. Financial policies became somewhat more expansionary in 1983/84 and prospects are for a more expansionary budget in 1984/85 than envisaged in the budget document. A setback on the inflation front would endanger much of what had been achieved during the period of the extended arrangement.

cc: Mr. Narvekar
Ms. Ripley
Mr. Collins

APR 11 1984

487949

No.6/3/84-F.B.I.

ORIG: ASD
CC: MD
DMD
MR. MALHOTRA
~~ETR~~
FAD
LEG
RES
SEC
TRE MR. S. COLLINS

487949

Mr. Thu Thi
Mr. Habermeier

वित्त मंत्री
भारत
MINISTER OF FINANCE
INDIA
NEW DELHI-110001

APRIL 6 , 1984.

Dear Mr. De Larosiere,

The Government of India had entered into an Extended Arrangement for a loan of SDR 5 billion with the International Monetary Fund in November 1981 in support of a balance of payments adjustment programme. The arrangement is now in its third year. During this period, there has been considerable progress. The Economy has achieved an average rate of growth of almost 5 per cent over the three fiscal years ending March 1984. Marked increases in public savings enabled us to attain high rates of investment, particularly in sectors critical for adjustment, without resort to excessive domestic or foreign borrowing. There has been a large growth in the domestic production of petroleum, a major increase in the level of foodgrains production, and fairly high rates of national savings. Notable gains in capacity and output had been achieved in coal, fertilizer and cement. Substantial new electric power and irrigation capacities were added. These developments have been reflected in a faster than expected improvements in the balance of payments position in fiscal year 1983-84. A further improvement is expected next year.

2. As conveyed to you earlier, the Government has decided not to avail of any further drawings beyond those envisaged in the current year's programme. Accordingly, I would like to notify you that the Government of India wishes to cancel as of May 1, 1984 the Extended Arrangement approved by the Fund on November 9, 1981. As a result of this decision, committed resources of SDR 1.1 billion would be released. We hope that this would strengthen the Fund's liquidity position and its ability to provide assistance to member countries in need.

3. I would like to take this opportunity to convey to you the Government's appreciation of the understanding and cooperation we have received from you personally and the Fund staff in the course of the Extended Arrangement. This testifies eloquently to the leadership you have provided to the Fund in these difficult times.

With regards.

Yours sincerely,

Pranab Mukherjee

(PRANAB MUKHERJEE)

Mr. J de Larosiere
Managing Director
International Monetary Fund
700 19th St. N.W.
WASHINGTON D.C. 20431.

~~GP~~ file

Office Memorandum

TO : Mr. Finch

DATE: March 19, 1984

FROM : V. Govindarajan SY

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 19th March 1984:

Spot buying Rs. 100 = pound 6.4475 (pound 1 = Rs. 15.51)

Spot selling Rs. 100 = pound 6.4144 (pound 1 = Rs. 15.59)

Middle rate pound 1 = Rs. 15.55."

CC: Mr. Tun Thin
Treasurer's Office

GB file

Office Memorandum

TO : Mr. Finch

DATE: March 16, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 16th March 1984:

Spot buying Rs. 100 = pound 6.4061 (pound 1 = Rs. 15.61)

Spot selling Rs. 100 = pound 6.3735 (pound 1 = Rs. 15.69)

Middle rate pound 1 = Rs. 15.65."

CC: Mr. Tun Thin
Treasurer's Office

~~EGR~~
2. file

Office Memorandum

TO : Mr. Finch DATE: March 14, 1984

FROM : V. Govindarajan SG

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 14th March 1984:

Spot buying Rs. 100 = pound 6.3857 (pound 1 = Rs. 15.66)

Spot selling Rs. 100 = pound 6.3532 (pound 1 = Rs. 15.74)

Middle rate pound 1 = Rs. 15.70."

CC: Mr. Tun Thin
Treasurer's Office

INTERFUND WSH

599947

RECEIVED
IMF CABLE ROOM
1984 MAR 10 AM 8:43

RCA MAR 10 0518

INTERFUND WSH

ORIG: ASD

248423 WORLDBK

cc: Mr. Pa[illegible] CC: MD

WASHINGTON DC 09 MAR 84

Mr. Guetan DMD

MR TUN THIN,1

Mr. Brau ETRD

INTERFUND WSH

EXR
FAD
LEG

RESTARTING

RES
SEC
MR.ZEGERS
MR.COLLINS

WASHINGTON DC 09 MAR 84
MR TUN THIN DIRECTOR
ASIAN DEPT INTERNATIONAL MONETARY FUND
WASHINGTON DC
(COPY TELEX BY MAIL)
PAGE 1 OF 1

RE INDIA, BURMA, SRI LANKA AID GROUP MEMBERS

I WISH TO CONFIRM THAT THE AID GROUP MEETINGS ON INDIA AND SRI LANKA WILL BE HELD THE WEEK OF JUNE 18 IN THE BANK'S PARIS OFFICE, BUT THE BURMA MEETING WILL BE POSTPONED AT THE REQUEST OF THE GOVERNMENT. THE MEETING ON INDIA WILL BE HELD AS SCHEDULED ON TUESDAY AND WEDNESDAY, JUNE 19 AND 20. THE MEETING ON SRI LANKA WILL BE ADVANCED TO THURSDAY, JUNE 21. WE WILL BE ADVISING YOU OF THE NEW DATE FOR THE AID GROUP MEETING ON BURMA AS SOON AS IT IS DETERMINED.

REGARDS, WIEHEN, DIRECTOR, SOUTH ASIA PROGRAMS

INTERFUND WSH

248423 WORLDBK.....

INTERFUND WSH

,,,

~~bp~~
file

Office Memorandum

TO : Mr. Finch

DATE: March 8, 1984

FROM : C.J. Batliwalla CJB

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 8th March 1984:

Spot buying Rs. 100 = pound 6.3857 (pound 1 = Rs. 15.66)

Spot selling Rs. 100 = pound 6.3532 (pound 1 = Rs. 15.74)

Middle rate pound 1 = Rs. 15.70."

CC: Mr. Tun Thin
Treasurer's Office

GB
file

Office Memorandum

TO : Mr. Finch

DATE: March 12, 1984

FROM : V. Govindarajan SG

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish -elow the rates for our intervention currency pound sterling effective 12th March 1984:

Spot buying Rs. 100 = pound 6.4061 (pound 1 = Rs. 15.61)

Spot selling Rs. 100 = pound 6.3735 (pound 1 = Rs. 15.69)

Middle rate pound 1 = Rs. 15.65."

CC: Mr. Tun Thin
Treasurer's Office

GB
file

Office Memorandum

TO : Mr. Finch DATE: March 7, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 7th March 1984:

Spot buying Rs. 100 = pound 6.3251 (pound 1 = Rs. 15.81)

Spot selling Rs. 100 = pound 6.2933 (pound 1 = Rs. 15.89)

Middle rate pound 1 = Rs. 15.85."

CC: Mr. Tun Thin
Treasurer's Office

INTERNATIONAL MONETARY FUND

TO : Mr. Palmer March 8, 1984

FROM: Margaret Kelly MRK

I have no major problems with the article by Mr. Baumgartner and Mr. Zavadjil on India which is well written and provides a short, but complete, description of the economic difficulties prior to the approval of the EFF, the main features of the adjustment program, its results, and the current economic approach. The paper stops short of attributing any of the decline in export volume in 1982/83 to competitiveness factors (page 9), but it would probably not be a good idea to debate this issue in an IMF Survey article. For the future, the paper stresses the importance of improved export performance to ensure the further reduction in the current account deficit required to maintain the debt burden within manageable limits (page 11). The only change in the text I would suggest deals with the effect of import liberalization on access to imports (page 8). I would replace the word "over" by "around", as recent import data suggest that the effects of import liberalization on imports are likely to be less than originally estimated.

Office Memorandum

Ms. Kelley

Any serious problems w/ the attached?

[illegible] Palmer

TO: Mr. Tun Thin

March 2, 1984

FROM: Ulrich Baumgartner UB

SUBJECT: IMF Survey Article on India

Attached is a draft of an IMF Survey Article on the EFF with India prepared by Mr. Zavadjil and myself.

I promised External Relations to provide them with the article by Friday March 9.

Attachment

cc: Mr. Palmer
Mr. Narvekar
Mr. Neiss
Mr. Smith (o/r)
Mr. Zavadjil

MI-MZ1 (3/2/84) MZ/CNE

IMF Survey Article on Extended Arrangement with India

Since 1981, the Indian authorities have been implementing a comprehensive adjustment program, with support from the Fund under an extended arrangement. India came to the Fund early; the fundamental objective of the adjustment program was not to achieve an immediate reduction in external deficits, with its unavoidable adverse impact on growth, but rather to carry out a comprehensive policy effort to improve the balance of payments position over the medium term. The efforts made have met with considerable success in strengthening the balance of payments, increasing public savings for the financing of an ambitious investment program in areas essential for external adjustment, and liberalizing imports and industrial regulations. Despite severe drought in 1982/83, average growth (4.5 percent) in the three years 1981/82-1983/84 was higher than in earlier Plan periods. The following survey briefly reviews the sources of the economic difficulties that arose in the period 1979-81, the main features of the adjustment program and its results, and the current economic outlook.

1. Background

The Indian economy performed well in the 1970s with relatively high rates of growth, a substantial increase in the rate of savings and external current account surpluses in the latter part of the decade. The 1979-81 period was, however, more difficult with two major supply disturbances affecting the economy. The second oil price shock had a powerful effect on inflation and the balance of payments, resulting in a tripling of the oil import bill. Severe drought caused by a monsoon failure in 1979 resulted in a sharp fall in agricultural production and made latent supply side problems in the economy acute. Reduced hydro generation of power induced a strong ripple of mutually reinforcing shortages in basic industrial inputs and infrastructure, including energy, steel, cement, and transportation. Real GDP declined by 5 percent in 1979/80, high rates of inflation re-emerged, and the balance of payments weakened in response to the adverse movement in the terms of trade, the shift in the supply position and accomodating financial policies. In 1980/81, economic activity began to recover from the drought, but inflationary pressures persisted and external difficulties intensified. Against this background, India entered in November 1981 into an extended arrangement with the Fund for an amount of SDR 5.0 billion, covering a three year period.

2. The adjustment program

The choice of an adjustment strategy was influenced by the fact that the external position had deteriorated only recently and had not become critical; this provided scope for a flexible approach without the imperatives of crisis. With supply bottlenecks having been a recurring influence, the adjustment strategy included, in addition to the traditional focus on demand management, a balanced attention to policies addressed to the supply side. External adjustment was to be achieved through a growth-oriented strategy which also emphasized a shift in the pattern of resource use in favor of productive investment and the external sector. The program recognized the potential for increasing exports provided by India's diversified industrial structure and agricultural resources and the scope for the replacement of imports of items where India is an efficient producer. Realization of this potential required a step-up of investment not only in export and import substitution industries, but also in areas where bottlenecks had to be overcome. Import policy was to be guided by the need to provide a growing volume of imports to support increased investment and production. Although exports were to increase progressively, the adjustment program provided for a broadly unchanged current account deficit of 2 percent of GDP until 1983/84, after which a gradual reduction was projected. Sizable overall deficits were expected during the life of the extended arrangement. While retaining a basically cautious posture towards external borrowing, larger commercial financing was to be obtained for a number of projects with high rates of return to supplement inflows from concessional sources. In view of the increased external borrowing, the debt service ratio was projected to peak at 16 percent in the late 1980s, a level considered manageable, before receding.

The successful implementation of the adjustment program required a high level of investment. Gross capital formation was projected to increase to 26.5 percent of GDP in 1983/84 from 24.7 percent in 1980/81, while total public Plan outlays during the entire period of the Sixth Development Plan (1980/81-1984/85) were projected to be 80 percent higher in real terms than during the previous Plan. The highest share of Plan expenditure was to be allocated to energy (power, oil, and coal), with rail transport, agriculture and irrigation, and intermediate industries (steel, cement, and fertilizer) being the other priority sectors.

The noninflationary financing of the step-up in investment required a substantial increase in domestic saving. In view of the already high level of private saving, at around 20 percent of GDP, the main burden of the resource mobilization effort was to fall on the public sector. With the scope to mobilize additional tax resources considered limited, the main focus was on reducing subsidies and increasing the profitability of public sector enterprises both by more flexible pricing policy and by improving capacity utilization and efficiency.

The promotion of efficiency and competition and the liberalization of import restrictions were major aims of the program. Private sector investment, production and exports were to be stimulated through the easing of restraints on capacity utilization and expansion and other regulatory constraints. Import policy was to support these objectives by allowing greater access to imports and foreign technology; in particular, more liberal access to imports was to be provided to exporters. Other disincentives for exports, such as domestic and trade taxes, were to be reviewed, and export profitability and competitiveness strengthened. Industrial pricing policies were to aim at improving profitability and promoting more rational use of key products.

Financial policy was to provide a stable,noninflationary environment during the period of adjustment which would facilitate further growth of private savings. The budget deficit was projected to remain at 6-7 percent of GDP which was considered consistent with the expected inflow of foreign aid and the measures to strengthen the performance of small savings and other nonbank sources of budgetary financing. The growth of bank credit to the Government was programmed to be reduced from 28 percent in 1980/81 to 16 percent in 1983/84. To contain inflationary pressures, narrow money was projected to increase at around 11 percent throughout the program period, compared with 17 percent in 1980/81. Broad money was to increase at a higher rate of about 15 percent, allowing for substantial growth in household savings deposits. To stimulate private financial saving, interest rates on deposits of more than one year were raised, and other measures were taken at the outset of the program to support the process of deepening financial intermediation.

3. Results of the program (1981/82-1983/84)

Under the extended arrangement, three annual programs covering the fiscal years 1981/81-1983/84 were formulated. All purchases were made as scheduled, amounting to SDR 3.7 billion through January 30, 1984; a further purchase of SDR 0.2 billion is scheduled for the end of April. The Indian authorities have informed the Fund that they wish to cancel the arrangement following this purchase, because of the more rapid adjustment in India's external accounts than was envisaged at the time of the formulation of the agreement.

In assessing the performance during the period 1981/82-1983/84, account needs to be taken of the unexpectedly harsh external environment and a severe drought in 1982/83. Despite these adverse developments, the balance of payments situation improved markedly, average growth amounted to 4.5 percent and inflation was largely brought under control. Production of foodgrains reached a record level in 1981/82 and another record is expected in 1983/84. The estimated 4 percent fall in real agricultural incomes in 1982/83 was far less than that caused by previous comparable droughts, and the increased resilience of agriculture to the vagaries of the weather is particularly encouraging. After strong growth in 1981/82, industrial production has been more subdued: weak demand both domestic--as a result of the shortfall in agricultural incomes--and foreign played a major role, but production difficulties in several important industries have also been a factor; in the case of electricity, continued shortfalls in generation have affected other industries.

Wholesale price inflation fell dramatically (to less than 3 percent) in the course of the first year of the program partly due to special supply factors; consumer price inflation also declined but less steeply. Inflation has since increased to around 10 percent reflecting mainly renewed pressure on food prices. However, skillful management of the food situation, including through imports of key items, helped to contain inflation. The monetary targets established during the program period have been observed, and the Central Government deficit remained within the originally envisaged range. Monetary and fiscal policy were adopted flexibly to changing circumstances; in particular, following the drought-related slowdown in growth, policies were strengthened in order to maintain the momentum of adjustment.

Plan expenditure rose substantially in the period 1980/81-1983/84 and investment in real terms was considerably higher than in earlier Plan periods. Nevertheless, there were shortfalls from the ambitious targets of the Sixth Plan. Among the key sectors, shortfalls were concentrated in electric power, irrigation and coal. Problems with project implementation were behind some of the shortfalls in the power sector, but resource shortfalls, in particular at the State level, were the major factors. With the demand for railway transport having been substantially less than expected, lower-than-foreseen investment in real terms did not lead to the recurrence of bottlenecks. In contrast with these sectors, an accelerated oil development program resulted in a rapid increase in production, so that the original Plan target for 1984/85 was achieved already in 1982/83, and oil production is expected to exceed by far the original estimates at the end of the Plan period.

A major success of the adjustment program was the increase in public savings for Plan financing from 3.6 percent of GDP in 1980/81 to an estimated 5.6 percent of GDP in 1983/84, somewhat higher than the original program target. The main factor behind this success was the performance of central nonfinancial enterprises, with the oil sector being a large contributor. In contrast, central budgetary savings declined in absolute terms since 1981/82, reflecting rapid growth in current non-Plan expenditure. The States' savings performance fell short of the program target, because of the pressure on State budgets from increased wage and material costs and the only limited progress achieved in raising resources in the areas of electric power, irrigation and road transport, where abundant opportunities would exist.

Important steps were taken to streamline and liberalize the complex network of industrial regulations. These measures included an increase in the limit below which an industrial license is not required from Rs 30 million to Rs 50 million, the recognition of capacity created in excess of authorized limits, and the expansion of the list of industries where large companies and companies with foreign equity participation (so called FERA companies) can operate. To stimulate investment, the norm for debt equity ratios was doubled, and investment-related tax concessions were widened to include other groups of industries in addition to the small-scale units previously covered. Freer access to foreign technology was provided, and, as a result of this policy, a substantial restructuring of the motor industry is now under way. Foreign collaboration also became stronger in the electrical equipment, industrial machinery, chemical and metallurgical industries.

The existing mechanisms and criteria for setting administrative prices were used more flexibly to adjust key product prices, especially energy prices, in line with costs and to provide a reasonable return to investments. Controls on steel prices were lifted, and prices for 30 percent of domestic cement production are now determined on the free market.

The import regime was liberalized significantly during the period of the extended arrangement. The measures were aimed at facilitating the modernization of the Indian industry, improving efficiency and promoting exports. Besides a simplification of import procedures, the measures provided for enlarged coverage of imports under Open General License (OGL) and built-in increases in the value of other licenses, with special consideration given to increasing access to imports by exporters. Taking account of the built-in mechnisms for growth in the licensing system, access to imports other than petroleum, fertilizers, edible oils and foodgrains is estimated to have increased by over around

50 percent. For about one fifth of these imports, licensing generally no longer imposes an effective restriction. For the remaining four fifths of imports, measures to increase access of restricted items have also lowered protection. Despite significant increases in import duties, including across the board increases in auxiliary duties, the level of protection afforded to domestic industry has been reduced.

Balance of payments developments have been more favorable than projected. The current account deficit which amounted to 2.0 percent of GDP in both 1981/82 and 1982/83 is estimated to have fallen to 1.9 percent of GDP in 1983/84, compared with 2.2 percent projected in the original program. The overall deficit declined from SDR 2.2 billion in 1981/82 to an estimated SDR 1.1 billion in 1983/84, whereas the original program had foreseen a deficit of well over SDR 2.0 billion in 1983/84. The main factor behind the better than expected performance was a substantial decline in oil imports. Apart from the weakening of oil prices, this reflected a nearly 30 per cent decline in the volume of oil imports over the period 1980/81-1982/83, as a result of increasing domestic production and conservation. There was also a decline in imports of non-oil bulk items reflecting higher domestic production. In contrast, the volume of other imports rose substantially, even though the impact of import liberalization was dampened by weak demand.

After a strong performance in 1981/82, exports did not expand as rapidly as projected. Export volume declined somewhat in 1982/83 but preliminary estimates indicate a recovery in 1983/84. The main reasons for the weaker than expected export performance were the world recession and a halting of earlier export growth under bilateral payments arrangements (mainly to the U.S.S.R.). The surplus in services and private transfers declined gradually, reflecting higher net interest payments, and a fall in remittances from Indians working abroad.

Net disbursements of concessional loans and grants, rose from SDR 1.0 billion in 1981/82 to an estimated SDR 1.5 billion in 1984/85. Commercial borrowing also increased, with net inflow estimated to have reached SDR 0.5 million in 1983/84. Another important source of capital were inflows into deposit accounts held by nonresident Indians, as deposits at Indian banks have become more attractive due to falling international interest rates.

Prospects

Entering the final year of the Sixth Development Plan, the Indian economy appears to be in quite a strong position. The economy has shown increased resilience in the face of adverse circumstances. Agricultural production is rebounding strongly from the effects of drought in 1982/83, and industrial activity is also increasing, if more slowly. The incidence of bottlenecks in infrastructure and basic goods industries has declined considerably and industrial regulations and the import regime have been liberalized. On present prospects, both the current account and the overall deficits of the balance of payments are set to decline.

Attaining India's development and social objectives in the period ahead will require sustained high growth and control of inflation; a sustainable balance of payments position is also a key condition. Perseverance with the adjustment strategy followed successfully over recent years will, therefore, be called for, especially in the areas of

UB-MI-TA2 (2/1/84) CNE

For Chart on Balance of Payments, 1979/80-1983/84

(In billions of SDRs)

	1979/80	1980/81	1981/82	1982/83	1983/84 1/
Exports	5.9	6.5	7.3	7.4	7.7
Imports	-9.2	-12.4	-13.3	-12.8	-13.1
Of which: oil	-3.1	-5.2	-4.8	-4.2	-3.5
Current account	-0.6	-2.1	-2.9	-2.9	-3.1
(In percent of GDP)	(-0.5)	(-1.6)	(-2.0)	(-2.0)	(-1.9)
Overall balance	0.3	-0.4	-2.2	-1.3	-1.1

UB-MI-TA3 (3/2/84) CNE

For Chart on Growth and Inflation, 1979/80-1983/84

(In percent)

	1979/80	1980/81	1981/82	1982/83	1983/84
GDP growth	-5.0	7.6	5.3	1.8	6.5 1/
Agriculture	-13.0	12.7	3.3	-3.9	7.5 1/
Manufacturing	-1.8	1.5	5.1	2.4	5.5 1/
Inflation (WPI; end of period)	23.3	15.8	2.6	6.2	9.0 1/

Source: Data provided by the Indian authorities.

1/ Estimate.

UB-MI-TA1 (3/2/84) UB/CNE

Table . Savings, Investment and Key Sector Performance, 1980/81-1983/84

(In per cent of GDP)

	1980/81	1981/82	1982/83	1983/84 1/
Savings and investment				
Domestic savings	23.1	23.0	22.2	24.6
Domestic investment	24.7	25.0	24.1	26.5
Public savings 2/	3.6	4.3	4.9	5.6
Plan expenditure	11.7	12.3	13.6	14.6
Key sector performance				
Crude oil production (Mn. tons)	10.5	16.2	21.0	26.3
Power capacity ('000 MW)	32.8	35.1	39.1	42.7
Irrigated area (Mn. ha)	54.2	56.2	58.7	61.1

Source: Data provided by the Indian authorities.

1/ Estimate.
2/ Public savings for Plan financing.

GB
file

Office Memorandum

TO : Mr. Finch

DATE: February 28, 1984

FROM : C.J. Batliwalla CJB

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 28th February 1984:

Spot buying Rs. 100 = pound 6.3052 (pound 1 = Rs. 15.86)

Spot selling Rs. 100 = pound 6.2735 (pound 1 = Rs. 15.94)

Middle rate pound 1 = Rs. 15.90."

CC: Mr. Tun Thin
Treasurer's Office

file

Office Memorandum

TO : Mr. Finch

DATE: February 27, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable messages have been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 24th February 1984:

Spot buying Rs. 100 = pound 6.3857 (pound 1 = Rs. 15.66)

Spot selling Rs. 100 = pound 6.3532 (pound 1 = Rs. 15.74)

Middle rate pound 1 = Rs. 15.70."

"We furnish below the rates for our intervention currency pound sterling effective 27th February 1984:

Spot buying Rs. 100 = pound 6.3654 (pound 1 = Rs. 15.71)

Spot selling Rs. 100 = pound 6.3331 (pound 1 = Rs. 15.79)

Middle rate pound 1 = Rs. 15.75."

CC: Mr. Tun Thin
Treasurer's Office

GB
file

Office Memorandum

TO : Mr. Finch

DATE: February 23, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 23rd February 1984:

Spot buying Rs. 100 = 6.4061 pound (pound 1 = Rs. 15.61)

Spot selling Rs. 100 = 6.3735 pounds (pound 1 = Rs. 15.69)

Middle rate pound 1 = Rs. 15.65."

CC: Mr. Tun Thin
Treasurer's Office

bB
file

Office Memorandum

TO : Mr. Finch

DATE: February 21, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 20th February 1984:

Spot buying Rs. 100 = pound 6.4267 (pound 1 = Rs. 15.56)

Spot selling Rs. 100 = pound 6.3939 (pound 1 = Rs. 15.64)

Middle rate pound 1 = Rs. 15.60."

CC: Mr. Tun Thin
Treasurer's Office

file

Office Memorandum

TO : Mr. Finch

DATE: February 17, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 17th February 1984:

Spot buying Rs. 100 = pound 6.4475 (pound 1 = Rs. 15.51)

Spot selling Rs. 100 = pound 6.4144 (pound 1 = Rs. 15.59)

Middle rate pound 1 = Rs. 15.55."

CC: Mr. Tun Thin
Treasurer's Office

1, ~~48~~
2. files.

Office Memorandum

TO : Mr. Finch DATE: February 16, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 15th February 1984:

Spot buying Rs. 100 = pound 6.4893 (pound 1 = Rs. 15.41)

Spot selling Rs. 100 = pound 6.4558 (pound 1 = Rs. 15.49)

Middle rate pound 1 = Rs. 15.45."

CC: Mr. Tun Thin
Treasurer's Office

Office Memorandum

TO : Mr. Finch

DATE: February 9, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 9th February 1984:

Spot selling Rs. 100 = pound 6.5189 (pound 1 = Rs. 15.34)

Spot buying Rs. 100 = pound 6.5531 (pound 1 = Rs. 15.26)

Middle rate pound 1 = Rs. 15.30."

CC: Mr. Tun Thin
Treasurer's Office

Office Memorandum

TO : Mr. Finch DATE: February 7, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 7th February 1984:

Spot selling Rs. 100 = pound 6.5402 (pound 1 = Rs. 15.29)

Spot buying Rs. 100 = pound 6.5746 (pound 1 = Rs. 15.21)

Middle rate pound 1 = Rs. 15.25."

CC: Mr. Tun Thin
Treasurer's office

Office Memorandum

TO : Mr. Finch

DATE: February 3, 1984

FROM : C.J. Batliwalla

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 3rd February 1984:

Spot selling Rs. 100 = pound 6.4977 (pound 1 = Rs. 15.39)

Spot buying Rs. 100 = pound 6.5317 (pound 1 = Rs. 15.31)

Middle rate pound 1 = Rs. 15.35."

CC: Mr. Tun Thin
Treasurer's Office

Office Memorandum

TO : Mr. Finch

DATE: February 2, 1984

FROM : C.J. Batliwalla cb

SUBJECT : India - Change in the Exchange Rate

The following cable message has been received from the Reserve Bank of India regarding change in the rupee rates against the pound sterling. This intimation may be regarded as a discharge of India's obligation regarding notification under Article IV, Section 2.

"We furnish below the rates for our intervention currency pound sterling effective 2nd February 1984:

Spot selling Rs. 100 = pound 6.5617 (pound 1 = Rs. 15.24)

Spot buying Rs. 100 = pound 6.5963 (pound 1 = Rs. 15.16)

Middle rate pound 1 = Rs. 15.20."

CC: Mr. Tun Thin
Treasurer's Office

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THE BOX

MR. V. K. SHUNGLU
JOINT SECRETARY, DEPARTMENT OF ECONOMIC AFFAIRS
MINISTRY OF FINANCE
GOVERNMENT OF INDIA
NEW DELHI 110 001, INDIA

DISPATCHED IMF
1984 JAN 28 PM 11: 27

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1. Mr. Palmer
2. Ms. Kelly
3. ETR Files

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MR.MALHOTRA
ASD
ETR
LEG
RES
SEC
TRE
MR.COLLINS

START TEXT HERE

EXECUTIVE BOARD TOOK FOLLOWING DECISIONS JANUARY 27 -

I. QUOTE 1. THE FUND TAKES THIS DECISION RELATING TO INDIA'S EXCHANGE MEASURES SUBJECT TO ARTICLE VIII, SECTION 2, AND IN CONCLUDING THE 1984 ARTICLE IV CONSULTATION WITH INDIA CONDUCTED UNDER DECISION NO. 5392-(77/63), ADOPTED APRIL 29, 2977 (SURVEILLANCE OVER EXCHANGE RATE POLICIES).

2. THE RESTRICTIONS ON THE MAKING OF PAYMENTS AND TRANSFERS FOR CURRENT INTERNATIONAL TRANSACTIONS DESCRIBED IN SM/84/15 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. UNQUOTE

AND II. QUOTE THE FUND AND INDIA HAVE COMPLETED THE

DO NOT TYPE HERE

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R

TRANSMIT TODAY JANUARY 27

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): RLaurent:jmh EXT.: 75983 DEPT.: SEC DATE: 1/27/84

AUTHORIZED BY NAME (TYPE): Leo Van Houtven AUTHORIZED BY NAME (TYPE):

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE ( )

Log A4601

SEC. 48 REV 1 11-18-82

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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INDIA

PAGE 2

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REVIEW CONTEMPLATED IN PARAGRAPH 3(C) OF THE DECISION ON THE PROGRAM FOR 1983/84 UNDER THE EXTENDED ARRANGEMENT FOR INDIA (EBS/83/130) AND IN PARAGRAPH 3 OF THE LETTER DATED JUNE 8, 1983, 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, 1984.

UNQUOTE

VAN HOUTVEN SECRETARY INTERFUND

DO NOT TYPE HERE

IF REQUIRED INITIAL BELOW

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TRANSMIT TODAY JANUARY 27

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): RLaurent:jmh EXT.: 75983 DEPT.: SEC DATE: 1/27/84

AUTHORIZED BY NAME (TYPE): Leo Van Houtven

AUTHORIZED BY NAME (TYPE): (**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log ________

SEC. 48 REV 1 11-18-82

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

Office Memorandum

TO : The Managing Director DATE: January 26, 1984

FROM : Donald K. Palmer DKP

SUBJECT : India--Supplementary Information

When Mr. Tun Thin sent you a memorandum on this subject last evening, he did not have the courtesy to advise me that he was proceeding over my objections, nor did he include my reasons. Even so, some attempt has been made in his memorandum to try to counter some (but not all) of the points which I made to the Asian Department.

My view was that the supplement should be entirely of a factual character and should not attempt to introduce judgments. More specifically:

1. Why single out additional export data to come to a more positive conclusion about exports, while at the same time saying nothing (paragraph 7 of the supplement) about the failure to depreciate the exchange rate in accordance with understandings with the staff and management? Quite clearly, we do not want to make the latter point in the staff paper, even though it has implications for future export trends.

2. Should any importance be attached to the new export data given the poor "track record" of such preliminary data? To illustrate, this time a year ago the staff paper informed Directors that during the first five months of 1982/83 export volumes had expanded by about 5 percent and therefore the staff presented a revised estimate for the export volume increase during the full year 1982/83 of 5-7 percent. In sharp contrast, the staff paper recently issued informed Directors that the actual (or at least the preliminary actual) result for 1982/83 was a <u>decline</u> of 3 percent. I do not wish to be interpreted as implying that there is something false about the preliminary data, but rather that such data have proved to be an unrealiable indicator of likely trends and therefore one should not use them to attempt to make judgments.

3. Why emphasize new export data as a basis for a judgment when nothing is said in the supplement about new import data? Or anything else in the balance of payments except the deficit?

I am sorry to have to write you this note on what otherwise might seem like a rather petty difference of view which should not have been brought to the management level. I am less concerned about the question of whether you decide to include this particular language in the supplement than that you be aware of some of the problems. I have tried since the beginning of the Indian EFF negotiations to take an evenhanded approach.

cc: The Deputy Managing Director
Mr. Collins

RECD JAN 26 RECD TREASURER'S DEPARTMENT

Office Memorandum

Front Office:
WOH
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DG

To: Mr. Walter O. Habermeier Date: January 26, 1984

From: Stephen A. Silard SAS

Subject: India - Formal Notification of Cancellation of Extended Arrangement

In response to your memorandum of January 26, 1984 to Mr. Tun Thin on this subject, I would like to point out that until the extended arrangement is cancelled formally, the Indian authorities retain the legal right to change their mind and not to cancel it. In order to carry out the intention of your memorandum, consideration should be given to an early formal cancellation.

cc: Mr. Tun Thin
Mr. Palmer

Mr. Silard,

The question whether we can rely on the Indians to cancel after they have said they would - which is my presumption - is a matter of judgement. So is the question of whether their ~~this~~ declar. ~~tion~~ ~~can~~ and should influence the amount of the commitment gap. I have no material problem to shade the commit gap down once India has declared to the Board that it plans to cancel by a certain date. The matter is in full view of the Board. Legal certainty is *

* not required ~~necessarily~~

Wab

cc: Mr. Tun Thin
Mr. Palmer

M. Palmer

Office Memorandum

To: Mr. Tun Thin

January 26, 1984

From: W. O. Habermeier

Subject: India--Formal Notification of Cancellation of Extended Arrangement

Mr. Malhotra informed me yesterday that he will shortly issue a buff statement to the Board legally releasing the undrawn balances committed under the extended arrangement with India, although India would wish to make the final purchase at the end of April 1984. Under these circumstances, I wonder whether it would not be preferable to consider amending the last sentence of your proposed memorandum to Mr. Malhotra to read:

> "The formal cancellation could be made close to the intended effective date, but might be indicated earlier to the Board so that the amount could be effectively removed already in the meantime from the commitment of the IMF to supply funds to India."

cc: Mr. Palmer
Mr. Silard

Office Memorandum

TO : Mr. Smith

DATE: January 25, 1984

FROM : Donald K. Palmer DKP

SUBJECT : India: Supplement

1. In agreement with my colleagues, I do not agree with the proposed addition.

2. What you refer to as "information" might better be termed an "assertion" which rests heavily on the words "if sustained". Is it wise to give so much importance to this apparent change in export results, especially given the "track record" on preliminary export data? What about the effect of the real appreciation of the exchange rate? Doesn't this point in the opposite direction for the future? If the case for significantly higher exports in 1983/84 is to be presented, shouldn't one also inform the Board about the apparent change in import trends (as compared with the staff paper) as indicated by preliminary data? How would one explain to the Board that the combination of higher export values and lower import values would result in an unchanged balance of payments deficit?

cc: Messrs. Tun Thin and Narvekar

Office Memorandum

M. Palmer
cc: Mrs. Kelly

January 25, 1984

To: The Managing Director
The Deputy Managing Director

From: Tun Thin T.T.

Subject: India--Supplementary Information

We have prepared the attached Supplement to the Staff Report for India in preparation for Friday's Executive Board meeting on the Article IV consultation and Review under the Extended Arrangement with India. However, Mr. Palmer does not agree to the inclusion of the words underlined on page 3 of the draft.

I believe it is important that Executive Directors be in no doubt as to the implications of the updated export data. The export projections for 1983/84 included in the staff report were based on the data for the period April-July available to the November mission. With the updated export data covering the period April-October, we would now revise our projection for the full year upward. Although the data have weaknesses, and later information could in time cause us to again revise our projections, at this stage our best export estimate, consistent with the earlier technique, would be higher than indicated in the staff report.

This does not imply any lessening of the need for strong export policies as expressed in the staff appraisal. Nor would it necessarily imply, because exports would be somewhat higher, that the overall deficit would be reduced. As indicated in the draft supplement, reserves data covering the first three quarters of 1983/84 indicate that the deficit is broadly in line with that projected in the staff report. As indicated in the staff report, there has been considerable uncertainty about likely developments in several other important components of the balance of payments (e.g., workers' remittances and nonresident deposits), and this could easily accommodate the relatively small (SDR 150 million) adjustment to exports without affecting the overall balance.

Attachment

cc: Messrs. Palmer ✓
Collins

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

INDIA

Staff Report for the 1984 Article IV Consultation and Review of the Extended Arrangement--Supplementary Information

Approved by Tun Thin and Donald K. Palmer

January 25, 1984

The authorities have taken some policy measures, and additional information has become available, since the staff papers for the 1984 Article IV consultations and review of the extended arrangement with India (EBS/83/276 and SM/84/15) were prepared.

1. Money and credit

The credit ceilings for December 1983 were observed. Updated details of monetary and credit developments are given in Table 1. The rate of expansion in domestic credit slowed from 17.9 percent in the 12 months to September 1983 to 15.9 percent by December 1983. Total domestic credit remained well below the ceiling; the difference from the ceiling amount, which was some Rs 16 billion in September, rose to Rs 24 billion in December 1983. Net bank credit to Government declined seasonally in December. The 12-monthly rate of increase (14.5 percent) continued to be well within the rate projected for the year as a whole (17.3 percent), and outstanding net credit to Government was Rs 4 billion below the subceiling amount; this represented little change since September. In contrast, the expansion in credit to the commercial sector slowed sharply in the December quarter. By December the 12-monthly rate of increase in commercial credit had been reduced to 16.9 percent, compared with 20.5 percent in September 1983 and the program projection of 18.1 percent for the year as a whole. The deceleration of commercial credit reflects the implementation by the Reserve Bank of more restrictive credit policies recently, including the imposition of a 10 percent incremental cash reserve requirement in November 1983. The slowdown in commercial credit has been accompanied by indications of a significant tightening in the liquidity position of the banking system.

The staff does not yet have corresponding data on developments in the money supply for December 1983. However, based on preliminary information, and in line with the above credit developments, it appears that the 12-monthly rate of monetary growth declined in December 1983.

2. External borrowing

During the period April-December 1983, commitments of external nonconcessional loans with maturities of 1 to 12 years subject to the

Table 1. India: Monetary Survey, 1982/83-1983/84

(In billions of rupees) 1/

	1982	1983								1984
	March	March		June	September		November	December		March
	Actual	Program	Actual 2/	Actual 3/	Program 4/	Actual 4/	Actual 4/	Program 4/	Actual 4/	Program 4/
Domestic credit (ceiling)	739.58	876.79	868.56	904.35	937.00	921.34	951.61	991.06	967.17	1,013.21
	(18.9)	(18.6)	(17.4)	(17.7)	(19.9)	(17.9)	(16.7)	(18.7)	(15.9)	(17.8)
Net credit to Govt. (subceiling)	309.11	364.53	355.21	381.65	385.89	382.54	398.04	398.09	394.14	413.34
	(19.1)	(17.9)	(14.9)	(14.7)	(15.6)	(14.6)	(13.4)	(15.5)	(14.5)	(17.3)
Credit to commercial sector	430.47	512.26	513.35	522.70	551.11	538.80	553.57	592.97	573.03	599.87
	(18.7)	(19.0)	(19.3)	(19.9)	(23.2)	(20.5)	(19.5)	(21.0)	(16.9)	(18.1)
Net foreign assets	26.61	9.01	15.22	18.15	7.99	14.51	12.04	3.64	...	0.74
Other liabilities (net)	-141.31	-161.66	-160.19	-158.75	-161.70	-155.04	-153.00	-171.55	...	-181.81
Broad money	624.88	724.14	723.59	763.75	783.29	780.81	810.65	823.15	...	832.14
	(12.7)	(15.9)	(15.8)	(15.5)	(17.1)	(16.7)	(17.5)	(14.9)	(...)	(15.0)
Narrow money	247.92	282.13	284.16	300.51	297.12	294.11	307.37	314.85	...	318.26
	(6.8)	(13.8)	(14.6)	(12.9)	(16.7)	(15.5)	(15.7)	(12.7)	(...)	(12.0)
Time deposits	376.96	442.01	439.43	463.24	486.17	486.70	503.28	508.30	...	513.88
	(16.9)	(17.3)	(16.6)	(17.2)	(17.4)	(17.5)	(18.7)	(16.3)	(...)	(16.9)

Source: Data provided by the Indian authorities.

1/ Figures in parentheses are percentage changes over 12 months.

2/ Adjusted for use of SDRs and other factors to maintain comparability with base data (for details of adjustments see "India--Recent Economic Developments", SM/83/28, Table 18).

3/ Growth rates are over June 1982 data adjusted for the creation of NABARD in July 1982 for comparability with 1983 data.

4/ Growth rates are over comparable unadjusted 1982/83 data.

ceiling of SDR 1.5 billion amounted to SDR 555 million; those with maturity between 1 and 5 years subject to the subceiling of SDR 200 million amounted to SDR 20 million.

3. Inflation

The authorities have reported that during the period April 1983 to January 7, 1984, wholesale prices rose by 8.7 percent, compared with 4.5 percent in the corresponding period of 1982/83. Correspondingly, wholesale price inflation in the 12 months to January 7, 1984 was 11.5 percent, compared with 10 percent in October 1983 as reported in the staff reports and 6.5 percent in 1982/83.

4. Public finances

With effect from January 8, 1984 coal prices were raised by an average of 25 percent. This is estimated to yield additional revenues of about Rs 5 billion in a full year and would be sufficient to offset recent cost increases, including a sizable wage increase, and restore profitability in the coal industry. It would also bring domestic coal prices more closely in line with those in international markets. Also in January 1984 the price of rice issued through the public distribution system was raised by Re 0.2 per kg, or 11 percent. This would fully cover the recent procurement price increase. At the same time, the levy sugar price was raised from Rs 3.75 to Rs 4.00 per kg.

On January 15, 1984, the authorities announced a package of new measures which are aimed at containing inflation. These include principally measures to sharply cut back government spending in the remaining two and a half months of 1983/84, both for current and Plan expenditures. Expenditure restraint is to be maintained in the 1984/85 budget which will be introduced at the end of February. Other steps include a ban on new government recruitment, postponement of government financial support to loss-making public enterprises, and the establishment of a task force to monitor the supply, stock and distribution of essential commodities. The staff has, as yet, no details of the likely magnitude of the expenditure cuts in 1983/84 and their impact on public finance aggregates.

5. Exports

Preliminary data for the period April-July 1983 that were available during the November 1983 mission showed an increase of 3.3 percent in non-oil exports or about 1 percent in real terms. On the basis of preliminary export data now available, non-oil exports were 6.3 percent higher (in terms of SDRs) during the period April-October 1983 than in the corresponding period of 1982, suggesting an increase in volume during that period of about 4 percent; if sustained, these developments suggest that aggregate export volume growth in 1983/84 would be significantly stronger than estimated in the staff report. Preliminary data for exports to markets covered by bilateral payments agreements were lower than in the corresponding period of 1982, indicating a higher volume growth of exports to other markets.

6. Overall balance of payments deficit

Recent developments in international reserves are given in Table 2. These indicate that a sizable balance of payments deficit was recorded in December 1983, bringing the cumulative deficit during the first nine months of 1983/84 to SDR 746 million. This is broadly in line with the projected deficit of SDR 1.1 billion for 1983/84 as a whole contained in the staff paper.

7. Exchange rate

By November 1983, the real effective exchange rate had appreciated by 4.7 percent since the beginning of the program in November 1981 and 3.0 percent, on a seasonally adjusted basis, since March 1983. During December and early January, the nominal effective exchange rate depreciated by 2.0 percent; details of relative price movements during this period are not yet available.

Table 2. India: Official Reserves, 1978-83

(In millions of SDRs)

End of Period	Gold 1/	SDRs	Reserve Position in IMF	Foreign Exchange	Total Gross Reserves	Net Reserves 2/
1978 Qtr. I	257	162	--	4,290	4,709	4,584
" II	286	177	76	4,415	4,954	4,753
" III	286	221	76	4,508	5,091	5,091
" IV	293	226	69	4,638	5,226	5,226
1979 Qtr. I	293	365	69	4,990	5,717	5,717
" II	293	332	148	5,196	5,969	5,969
" III	293	352	154	5,303	6,102	6,102
" IV	300	371	162	5,110	5,943	5,943
1980 Qtr. I	300	529	174	5,054	6,057	6,057
" II	300	523	179	4,641	5,643	5,643
" III	300	522	187	5,104	6,113	5,847
" IV	300	377	330	4,738	5,745	5,479
1981 Qtr. I	300	491	330	4,762	5,883	5,617
" II	300	481	330	4,276	5,388	5,122
" III	300	477	330	3,570	4,677	4,411
" IV	300	468	330	3,234	4,332	3,766
1982 Qtr. I	300	425	364	3,219	4,308	3,442
" II	300	399	364	3,141	4,204	3,038
" III	300	361	364	3,224	4,249	2,483
" IV	300	339	364	3,233	4,236	2,170
1983 Qtr. I	300	270	364	3,966	4,900	2,234
" II	300	220	364	4,466	5,350	2,378
" III	300	133	364	4,561	5,358	1,992
October	300	132	364	4,522	5,318	1,752
November	300	55	364	4,513	5,232	1,699
December	300	105	487	4,125	5,017	1,488

Sources: IMF, International Financial Statistics and data provided by the Indian authorities.

1/ Gold valued at SDR 35 per ounce.
2/ Defined as gross reserves minus use of Fund resources.

Mr. Palmer

Office Memorandum

January 24, 1984

To: The Managing Director
The Deputy Managing Director

From: Tun Thin

Subject: India--Formal Notification of Cancellation of the Extended Arrangement

Following a request from Mr. Malhotra, and in consultation with Messrs. Wittich (TRE) and Silard (LEG), we plan, with your approval, to forward the attached memorandum outlining steps the Government should follow in formally cancelling the extended arrangement.

Attachment

cc: Messrs. Palmer ✓
Wittich
Silard
Collins

BJS-MEM13 (1/24/84)

To: Mr. Malhotra

From: Tun Thin

Subject: India--Formal Notification of Cancellation of Extended Arrangement

In response to your inquiry, we have considered what steps would be required to formally complete the cancellation of the extended arrangement for India.

In this case, it would be appropriate for the cancellation to be conveyed in a cable or letter, signed by the Finance Minister, addressed to the Managing Director. Presumably, you would want to record in the communication the reasons why the Government has decided to take this action, although this would by no means be necessary. The following formal sentence would follow such an explanation:

> "[In view of the above reasons,] this is to notify you that India wishes to cancel the extended arrangement approved by the Fund on November 9, 1981, as of ...., 1984."

The effective date of cancellation (which would be after April 30, 1984 to allow the final purchase under the 1983/84 program), and the timing of the letter of cancellation would be a matter for the Government to decide. The formal cancellation could be made close to the intended effective date.

cc: Mr Finch
Ms Kelley

Office Memorandum

TO : The Managing Director
The Deputy Managing Director

DATE: January 12, 1984

FROM : P.R. Narvekar and Donald K. Palmer

SUBJECT : India--Visit of Mr. P.K. Kaul

Mr. P.K. Kaul, Finance Secretary in India, is to call on you. Mr. Kaul now has been in the Department of Economic Affairs for about six months since taking over from Mr. Narasimham; you will recall meeting him during the last Annual Meeting.

Mr. Kaul has other business in Washington and we are not aware of any particular issues that he wishes to raise with you. He will probably want to appraise you of recent developments and policies in India in advance of the forthcoming Board discussion of the Article IV consultation and review under the 1983/84 program of the extended arrangement. Since the staff reports were issued the authorities have taken policy action in several areas which were identified by the staff as being necessary. Most importantly, coal prices have been raised by 25 percent, which would be more than sufficient to offset recent cost increases and restore profitability. Issue prices for rice have also been raised by more than sufficient to cover the recent procurement price rise, which will contain the food subsidy. In addition, the levy price for sugar has been raised. These are most positive developments which go a long way toward nullifying the criticism included in the staff report regarding "inflexible pricing" policies, although in other areas, such as fertilizer and electricity, price increases are still needed.

On the exchange rate front, recent developments indicate a further depreciation in the nominal effective exchange rate of 2.0 percent in December and early January. This would go part of the way toward restoring the real effective exchange rate to the same level, in seasonally-adjusted terms, as at the beginning of the program in November 1981, which the October mission considered to be a necessary step. However, inflation is continuing at close to 10 percent and prices have yet to recede as the authorities had been expecting. If inflation continues at current rates, a somewhat larger depreciation in the nominal rate than earlier estimated would be needed to meet the minimum real exchange rate objective.

Mr. Malhotra had promised to make a strong statement in the Board on the issue of export incentives and policies. You may wish to stress to Mr. Kaul our concern about the unsatisfactory export performance of India which falls well short of the EFF targets and has important implications for medium-term balance of payments prospects. Some suggestions for improved policies are mentioned in the final paragraph of the attached memorandum of December 21. In addition, you may wish to suggest that the shortfall in export performance raises the question whether an additional change in the exchange rate is needed.

Attachment

cc: Mr. Collins