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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/16

10:00 a.m., January 27, 1984

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	H. G. Schneider
	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
	L. Leonard
	D. I. S. Shaw, Temporary
	C. Robalino
G. Laske	G. Grosche
G. Lovato	
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
A. R. G. Prowse	
	O. Kabbaj
	A. A. Agah, Temporary
F. Sangare	
M. A. Senior	
J. Tvedt	A. Lindø
	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
J. A. Kay, Assistant

Also Present

Asian Department: Tun Thin, Director; P. R. Narvekar, Deputy Director; U. Baumgartner, D. Burton, D. M. Ripley, B. Smith. Central Banking Department: P. N. Kaul, Director. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; H. W. Gerhard, M. R. Kelly. Fiscal Affairs Department: P. S. Heller. IMF Institute: D. Kumar, Participant. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; S. A. Silard. Middle Eastern Department: A. S. Shaalan, Director; M. Shadman, S. Takagi. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; A. G. Chandavarkar, O. Roncesvalles. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, H. A. Arias, C. J. Batliwalla, S. El-Khouri, W. Moerke, G. E. L. Nguyen, Y. Okubo, I. R. Panday, D. C. Templeman. Assistants to Executive Directors: J. R. N. Almeida, R. Bernardo, M. Camara, M. Eran, G. Ercel, I. Fridriksson, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, H. Kobayashi, E. Portas, Shao Z., Wang C. Y., A. Yasseri.

1. INDIA - 1984 ARTICLE IV CONSULTATION, AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1984 Article IV consultation with India and the review under the extended arrangement for SDR 5 billion (291 percent of the old quota) approved on November 9, 1981 (EBS/83/276, 12/30/83; and Sup. 1, 1/26/84), together with proposed decisions concluding the 1984 Article XIV consultation with India and the review under the extended arrangement. They also had before them a report on the most recent economic developments in India (SM/84/15, 1/13/84).

Mr. Malhotra made the following statement:

My Indian authorities and I would like to thank the staff for the excellent set of papers they have prepared on India (EBS/83/276 and SM/84/15). My authorities are in broad agreement with the staff's assessment.

It is necessary to update the information contained in the staff papers with regard to the following areas:

a. Exports

On the basis of earlier information, the staff had revised the estimated growth in the SDR value of exports, net of oil exports, to 5.1 percent, down from 7.2 percent envisaged in the program for fiscal 1983-84 (April-March), implying an increase in export volume of only 2 percent instead of 5 percent originally projected on page 3 of EBS/83/276. Latest data show that during April-October 1983 exports grew by 10 percent in rupee value and over 5 percent in volume. Exports to convertible currency area, the major component of India's exports, appear to have grown by well above 20 percent in value and over 12 percent in volume. Exports to the bilateral payments area, which had shown dramatic increases for some years, up to and including 1981, have entered an adjustment phase during which the Indian surplus in the bilateral trade accounts has been virtually eliminated. There are indications that after the restoration of balance in bilateral trade in the current fiscal year, India's exports to that area will start growing again.

b. Reserve movements

In EBS/83/276, the cumulative overall balance of payments deficit during April-November 1983 has been shown to be SDR 535 million. The cumulative deficit at the end of December 1983 stood at SDR 923 million, broadly in line with the revised staff estimate for 1983-84. Indeed, there is a possibility of the cumulative deficit exceeding the revised estimate.

c. Increase in administered prices

Effective January 8, 1984, coal prices were increased by an average of about 25 percent. This would enhance the receipts of coal companies by Rs. 5 billion in a full year and Rs. 1.30 billion in the current fiscal year. The issue price of rice from the public distribution system has been increased by Rs. 20 per quintal to more than cover the increased cost of procurement. An upward adjustment has also been made in the levy price of sugar.

d. Monetary growth

According to Table 2 on page 8 of EBS/83/276, the growth of narrow money during the twelve months to end-September 1983 amounted to 15.5 percent. This growth rate had declined to 12.4 percent by end-December 1983 and was close to the end-March 1984 target of 12 percent.

e. Resource mobilization by states

In the staff paper, additional resource mobilization by the states by October 1983 was indicated at Rs. 5.3 billion as against a target of Rs. 8.3 billion for 1983-84. By December 1983, additional resource mobilization by the states had increased to Rs. 7.1 billion.

f. Quantitative performance criteria for end-December have been met.

The three-year extended arrangement with India for SDR 5 billion approved by the Executive Board on November 9, 1981 straddles four fiscal years, 1981/82 through 1984/85. The arrangement was necessitated by adverse exogenous developments characterized by a sharp deterioration in India's terms of trade. To date, purchases aggregating SDR 3.3 billion have been made on schedule, as all performance critera were duly met. An additional SDR 0.6 billion remains to be purchased under the program for 1983/84. Recently, I had informed Executive Directors of the decision of my Indian authorities to stop purchases under the extended arrangement after the successful conclusion of the program for 1983/84. This decision has been taken in the light of a more rapid adjustment in India's external account than was envisaged at the time of the formulation of the arrangement. Though a substantial overall deficit is foreseen for 1984/85, the authorities are reasonably confident of managing it on their own. An important consideration for the decision was that it would release SDR 1.1 billion, which would enable the Fund to meet the requirements of other countries whose balance of payments needs may be more acute. Accordingly, it is intended to formally cancel the arrangement. The authorities highly value their cooperation with the Fund. They also realize that the adjustment effort will have to be continued. Within days of the announcement of the decision by the Prime Minister, important measures have been initiated for curbing expenditures with a view to containing inflation, which is currently running at an annual rate of about 9 percent, 2 percent above the rate envisaged for the current fiscal year. Central non-Plan expenditure is to be reduced by 3 percent of the approved amounts for 1983/84. The cut is expected to achieve a saving of about Rs. 5 billion. A committee of senior officials has been set up to identify cuts of about 5 percent in planned outlays for the current year. Creation of new posts and filling up of existing vacancies has been banned for nine months. No further financial allocations will be made in 1983/84 for financing losses of public sector enterprises. Supplies of critical mass consumption goods are being further augmented.

It is appropriate at this juncture to take stock of how the wide-ranging and comprehensive extended arrangement has evolved and whether the progress achieved is broadly in line with what was expected. In doing so, it is well to remember that the arrangement has proceeded in the shadow of a prolonged and deep world recession marked by stagnation in international trade, protectionism, and severely adverse terms of trade, particularly for non-oil developing countries. Further, there was a severe drought in 1982-83, which inevitably had an adverse impact on output, savings, investment, demand for industrial products, fiscal outturn, and the balance of payments. Despite these developments, the extended arrangement has been kept on track mainly because it was conceived in the context of the Sixth Plan (1980/81 through 1984/85), which is backed by a strong national commitment. The Plan incorporated a comprehensive framework of policies regarding growth with stability, savings and investment, expansion of infrastructure, efficient import substitution, resource mobilization, industrial and investment objectives, management of demand and supply, and improvement of the balance of payments. These policies have been vigorously and consistently pursued with suitable adaptations to meet changing economic conditions.

The extended arrangement had originally assumed an annual growth rate of 4.8 percent. In the event, GDP at constant prices grew by 5.2 percent in 1981/82, 2 percent in 1982/83, owing to the severe impact of the drought, and an expected 6-6.5 percent in 1983/84. The cumulative output growth matches the original assumptions of the program. After a slight dip in 1982/83 drought year, gross domestic savings and gross capital formation as percentages of GDP are projected to rise to 24.6 and 26.5, respectively, in 1983/84, in line with the figures envisaged in the original program.

For several years, India has followed an agricultural strategy aimed at self-sufficiency in foodgrains and other important agricultural commodities. The strategy has emphasized expansion of irrigation, greater use of inputs like fertilizer, high-yielding seed varieties and pesticides, improvement in extension services, provision of credit, and remunerative prices for producers. Though the drought of 1982-83 occasioned imports of foodgrains aggregating 6.4 million tons during 1982-84, it also demonstrated the increased resilience acquired by the agricultural sector, as the decline of output was successfully contained and the subsequent price rise has been relatively moderate. Foodgrain production in 1983/84 is expected to rise by 11 percent over that of 1982/83 to the historically high level of 142 million tons. Production of sugarcane, cotton, and jute has also been satisfactory. These developments should have a beneficial impact on the balance of payments. However, a breakthrough in the production of oilseeds has yet to be achieved, and imports of edible oils are likely to continue at a fairly high level for some time. Foodstocks with the public distribution system have increased substantially and should help to contain undue pressures on prices of cereals.

The growth of 8.6 percent in industrial output in 1981/82 could not be sustained in 1982/83, when the growth rate slipped to 3.8 percent, owing mainly to lower agricultural production and consequent low domestic demand, tight credit conditions, weak world demand, and a prolonged strike in an important segment of the textile industry. A gradual revival of industrial production in 1983/84 is in evidence, with the average monthly index for the first seven months of the year showing an increase of over 4.5 percent. As increased agricultural incomes push up demand, expectations are that industrial output will acquire further momentum so as to yield a growth of 5.5 percent in the year. Despite somewhat subdued industrial activity, there are indications that investment in industry has been growing strongly.

The strategy of adjustment attached a high priority to controlling inflation through demand management and supply policies. The first two years of the extended arrangement witnessed a dramatic deceleration of inflation, well below the rates envisaged in the original program. Wholesale price increases declined from 18.2 percent in 1980/81 to 9.3 percent in 1981/82 and to 2.5 percent in 1982/83. In the current fiscal year, up to January 7, the wholesale price index has risen by 8.9 percent over the corresponding period of last year. The pressure on prices is mainly the delayed effect of the drought and increases in administered prices. Price increases have been particularly marked in respect of pulses, oilseeds, edible oils, and gur. Recently, there has been a substantial abatement in cereal prices. A bumper foodgrain crop of 142 million tons holds out promise of considerable lowering of price pressures.

Throughout the period of the extended arrangement, the stance of monetary policy has been one of restraint consistent with the requirement of meeting the legitimate needs of the economy. Credit expansion has remained well within the ceilings established in the annual financial programs. Narrow and broad money targets rose in line with program projections in the first two program years. In the first half of the current fiscal year, there was a substantial buildup of excess liquidity in the banking sector, due partly to an unanticipated improvement in the external payments position, which is now reversing itself. Consequently, there was some overshooting of M-1 and M-3 targets. The Reserve Bank of India, therefore, progressively raised the cash reserve ratio from 7 percent to 8.5 percent of time and demand liabilities of banks. Later, a 10 percent incremental cash reserve requirement was imposed and the threshold of refinance of foodstocks was substantially raised. As a result, M-1 growth is now evolving close to the target of 12 percent, and M-3 growth, though somewhat higher than the March 1984 target, has started declining.

In fiscal 1983/84, the rate of inflation may be about 9 percent as against the 7 percent envisaged in the program for the year. Yet the cumulative price increase during the extended arrangement period so far has been about 10 percent lower than originally envisaged. As already indicated, my Indian authorities attach great importance to containing inflation and to that end have taken strong additional measures.

In the fiscal area, the authorities have emphasized mobilization of public savings, which, as a proportion of GDP, have increased from 3.6 percent in 1980/81 to 4.9 percent in 1982/83 and will further rise to 5.6 percent in 1983/84, thus exceeding the program target of 5.4 percent. Public savings have provided a strong support to the Sixth Plan. Bank financing of the central and state governments, as a proportion of GDP, is projected to decline from 4.5 percent in 1980/81 to about 3 percent in 1983/84. Apart from the tax measures through the central and state budgets, a major contribution to public savings has come through price adjustments and better management of the nonfinancial public sector undertakings. Indeed, pricing policies over a broad range of goods and services have been flexible and effective. Apart from prices of petroleum, which are above international levels, major changes were made for steel, cement, and coal. Railway fares and freights as well as postal tariffs have been increased repeatedly and substantially. Issue prices of foodgrains from the public distribution system have been increased from time to time to cover increased costs of procurement and distribution and to contain food subsidies. Electricity tariffs and fares of public road transport undertakings have also been increased from time to time. Fertilizer prices were raised by over 60 percent. This had an adverse impact on the rate of increase in fertilizer consumption. In the beginning of the 1983 summer crop season, considering the poor offtake and accumulation of stocks, fertilizer prices were reduced by 7.5 percent. As a result of the subsequent improvement in weather and the price decrease, the rise in fertilizer consumption picked up from 6.5 percent in 1982/83 to 17 percent this year, with beneficial implications for agricultural production and the balance of payments. As noted by the staff, fertilizer prices in India are higher than those in other countries in the region. A committee is now looking into the complex question of fertilizer prices and their implications for fertilizer production and consumption as well as budgetary subsidies.

Total resource mobilization by the states envisaged in the Sixth Plan was Rs. 90.12 billion, against which measures taken through 1982/83 were expected to net Rs. 116.82 billion over the Plan period. Further measures taken in 1983/84 are expected to net Rs. 7.10 billion. While these efforts by the states have been substantial and commendable, net availability of resources for the Plan in real terms has fallen somewhat short of the expected levels owing mainly to the impact of inflation, especially in the first two years of the Plan. As a result, investments in the power sector, and to a lesser extent in irrigation, have lagged. Revised arrangements were made in order to monitor borrowing by the states from the Reserve Bank of India. These arrangements have helped in improving fiscal discipline.

As noted by the staff, the key sector investment program for 1983/84 has generally progressed well. The accelerated oil development program should at least achieve the target of 26.3 million tons, up from 16.2 million tons in 1981/82 and about 10 million tons in 1980/81. Availability of domestic oil production is expected to account for two thirds of consumption by 1984/85, a dramatic achievement that would contribute substantially to improving the external account. The capacity expansion targets in cement and fertilizer are likely to be achieved and the expansion in utilized irrigated area is likely to increase in 1983/84 by close to the target of 2.5 million hectares. The power capacity expansion in 1983/84 is projected at 4,100 MW, as against last year's record of 3,060 MW. The growth in power generation was depressed in the first six months of 1983/84 owing to declines in hydroelectric generation, reflecting the drought conditions of the previous year. However, power generation is picking up substantially in the second half of the current fiscal year. Coal production and railway capacity are sufficient to meet current demands of the economy.

The functioning of the infrastructure in power, coal, and railways was severely constrained in 1980. This situation was rapidly remedied, and these sectors have continued to provide crucial support to economic activity.

Consequent on a midterm appraisal of the Sixth Plan and its conclusion that, despite a high rate of public savings, Plan resources in real terms are likely to fall short of the requirements by about 15 percent, the Plan targets have been suitably adjusted. This was also necessary because the demand on several sectors is likely to be lower than previously expected. The major downward revision is for capacity creation in the power sector, but it is noteworthy that even the lower target implies a rise in power generation capacity of 47 percent since the beginning of the Plan. There has also been a marginal reduction in the target for new irrigation potential. These adjustments should help the revised investment program to proceed in an environment of relative price stability.

Adjustment on the external account has been speedier than projected earlier. Successful import substitution in petroleum, foodgrains, fertilizer, and cement has been of crucial significance. Despite a continuing worsening of terms of trade of about 26 percent since 1978, policies supportive of exports have brought about a healthy growth of exports in 1983/84. Imports during April-October showed a decline of 2.8 percent from the corresponding period of 1982/83. Reduction of imports has taken place mainly in bulk commodities owing to higher domestic production, and there has been no constriction of imported inputs for industry and exports. With greater activity in industry, imports are expected to pick up. Indeed, available evidence shows that demand for capital goods and other industrial imports is already rising. The existing mechanism for adjusting the exchange rate has served India well, and the competitiveness of the rupee has been effectively maintained. At the same time, the policy of import liberalization begun in 1978/79 and considerably advanced since then has greatly improved the availability of imported inputs, especially for exporters. Similarly, industrial policy has been progressively liberalized, and investment, both domestic and foreign, has been encouraged. Major steps have been taken to update technology in several important areas.

Due to a harder mix of IDA and IBRD money and greater recourse to commercial borrowing, the debt profile of India is undergoing a change: debt service as a percentage of current receipts will rise over the next few years. My authorities will, therefore, continue to follow prudent policies regarding external commercial borrowing. The overall balance of payments deficit for 1983/84 has declined from the original program projection of SDR 2.6 billion to SDR 1.1 billion. The current account deficit in 1984/85 is expected to equal 1.6 percent of GDP.

It would thus appear that, despite a very difficult environment, the extended arrangement has been successfully implemented and has contributed materially to a rapid and substantial improvement in the external account. As to the future, it is evident that the present set of policies, which have brought about these improvements, will have to be continued and improved upon still further. The authorities, while recognizing that some difficulties may lie ahead, are cautiously optimistic about their ability to resolve them. They deeply appreciate the strong support that the Fund--the Executive Board, management, and the staff--have extended. I would request the support of the Executive Board for the proposed decisions in respect of the 1983/84 program.

Extending his remarks, Mr. Malhotra said that the Reserve Bank of India had informed him that, according to an announcement made on January 26, 1984, the cash reserve ratio had been further increased from 8.5 percent to 9 percent. The Bank had indicated that, although the expansion of narrow money was running very close to the target, it was rather worried that the figure for M-3 had been higher than expected. It had therefore raised the cash reserve ratio further, to immobilize part of the liquidity in the banking system.

Mr. Hirao welcomed the recent decision by the Indian authorities to forgo the final part of their purchase under the extended arrangement. The SDR 1.1 billion forgone would significantly contribute toward improving the liquidity position of the Fund, and would thus be helpful for all members.

The Indian economy was recovering from the setback caused by the drought of 1982/83, Mr. Hirao commented. Developments so far had been favorable, all performance criteria had been met, and further progress was expected toward the objectives of the program.

Commenting on individual issues, Mr. Hirao said that he was glad that the real growth target of 6-6.5 percent for 1982/83 was likely to be reached, reflecting the rebound of the agricultural sector, although industrial activity had remained subdued. As domestic demand for the industrial sector picked up in future years, the scope for industrial recovery might be constrained by the supply side, especially by shortfalls in several key industries such as power, coal, steel, and railways. The staff had indicated that electric power shortages had already adversely affected other industries. He therefore shared the views of the staff that it would be vital to protect investment levels in those areas, particularly in the power sector.

On the monetary policy of India, Mr. Hirao considered, demand management policy should remain cautious in order to contain the lagged inflationary pressures resulting from the supply shortfalls of 1982/83. Careful attention should be paid to prices, which had been rising in recent months so that the increase was likely to exceed the program target of 7 percent by the end of the year. Although he understood that the increase was temporary, due to the delayed impact of the drought, the rate of growth of money seemed to have been excessive up to September 1983, partly reflecting a stronger than expected external account. The progressive increases in the cash reserve ratio announced by the Reserve Bank were clearly steps in the right direction, as were the measures mentioned by Mr. Malhotra. The rate of growth of money had declined to 12.4 percent by the end of 1983; he hoped that the authorities would continue to monitor the price movements closely and take further action if the expected reduction in inflation were delayed.

Regarding fiscal policy, Mr. Hirao observed, one of the important elements envisaged in the adjustment program was to encourage larger supplies of basic industrial goods and the production of infrastructure items, while raising domestic savings, especially in the public sector, to provide adequate resources for investment. It was satisfactory that public savings had been growing even beyond the program target, and that the proportion of total Plan expenditure financed by public savings had increased over the past two years. Such a satisfactory position had been brought about mainly by a strong savings performance by public enterprises belonging to the Central Government, particularly the oil sector. However, state savings had been below the program target, despite some increases in taxes and tariffs. The staff had pointed out that there was ample room for raising resources in such fields as electric power, irrigation, and road transport. He hoped that the authorities would further examine those possibilities, and introduce additional measures for mobilizing domestic resources.

Commenting on the central government budget, Mr. Hirao remarked that the overall deficit for the current fiscal year was estimated to reach 7.1 percent of GDP, the highest in the past two years. A significant part of the excess deficit arose from an institutional arrangement under which the increased investment spending financed by public savings was recorded as an increase in the central government budget deficit. However, the increase in current expenditure, notably the fertilizer subsidy, also contributed to the increased fiscal deficit. He therefore welcomed the fact that the problem of fertilizer pricing had come under careful examination by a government committee. Although the current fiscal situation might not create any immediate deficit financing problem, it seemed only reasonable to take measures to strengthen the financial position over the longer term. SM/84/15 contained an interesting analysis showing that the structural deficit had increased steadily in the recent past and was placing an increasingly large demand on private savings. If the trend continued, it could adversely affect investment. Perhaps the authorities should re-examine the appropriate rate of growth in current expenditure, in relation to the buoyancy of tax revenues. He fully supported the staff in its view that if the Government's borrowing requirements from the private sector were reduced through further resource mobilization measures, the reduction would help to strengthen the external adjustment effort over the longer term.

On the external side, Mr. Hirao observed, the overall external position had been somewhat better than the program target. Continued progress had been made in import substitution, particularly in connection with oil, even though important steps had been taken to liberalize the import system. Nevertheless, SM/84/15 showed that, even after the import liberalization, four fifths of domestic industry continued to receive protection through restrictive measures. Further liberalization could be undertaken with a view to improving the efficiency of domestic industry in the long run. He was glad to have heard Mr. Malhotra say that exports had shown an upward turn after a weak performance. The improvement might partly reflect measures to enhance export incentives by easing industrial regulations for export manufacturing industries, and by increasing access to imports. The staff appeared to consider that the weak export performance had for some time been mainly due to a decline in exports to Eastern Europe--mostly the Soviet Union--with which India maintained bilateral payments arrangements. Like the staff, he felt that the outcome did no more than emphasize the dangers of an export growth strategy relying too heavily on bilateral payments agreements. The authorities would be well advised to diversify the export market and to make efforts toward reducing reliance on such agreements. As for exchange policy, he endorsed the authorities' intention to pursue a realistic exchange rate policy in support of external adjustment.

The staff paper provided two interesting scenarios on medium-term balance of payments adjustment, Mr. Hirao considered. The analysis showed that a policy approach involving the maintenance of the same level of current account deficit in proportion to GDP as at the end of the program period would create external borrowing and debt servicing difficulties toward the end of the 1980s. Even under the adjustment-oriented scenario, the debt service ratio was estimated to increase to close to 20 percent by 1989. It seemed particularly important for the Indian authorities to continue to make the adjustment effort to reduce the current deficit further in the years following the end of the arrangement. Finally, he could support the proposed decisions.

Mr. Suraisry remarked that India's performance under the extended arrangement continued to be favorable. Both the quantitative performance criteria and the output and balance of payments targets for 1983/84 were likely to be realized. The authorities were to be commended for their pursuit of sustained adjustment efforts.

India's successful performance under the extended arrangement had served both India and the Fund well, Mr. Suraisry considered. India had been able to strengthen its external payments position considerably. As a result, the authorities had decided recently not to seek to draw the final SDR 1.1 billion available under the extended arrangement, a decision for which they were to be warmly commended. Insofar as the Fund was concerned, the success of the Indian program had shown that the Fund was right to support adjustment at an early stage of balance of payments difficulties. It had also demonstrated that the extended arrangement was a useful vehicle through which member countries could pursue comprehensive financial and structural policies.

There were nevertheless certain areas of policy that needed attention, Mr. Suraisry commented. First, the authorities ought to strengthen the finances of the Central Government. India had traditionally followed prudent fiscal policies. It was therefore somewhat disquieting that the central government budget deficit was expected to reach 7.1 percent of GDP in 1983/84, a new high proportion. Clearly, greater control was needed over government expenditure, particularly current expenditure, which had grown rapidly in recent years. In that way, the authorities would be able to preserve the domestic financial stability that had been a hallmark of the Indian economy. He welcomed the recent expenditure cuts mentioned by Mr. Malhotra.

Second, there was also clearly a need to strengthen the finances of the states, Mr. Suraisry observed, if only to enable the states to shoulder their investment burden under the Development Plan. There had been shortfalls in investment in key infrastructure sectors such as energy, coal, railways, and irrigation, primarily owing to difficulties in project implementation. Consequently, some of the Plan targets had been revised downward. If the Plan targets in the power and irrigation sectors were not to be reduced further, the states would have to make the necessary investments, even if they had to produce a stronger savings performance.

Third, Mr. Suraisry stated, it was important for India to maintain its export competitiveness by increasing the efficiency of the export sector and adopting a continually flexible exchange rate policy. The authorities needed to achieve a strong export performance if the current account position were to continue to evolve in a satisfactory manner over the medium term. The policy of import liberalization, introduced a few years previously, had resulted in a more efficient resource allocation within the Indian economy. The authorities should therefore continue along the same lines. On debt management, he agreed with the authorities that they should be prudent in undertaking borrowing on commercial terms. A favorable feature of the Indian economy was its low debt service burden, both current and prospective. He hoped that the authorities would be able to maintain that position.

In conclusion, Mr. Suraisry remarked that India's successful performance under the extended arrangement had allowed the economy to adjust remarkably well to the adverse external circumstances of the past few years. They had benefited from coming to the Fund at an early stage of their balance of payments difficulties. India's long-term development effort could best be served, as the authorities recognized, by continued pursuit of the cautious policies that had always been associated with India's economic performance. Finally, he supported the proposed decisions.

Mr. Lovato commended the Indian authorities for the economic policy that they had followed during the past two years and for the success that they had enjoyed with the Fund program. They also deserved commendation for their recent decision to forgo the right to draw the remaining SDR 1.1 billion for fiscal year 1984/85 and for their determination to continue nevertheless with their adjustment process.

He agreed with the proposed decisions, Mr. Lovato went on, while stressing the encouragement to the authorities to terminate the bilateral payments agreement with a Fund member as soon as possible and to simplify the exchange system further. Generally speaking, he agreed with the staff appraisal. He would therefore limit his comments to the three points mentioned at the end of the staff report. Executive Directors had before them for review an extended arrangement. The purpose of the extended arrangement was to give medium-term assistance, particularly to economies suffering serious payments imbalances relating to structural maladjustments in production and trade, for the purpose of correcting structural imbalances in production and elsewhere in the economy. In practice, that kind of assistance was supposed to encourage countries to re-establish equilibrium in their balance of payments on the supply side. In that endeavor, India had made considerable progress. Nevertheless, the staff had reported that "supply cutbacks deriving from production problems in some important basic sectors have had adverse effects also in other sectors." As was well known, it was not easy to eradicate bottlenecks in the productive system in a year or two, or to make infrastructure sufficiently responsive to bring about a rapid industrial recovery in the short or even in the medium term. Nevertheless, that kind of improvement was crucial for bringing the balance of trade into equilibrium if a country had to rely on an increase in exports more than on a reduction of imports. In India, weak export performance in the past two years had to some extent reflected reduced demand, but it had also in part been the result of a domestic shortfall in supply.

Some fundamental difficulties therefore still remained in the Indian economy, Mr. Lovato considered. For instance, real investments in certain key sectors, especially electric power and irrigation, continued to be inadequate. Naturally, real investment required real resources, which had to be found elsewhere; in a country with a relatively low level of income, it was not easy to find an equilibrium between consumption and savings. In any event, the adjustment process should be carried further, even if gradually, taking into account the conditions of the country. In that respect, the commitment by the authorities to continue their adjustment program was reassuring. While welcoming the recent alteration of the exchange rate, he was convinced that in the medium term the authorities should pay more attention to improving productivity and to increasing the efficiency of the system.

As to the balance of trade, Mr. Lovato observed, the staff had stated that in past years India had taken a number of policy changes to liberalize imports. The staff had added that "it appears that the import liberalization measures in 1983/84 are not, as yet, having the full impact originally expected" and that "import policy must be implemented so as to ensure that the intent of the change is realized." He wondered whether the less than expected impact of the import liberalization measures could be explained to some extent by the adoption of an import substitution policy, and whether the staff was implying that in substance the restrictions were still being maintained. If so, he would urge the authorities not only to adopt, but also to implement, the needed measures.

He noted from the staff report, Mr. Lovato mentioned, that the inflation rate would remain "significantly above the program target of 7 percent by year's end." Some imponderable factors had acted in an unfavorable way on the supply side for food, but public sector finance had not been used to help to reduce the inflationary pressures. The public enterprises continued to be run inefficiently, and they still practiced an inflexible pricing policy. In the states, serious financial problems had not diminished. He shared the view that the Central Government and the states should cooperate more closely in order to bring about a rational use of their resources as a means of achieving the program objectives.

On the question of subsidies to fertilizer, Mr. Lovato stated that while subsidies had an adverse impact on the budget, they could help to heighten the efficiency of the agricultural system and expand food production. As for monetary policy, he agreed that the introduction of a 10 percent incremental reserve ratio was an appropriate step for dealing with the present liquidity situation. Nevertheless, he doubted whether the measure would be sufficient in itself to bring about the flexibility that monetary policy required.

Mr. Schneider noted that, despite some internal and external difficulties, the Indian authorities had made satisfactory progress in implementing the program for 1983/84. The results achieved, especially in economic growth, the balance of payments, savings and investment, import liberalization, and pricing policy, were encouraging and not inconsistent with a favorable medium-term and long-term outlook. The restoration of economic activity, together with the implementation of sound domestic economic policies, would not only help to achieve the program targets but also contribute toward improving living conditions for the people of India.

As to the extended arrangement and the balance of payments prospects, Mr. Schneider went on, Table 1 in EBS/83/276 clearly showed how closely performance during the program period was aligned with the targets. Progress in some areas had been much better than expected, while in others it had not been. Some slippage had occurred in connection with inflation, export performance, and monetary aggregates, especially during 1983. He therefore welcomed the authorities' statement that they intended to take further measures in those fields. On the other hand, the central government deficit was still high at about 7 percent of GDP despite a large increase in public savings, and financial problems at the state level were serious. These constraints might have an adverse effect on investment in certain key sectors, which remained inadequate in real terms.

Another major problem had been the occurrence of power shortages, which had kept production and capacity utilization levels undesirably low during the first half of 1983/84, Mr. Schneider observed. Power shortages were in fact one of the main constraints on the economy in the medium term. The authorities needed to shorten the down time for maintenance as much as possible in some thermal units, and to make sure that hydropower reservoirs were fully replenished during the monsoon season. In addition, it was vital to increase real investment in the electric power sector. He agreed with the staff that curtailing investment in key sectors such as the electric power sector would not afford any protection from the impact of the shortfall in real resources.

Fertilizer pricing policy was one of the more complex issues affecting India, Mr. Schneider considered. The report by a committee appointed to study the issue could help the authorities to reach a decision. The staff had mentioned that the reduction in fertilizer prices in July had brought about an increase in fertilizer use. It had been estimated that favorable weather would increase agricultural production by about 7.5 percent in 1983/84. Was the staff in a position to indicate what increase might result from a reduction in fertilizer prices for the same period?

As to the medium-term prospects for the balance of payments, domestic economic policy would be a key factor in achieving a sustainable external position, Mr. Schneider stated. It was especially important that increased emphasis should be given to maintaining the present domestic savings rate and increasing public savings, improving the efficiency of investment, encouraging investment in export industries and investment abroad, and also increasing the direct contribution of the public sector to the external account. As the staff had indicated, net commercial borrowing would be an important element in financing the gap during the second half of the 1980s. Finally, he supported both the proposed decisions.

Mr. Blandin remarked that the 1984 Article IV consultation with India came at an appropriate time to enable the Executive Directors to take stock of the achievements of the Indian authorities some two years after the beginning of an extended arrangement. The staff had, as usual, clearly identified the areas of progress and those where additional efforts seemed needed.

The news that India was likely to record its best harvest ever was truly welcome, Mr. Blandin stated. Furthermore, India's domestic oil production now represented 74 percent of consumption, compared with 54 percent two years previously. Partly as a result of those changes, in 1983/84 the current account deficit was expected to be 1.9 percent of GDP instead of the 2.1 percent envisaged earlier, while real GNP was expected to increase by 6-6.5 percent. In view of such satisfactory developments, he recalled that in July 1983, at the time of the previous review of the extended arrangement with India, his chair had commented that Fund conditionality need not imply costs in terms of economic growth. The Indian authorities had shown what could be achieved when an adjustment program was well managed by the country's authorities, in cooperation with the Fund. It was still more encouraging to learn from Mr. Malhotra that his authorities appeared fully committed to continuing the main reforms under way and to promoting further adjustment in the economy, even if they had decided to forgo the SDR 1.1 billion of purchases for 1984/85. In that connection, his authorities greatly appreciated the action of the Government of India.

He fully endorsed the thrust of the staff appraisal, Mr. Blandin observed. He also agreed with the staff that, despite the progress made so far, the authorities needed to correct the remaining distortions. On the demand management side, monetary policy had not been completely in line with expectations. The rate of expansion of the money supply appeared to have been some 13-16 percent during the first half of 1983/84, compared with the projected 12 percent, while the expansion of broad money had exceeded the 15 percent provided for in the program. In that connection, the imposition of a 10 percent cash ratio requirement might not be a sufficient signal that the control of the growth of money had now become a priority.

On the supply side, Mr. Blandin continued, the authorities had certainly not been inactive, but the results had not been very encouraging. As to the rate of inflation, changes in food prices seemed to contain most of the explanation for the wide fluctuations in price increases.

On the external side, Mr. Blandin considered, one area of immediate concern was the outlook for the demand for Indian exports in 1984, as well as the behavior of capital flows and remittances. Table 34 on page 117 of SM/84/15 showed the heavy dependence of India on rather slow-growing markets such as those in Africa and Eastern Europe. Clearly, the authorities would do well to redirect exports toward Western countries in the medium term. As to restrictions on imports, the authorities seemed so far to have taken only the easiest steps. Additional measures were required to open up the economy, for the benefit of India's partners but mostly for its own sake. The introduction of more competition in wholly protected sectors, such as the consumer goods sector, would help to lower prices. Another element not to be overlooked was the impact of the exchange rate for the rupee on capital flows and workers' remittances.

Tbe rigidities in the Indian economy, frequently mentioned by the staff, were partly due to the involvement of the authorities in every aspect of the economy, and to the complicated system of rules and regulations, which might well impair both private and public initiatives, Mr. Blandin considered. Delays, shortfalls, and bottlenecks that had occurred in the key sectors of the economy--such as electricity, coal, or railroads--could perhaps have been avoided if there had been a greater delegation of responsibility. In that respect, he found the assistance given to India by the staff of the World Bank most helpful.

He strongly encouraged the Indian authorities to continue with the adjustment scenario described on pages 31 and 32 and in Chart 5 of EBS/83/276, Mr. Blandin remarked. The slackening of the adjustment process only indicated that less than complete adherence to the program and to the measures embodied in it was likely to have severe consequences. Meanwhile, he commended the Indian authorities for the progress so far achieved, and he remained confident in the wisdom of the Indian people. He supported the proposed decisions.

Mr. Shaw remarked that since the inception of the extended arrangement, the Indian authorities had generally adhered to the thrust of the adjustment program, for which they deserved commendation. They had done so although the external environment had become more difficult than had been projected in 1982. He also welcomed the notable progress made on some aspects of medium-term adjustment. In particular, real growth was expected to reach 6-6.5 percent in 1983/84, up from the program target of 4.8 percent in 1981. A substantial increase in domestic oil production had brought with it a corresponding reduction in the country's dependence on oil imports, and savings and investment had increased as a proportion of GNP over the two years of the extended arrangement.

Nevertheless, further action was required, and he welcomed the commitment by the authorities to continuing the adjustment effort even if they did not intend to draw the remaining SDR 1.1 billion, Mr. Shaw observed. Recent developments in inflationary pressures, together with a continuing weakness in the public finances, slippages in the investment program, and export volumes substantially below target, pointed to the need for additional structural reforms if the hard-won gains of the past two years were not to be lost. He was encouraged by the recent measures announced by the Prime Minister and described by Mr. Malhotra. It was clear from those statements that the commitment of the Indian authorities to the adjustment program was still strong.

Commenting on a number of specific policy aspects, Mr. Shaw said, first, that monetary and fiscal policy would have to be carefully managed to reduce the rate of inflation, particularly if the staff was correct that economic growth was set to recover strongly. The current price increases had been foreseen by the staff in its previous assessment, when it had noted that pressures for price increases could emerge as a result of the lagged impact of the previous year's supply shortfall and increases in both administered prices and direct taxes. Although inflation rates reflected the drought of 1982/83, and although the increase in administered prices was welcome, the greater than expected inflationary pressures might reflect a somewhat easier monetary policy than had been intended. In the circumstances, he welcomed the steps that the authorities had taken to tighten monetary policy, but he wondered whether their action would be sufficient to reduce inflation.

The staff had also noted some slack in the monetary system, with the banks continuing to extend loans, Mr. Shaw went on. The recent introduction of an incremental 10 percent reserve ratio should help to bring about an appropriate reduction in liquidity. In view of the importance of containing the increase in inflationary pressures, domestic credit targets should be set to reduce the danger that the expansion of net foreign assets would again result in a rise in the monetary aggregates more quickly than foreseen. He also wondered whether interest rates would remain positive for all types of financial assets, given the estimate for the consumer price index and the interest rates on five-year savings deposits shown in Table 1 on page 3 of EBS/83/276. It was unclear to him whether the increase in the inflation rate was likely to persist or whether, for example, a particularly large number of administered price increases had given an exceptional boost to prices quite recently. Could the staff elaborate on its statement that underlying price pressures appeared to have increased?

He was concerned about the weaknesses in the public finances, Mr. Shaw stated, despite the adherence by both the states and the Central Government to the target set for bank financing. The main reason that they had been able to adhere to the target was the additional financing provided by revenues from the oil sector, which might be largely fortuitous. As the staff had explained on page 11 of EBS/83/276, the deposits by the oil sector with the Government could be withdrawn if the conditions that had generated the surplus revenue were to change. In those circumstances, the continued overshooting of the Central Government's budget deficits, and the even more severe financial problems of the states, could be expected to vitiate the targets for bank financing of the public sector. Even so, the target of 6.5 percent of GDP for the overall public sector deficit was rather on the high side, seeing that it represented an increase from the revised 6.3 percent target for 1982/83, which itself had been 0.7 percent above the initial target for that year. Current estimates showed that the deficit was likely in practice to reach 7.1 percent of GDP before 1983/84. He therefore urged the authorities to take additional measures to reduce the deficit by lowering the fertilizer subsidy, and by increasing the prices in government enterprises as a means of reversing the recent erosion of profits. He would also support the authorities' efforts to encourage the state governments to reduce their unrealistically high sugarcane prices.

On industrial policy, Mr. Shaw went on, the staff had referred to government committees reviewing fertilizer subsidies and coal prices. Although he understood from Mr. Malhotra that some action had been taken, he wondered whether the reviews were not unduly delaying the necessary price adjustments. In more general terms, it would be interesting to know what proportion of Indian industry was still subject to price controls.

Commenting on trade policy, Mr. Shaw remarked that there seemed to have been little change in the position from the staff assessment of July 1982; a system of restrictions geared to the protection of domestic industry remained essentially intact. He was also rather concerned about slippages in the investment program. If the Government wished to lay the foundations for steady noninflationary growth, it would have to take action to ensure further investment, not only in electricity but also in other sectors in which there were also potential bottlenecks. It would also be necessary to increase the capacity of the states to finance such investment, and to reduce further the extent of regulation of prices in industry. Now that the policy of raising the rate of savings had been successful, efforts would have to be made to make more efficient use of investment funds; especially in many industrial sectors, the expansion of capacity had fallen short of the original expectations.

On the external sector, Mr. Shaw observed that, although the performance of the current account had been better than originally projected, the outcome had been due primarily to a weakness of imports, rather than to a strength of exports. He urged the authorities to continue their efforts to bring about external adjustment, and in particular to adopt an appropriate exchange rate policy to ensure competitiveness for the traded goods sector. Exports had increased much less than had been projected, and, in view of the structure of India's trade, sluggish export growth might persist for some time. In addition, cutbacks in expenditures by the Gulf States and restrictions on remittances might further weaken the external position. Therefore, external adjustment was particularly important if the necessary import liberalization were to continue, and even more so if India were to rely more heavily on commercial borrowing. Further progress would also have to be made on reducing the current account deficit, if India were to avoid debt servicing problems later on. Naturally, he supported the decision and welcomed the authorities' recent announcement that they would not draw the last SDR 1.1 billion available under the extended arrangement.

Mr. Agah interjected the question, "Which gulf do you mean, sir? There are many gulfs."

In reply, Mr. Shaw said that he had not specifically mentioned any Gulf State, but clearly there was a considerable number of Indian expatriate workers, and the term "Gulf States" would, he assumed, refer to entities around the Persian Gulf.

Mr. Agah expressed his chair's appreciation of the Indian authorities' announcement that they had decided to pursue the current economic and financial adjustment program without using the SDR 1.1 billion of the Fund's resources that would have been available to them under the extended arrangement. At a time of global liquidity shortage, such a decision could be interpreted, first, as an indication of India's comparative success in meeting at least part of the midterm objective envisaged under the present adjustment program and, second, as an effort to make the Fund's scarce financial facilities available for use by other members.

He generally concurred with the staff appraisal and would support the proposed decisions, Mr. Agah went on. He was pleased to note that considerable progress had been made toward economic stabilization and growth, the twin objectives of the 1983/84 adjustment program. Although there were certain shortcomings in economic policy formulation and implementation, the favorable results were nevertheless attributable to the meticulous formulation of policies, and in most cases a close monitoring of the program by the Indian authorities. For instance, although there had been an overall decline in agricultural output, specifically of foodgrains, from 133.3 million tons in 1981/82 to 128.4 million tons in 1982/83, the combination of favorable weather and appropriate actions such as the provision of financial incentives to farmers in the form of procurement/support prices and the use of modern production techniques and inputs, the winter production of wheat had risen from 37.5 million tons in 1981/82 to 42.5 million tons in 1982/83. Accordingly, it was expected that foodgrain production would continue to rise to new heights, an achievement that would have its own effect on other aspects of the economy. Apart from leading to cutbacks in supply and a sharp fall in income, the drought had contributed to a slowdown in the rate of growth in India's industrial production from 8.6 percent in 1981/82 to 3.8 percent in 1982/83. Although other factors such as rapid expansion during

1981/82 and weak world demand in 1982/83 had contributed to the decline in industrial output, he hoped that the situation would improve as a rise in incomes and the return of favorable weather revitalized those sectors of industry, such as power generation, which had been held back partly by drought, partly by the lack of domestic demand, and partly by exogenous factors.

Despite the progressive tightening of monetary policies, the banks had so far been able to provide sufficient resources to meet most credit demands, Mr. Agah stated. Nevertheless, he agreed with the staff that, it being likely that the volume of reserve money would fall and that demand for credit would rise, the authorities were correct to adopt policies like the recent introduction of a 10 percent incremental reserve ratio as a means of ensuring that the growth of monetary reserves would be no faster than the rate of inflation. He also agreed with the staff that since net credit to the Government and public savings and resources available for Plan financing were together either in line with or well in excess of the program targets, the authorities had an excellent opportunity to implement a firm fiscal policy and tight commercial policies as a means of reducing the rate of growth in the volume of money and the rate of inflation.

While the introduction of a number of liberal policies during 1983/84 was expected to bring about a relaxation of import restrictions and ease the regulation of industry, Mr. Agah observed, certain specific policies such as an adjustment in exchange rate policy should bring about more efficient export performance. Finally, as the Indian authorities had stated that they would continue to follow the economic and financial policy adopted under the present program, he hoped that they would succeed in maintaining a viable balance of payments position despite their decision to forgo the use of more than one fifth of the total amount that would have been available to them under the extended arrangement with the Fund.

Mr. Laske welcomed the progress made by India under the extended arrangement. The real rate of growth of between 6 percent and 6.5 percent was impressive. The staff based its expectation of such excellent performance on developments in the agricultural sector, which reflected the great efforts undertaken by the Indian authorities in recent years. However, he had gained the impression from other publications that progress in agriculture had largely been confined to specific geographical areas that might have a competitive advantage over others. It would be most valuable if Mr. Malhotra were able to give information on the possibilities for agricultural development in the less favored districts. The present uneven distribution of agricultural production in India had repercussions on the need for storage and transportation facilities, sectors where progress had in the past been impaired by serious bottlenecks. The staff had warned that shortfalls in investment might perpetuate some of those bottlenecks.

The staff had made a powerful case for policy action in the fiscal, monetary, and exchange rate fields, together with certain structural reforms, Mr. Laske noted. In the fiscal field, additional efforts were needed to contain the public sector deficit. What was needed was intensified cooperation between the Central Government and the authorities in the states, in order to facilitate the completion of projects of national importance, particularly in the energy and irrigation sectors. Constant vigilance was also needed with respect to the financial performance of the nationalized industries. While more realistic pricing policies had brought about considerable progress, improvements in management skills and reductions in bureaucratic regulations had not been taking place as fast as could have been wished. It would be regrettable if the measures to raise productivity in the manufacturing sector were given inadequate attention. Efforts to reduce the public sector deficit would be enhanced by continuing reforms on the revenue side; a broader and more equitable system of tax collection could contribute to that end without creating disincentives.

On structural reform, Mr. Laske stated that he would like to encourage the Indian authorities not to slow down the process of removing institutional rigidities in the economy. Further liberalization could make an important contribution toward the necessary increases in economic efficiency. In that way the manufacturing sector would be strengthened and the overall performance of the Indian economy reinforced. Structural reforms would also have a positive effect on eliminating the bottlenecks that he had mentioned.

On monetary policy, Mr. Laske remarked, he welcomed the steps taken by the authorities in November 1983 to slow down the growth of the monetary aggregates. Changes during the year seemed to indicate that the action taken in November could usefully have been taken earlier. The recent re-emergence of inflationary pressures, although largely attributable to temporary shortages of foodstuffs, could probably have been forestalled by a prompter reaction to the acceleration in the volume of money in circulation. Like Mr. Lovato, he was uncertain whether the recent increase in special reserve requirements would be sufficient to keep the monetary aggregates in check.

On external policy, Mr. Laske observed that a more vigorous liberalization of imports and other transactions could stimulate the growth of exports. He encouraged the authorities to pursue a more flexible exchange rate policy. Fairly substantial fluctuations in the real effective exchange rate had occurred during the past year; it should have been possible to avoid such fluctuations by appropriate exchange rate adjustment. He welcomed the decision of the Indian authorities not to draw on the Fund during the third year of the extended arrangement on the grounds that external constraints on India's finances had eased considerably. He was also pleased that India would nevertheless continue to follow the adjustment policies adopted under the extended arrangement. They had helped India to obtain substantial progress both internally and externally. He was confident that the continued pursuit of those policies would enable the country to press ahead with its development efforts, to achieve and to maintain a sustainable balance of payments position, and to safeguard its excellent credit standing with the international banking community. In conclusion, he supported the two decisions.

Mr. Senior stated that he would support the two proposed decisions. The recent performance of the Indian economy under the program for 1983/84 was satisfactory, as was the outlook for the future. Despite the unfavorable impact of the difficult external and domestic environments in 1982 and 1983, substantial progress had been achieved toward the attainment of the authorities' objectives. Economic activity had started to recover, and it was estimated that real GDP would grow in line with the target set down in the program. Developments in the external accounts had also been more favorable than originally envisaged. While further progress would still be needed to improve the external position of the economy in the future, the current and overall deficits as proportions of GDP were expected to be below the original targets at the end of the program period.

Partly owing to poor weather in 1983, the impact of increases in administered prices, and some supply difficulties, Mr. Senior observed, the inflation rate would be above the forecast. However, the combination of the structural efforts under way with the recent adoption of several measures in the monetary, credit, and fiscal fields could be expected to have a positive effect on reducing future pressures. All in all, the authorities should be commended for persisting in their adjustment effort, as demonstrated by their continuation of the prompt and forceful implementation of a wide range of policy measures, which had placed the Indian economy in a better position to achieve higher growth in the future.

In public finance, Mr. Senior considered, significant progress had been made toward achieving financially sound budgets. Clearly, public savings had continued to play a key role, and the expectation that they would rise above the program target of 5.6 percent of GDP was especially encouraging. He was glad to note that the authorities were determined to implement flexible pricing policies, particularly in the petroleum sector, and he welcomed the recently announced increases in other key sectors. However, he agreed with the staff that further progress in reducing subsidies was needed, particularly in the fertilizer sector, so as to take full advantage of the progress already achieved by public investment in some key sectors of the economy.

The performance of public investment as a whole had been satisfactory, Mr. Senior stated. However, as other speakers had pointed out, further progress was needed in certain sectors in order to foster future production and support the expected industrial recovery. The continuation of structural adjustment in the industrial and agricultural sectors was very welcome. A further liberalization of imports, a reduction of regulations, the reorientation of some industries, and the introduction of flexible pricing policies should together promote efficiency in the industrial sector. Similarly, the measures adopted in the agricultural sector had proved effective in raising output. He was encouraged by Mr. Malhotra's announcement regarding the recent decision to increase the prices of rice and sugar, which, together with the previous increases in the price of jute and other agricultural products, would add to the value of producer incentives.

The measures adopted to stimulate agricultural production, together with the continuation of restrictive monetary and credit policies, were already mitigating inflationary pressures, Mr. Senior observed. The gradual increases in the cash reserve requirements during the past few months were welcome; they seemed to have been instrumental in bringing the growth of narrow money nearer to the target for March 1984.

The external policies pursued during the program period had resulted in a better than expected improvement in the balance of payments position, Mr. Senior noted. The authorities' export development policies and industrial policies, taken together with the liberalization of imports and a flexible exchange policy, had significantly increased the competitiveness of established trade goods and had helped to increase the country's export potential. The expansion of the scheme for export-oriented manufacturing units would further enhance potential gains in export growth during the coming years. Nevertheless, he agreed with the authorities and the staff that a lasting improvement of the balance of payments position would require considerable perseverance, and adaptation to changing economic conditions. He supported the proposed decisions, and he wished the Indian authorities continued success.

Mr. Tvedt stated that he agreed with the staff appraisal. Despite the effects of the protracted world recession, India had been able to achieve the major objectives set out in the extended arrangement approved in 1981. In particular, the external position had been strengthened considerably, and international reserves had been built up to a relatively comfortable point. Moreover, efforts seemed to be under way to increase the efficiency of production and investment. Nevertheless, there was not much room for flexibility in the years ahead, as indicated by the staff. The Indian authorities would have to continue to pursue firm policies, much along the lines of conventional Fund programs. The authorities had demonstrated their ability to deal effectively with their economic problems; consequently, they enjoyed an excellent standing in the international credit markets. They should give high priority to preserving that reputation.

The prudence demonstrated by the Indian authorities in refraining from drawing all the resources to which they were entitled was to be commended, Mr. Tvedt considered, particularly if they continued to pursue their adjustment policies with determination. However, despite the progress already made under the arrangement, he wondered whether it would have been helpful to India to accept the Fund program throughout the period originally envisaged. The benefits of the program, after all, extended well beyond the financial resources directly involved. The point should perhaps be considered further if similar cases were to arise in the future.

Mr. de Vries welcomed the favorable developments in the Indian economy. The prospect for a 6.5 percent growth rate and a decline in the current account deficit in terms of GDP were both welcome, as was the decision of the Indian authorities not to draw on the SDR 1.1 billion available to them in the third year of the extended arrangement.

In the circumstances, Mr. de Vries went on, the extended arrangement could be considered to have come to a conclusion, and he had tried to assess the results that had been achieved. The authorities, it was clear, had made adjustments in exchange rate policy, in interest rate policy, and in pricing policy; they had succeeded in raising the rate of public savings, and they had moved much nearer toward agricultural self-sufficiency. Nevertheless, however valuable in themselves, those changes had made only a relatively small contribution to the authorities' success; indeed, the staff had not clearly indicated the main factor in their achievement.

One of the central features of the program, Mr. de Vries recalled, had been the improvement in public savings. It was true that the Central Government had more than achieved its target for increases in public savings, largely due to higher than expected receipts from the oil sector. On the other hand, some central government public enterprises had had their profits eroded by inflexible pricing policies, and perhaps by some lingering inefficiencies. At the same time, there had been rather serious shortfalls in the savings efforts by the states, an aspect that had been worrisome from the start of the program. Resolute steps were clearly necessary to improve the states' savings campaigns if the overall investment program were to be completed. From what Mr. Malhotra had said, there had been a shortfall of some 15 percent in invisible funds, and a reduction in the plan for expanding electric power generation had become necessary, together with a cut in irrigation projects. Shortages in electric power, irrigation, and coal production, as well as transport bottlenecks, were still adversely affecting the production effort. In brief, while the Indian authorities had achieved a great deal, they had not achieved all that had been hoped for at the time when the extended arrangement had been launched. The key to the improvement in output was clearly not in savings.

Regarding the subsidy on fertilizers, Mr. de Vries remarked in passing, he was rather agnostic. He could for instance imagine that subsidizing fertilizers might be a particularly valuable undertaking if the authorities intended to continue to increase agricultural output. Naturally, the cost of subsidizing fertilizers had to be set against the situation of the public finances as a whole. As Mr. Hirao had mentioned, there had been a steady increase in the overall deficit of the public sector from some 5 percent of GDP to almost 7 percent of GDP in the six years ended 1983/84.

On the balance of payments, Mr. de Vries noted, if the current account deficit were maintained at a constant share of GDP, there would be a rather worrying increase in the debt service ratio. The staff had therefore rightly concluded that the authorities should make continuous efforts to reduce the current account deficit to about 1 percent of GDP, a figure that the staff considered quite achievable. Even then, the debt service ratio would rise for the next two years until it reached 17.5 percent or 18 percent.

The one area of considerable success in the Indian program, Mr. de Vries considered, had been the oil sector. It had performed more favorably than expected by the authorities and considerably more favorably than expected under the original extended arrangement. Price developments had been more favorable for the consumer than had been assumed; the volume of output had risen much faster than originally envisaged; and the consumption of oil in India had shown greater elasticity in reaction to the major price increases of the past decade than had been expected, so that total consumption had substantially declined. As a result, India currently produced two thirds of its domestic oil requirements, a dramatic change for the better. Indeed, the staff had estimated informally that the value of Indian oil production had been some SDR 2 billion higher than originally expected, thus providing at least a partial explanation of how the authorities had been able to forgo the SDR 1.1 billion that would have been available to them from the Fund. Unfortunately, although the achievement of the oil sector was outstanding and commendable, he had the impression that many of the fundamental problems of the Indian economy were still unsolved. The easier foreign exchange situation might well give the Indian authorities a breathing spell in which to act on their preference for equity over efficiency. While he personally believed that the authorities might considerably underestimate the cost of that policy, it was of course entirely open to them to make such a choice; if they decided to pay for the pursuit of greater social equity with some loss of efficiency, the Fund could have nothing to say.

In brief, Mr. de Vries concluded, a number of important improvements had been made, and the considerable efforts undertaken in the oil sector had greatly eased the external position. He looked forward to seeing how the Indian authorities would resolve the conflict between modernization on the one hand and the claims of greater social equity on the other.

Mr. Alhaimus said that he was in broad agreement with the staff appraisal and had no difficulty with the proposed decisions. Prudent economic policy had enabled India to avert major adverse effects on prices and on external balances from the drought of 1982/83 and the worldwide recession. An adjustment program aimed at consolidating economic growth, controlling inflation, and moving toward a sustainable balance of payments position had contributed to strengthening the authorities' policy efforts. Their adherence to the performance criteria indicated that they had a sound grasp on the economy. More important, the authorities remained firm in their commitment to maintain the broad thrust of their adjustment, even after the end of the Fund program.

With GDP growth increasing from 2 percent in 1982/83 to an expected 6.5 percent in 1983/84, agricultural production recovering from the drought of 1982/83 better than expected, and the balance of payments position improving, the program for 1983/84 seemed to have been largely carried out, Mr. Alhaimus observed. Unfortunately, owing to developments in both demand and supply factors, industrial activity continued to be relatively subdued. While demand conditions were expected to improve considerably as a result of the hoped for world economic recovery and of the anticipated rise in agricultural output, supply problems would continue to hamper growth in the industrial sector. Consequently, at the present moment the authorities might be well advised to try to improve productivity in specific industries while attempting to quicken the pace of improvement in infrastructure, particularly in the energy field. In view of the existence of supply bottlenecks, the relaxation of demand management as a means of stimulating recovery could well lead in the present instance to inflationary consequences. The authorities had after all already initiated an attempt, in the midterm appraisal of the Sixth Plan, to protect investment levels in key infrastructure sectors, including power, irrigation, coal, and railways.

On the fiscal side, Mr. Alhaimus continued, the combination of a small shortfall in revenue with a larger than expected increase in expenditures was liable to lead to a somewhat larger than expected budget deficit. However, mainly because of a sharp rise in domestic nonbank financing--including loans from the newly developed oil sector and the enthusiastic public response to the Government's small savings scheme--the program ceilings for net credit to the Government were expected to be adhered to. Moreover, public savings--a point on which the program laid emphasis--were likely to exceed the target because of a rise in public enterprise savings and more realistic pricing policies. Although such savings were likely to raise the volume of finance available for planned expenditures, real investment was still likely to be squeezed, particularly at the state level. Some improvement also needed to be made in state government budgets, where savings were well below the program targets.

On the monetary side, Mr. Alhaimus observed, a rapid growth in the volume of money, resulting from the improvements in the external sector, had been met by the authorities with successive increases in the cash reserve ratio for commercial banks. Although the ceilings on domestic credit were likely to be observed, the rise in the volume of money would exceed the program projections and thus lead to a higher than projected rate of inflation. Nevertheless, the authorities believed that the inflationary pressures that were in part derived from recent supply problems, especially those in the agricultural sector, should abate when the supply position again became more favorable. Mr. Malhotra, indeed, had stated that the increase in agricultural output was already showing some signs of relieving price pressures. In any event, the authorities recognized that the situation would require careful monitoring and might eventually need a tighter monetary stance.

In the external sector, Mr. Alhaimus considered, the favorable overall balance of payments outcome was largely a reflection of increased capital flows into nonresident investment accounts. Export growth was expected to be below the program target as well as below the average for non-oil LDCs in 1983/84. Although the relatively slow export growth could be attributed to the weak recovery in India's export markets, the authorities had started taking steps to ensure export competitiveness, including easing regulations, increasing export incentives, and improving overall productive efficiency. It was encouraging to note that the revised projections for exports seemed to be more favorable. Import growth, too, had also been slower than expected, mainly because of the weak industrial recovery and higher domestic oil production.

In the medium term, Mr. Alhaimus observed, the authorities would need to continue their adjustment efforts, especially if the prudent policy of avoiding external debt service difficulties were to be maintained. Clearly, sustained export growth would also contribute to the adjustment effort. It would however be difficult to increase exports very greatly without a significant reduction of protection in the industrial countries. In addition, a further improvement in investment efficiency ought to help export growth.

In conclusion, Mr. Alhaimus considered, the case of India was a successful example of an extended arrangement, where adjustment need not take place at the expense of growth, and where sustained policy effort was combined with a timely approach to the Fund. Having used their resources from the Fund to reach a relatively favorable economic position, the authorities had correctly decided not to draw more resources while still continuing with the needed adjustment policies. Their commendable action would allow the Fund to direct resources to wherever they were needed most.

Mr. Erb stated that his authorities were pleased that the Government of India had decided that its balance of payments position was sufficiently strong to enable it to forgo purchases of SDR 1.1 billion under the Fund program and to cancel the program beyond 1983/84. The decision would preserve India's ability to seek Fund financing in the future if unexpected developments were to lead to a need for a balance of payments financing program; it was also consistent with preserving the temporary and contingent nature of Fund financing.

When he had first spoken on the program for India in November 1981, Mr. Erb recalled, he had said that his authorities had serious doubts whether India's balance of payments prospects justified the application of enlarged access in the magnitude envisaged. He had expressed the hope that India would reduce its expected or planned purchases from the Fund, treat the Fund's resources as a truly stand-by source of financing, and draw from the Fund only when absolutely necessary. During the first major review of the program in April 1982, he had supported India's drawings at that time, in part because India's balance of payments position had temporarily turned out worse than expected, although the authorities' policies had remained on course. In view of the current and future balance of payments prospects and the authorities' policy intentions, he could support the request by the authorities to draw the remaining SDR 600 million available during 1983/84.

His authorities were also pleased that India intended to continue to pursue the policy objectives and actions that the Fund had supported under the program, Mr. Erb remarked. The intention to follow macroeconomic policies designed to improve domestic savings and investment and to achieve relative price stability, and also to reduce or remove structural rigidities certainly represented objectives that his chair continued to believe were in the best interests of India and the world economy. What was at stake was not only India's domestic growth prospects, but also the prospects for a strong balance of payments position that would perhaps enable India to attract larger-scale net capital inflows. He was glad to see that the Indian authorities intended to continue to seek the analysis and advice of the Fund, including, naturally, normal Fund consultations. The Fund should stand ready to provide technical assistance and special analyses if requested by the authorities.

Commenting on the broader macroeconomic policies of the Indian authorities, Mr. Erb remarked that a basic assumption of the program was that India would continue to pursue, and indeed strengthen, its record of prudent policy management designed to expand savings and investment and to improve price performance.

As for price performance, Mr. Erb went on, after reaching a peak of 12.5 percent in 1981/82, the rate of inflation as measured by the consumer price index had fallen to 7.7 percent in 1982/83. He was disturbed by the resurgence to about 12 percent in 1983/84, and by the rapid growth in the monetary aggregates. A relatively low rate of domestic inflation was important if India was to achieve its objective of a relatively stable exchange rate.

Although the target for the overall domestic savings ratio had been achieved in 1983/84, Mr. Erb observed, there appeared to have been some shift in the composition of savings, with public savings representing a larger share of the total than hitherto, while private gross savings, which had amounted to 19.6 percent of GDP in 1978/79, had fallen to about 17.8 percent in 1982/83. The fall in private gross savings seemed to him to reinforce the need to permit deposit rates to become positive in real terms. Also, as the staff had pointed out, the improved financial position of the state oil sector, due to the decline in world oil prices, accounted for an important part of the improved savings position of the public sector, while the performance of the Central Government, of non-oil public enterprises, and the states had been less favorable.

In reference to central government finances, Mr. Erb stated that he was worried that the ratio of the budget deficit to GDP would increase for the second consecutive year. The Government's use of subsidies was a major part of the shortfall in the deficit performance, as the subsidies not only distorted relative prices but were ultimately inefficient and self-defeating; he urged the authorities to make every effort to eliminate them.

Over the longer term, Mr. Erb considered, India's growth potential would depend on achieving sufficient fixed investment. India had traditionally maintained a rather high ratio of fixed investment to GDP--24.4 percent in 1977/78, before the oil shock--and the ratio had increased somewhat to an estimated 26.5 percent for 1984/85. Although the staff report for the most recent period had not shown a breakdown between private investment and public investment, there seemed to have been some shift toward public investment. That could be a negative development. Indeed, a slower rate of public sector investment might be appropriate, given the limited possibilities for raising India's private savings rate and the problems with raising public savings further. Perhaps more important, close attention should be given to the quality of future public investment.

Under the terms of extended arrangements, countries were expected to try to bring about structural changes, Mr. Erb noted, so that the intentions of the Indian authorities to improve the structure of the economy lay at the heart of the program. At an earlier stage, his authorities had had a major reservation about the program because the Indian authorities had not produced a more detailed statement of the structural adjustment measures that they intended to carry out under the program. At that time, indeed, one of his criticisms had been that the Executive Directors had not been provided with sufficient information on price regulations, licensing, or other restrictions affecting domestic and external trade transactions that the Government sought to remove or reduce. During the past two years, however, the staff had made a successful effort to provide such information, and the Executive Board's understanding of the rigidities in the Indian economy had improved accordingly. Section IV of SM/84/15, for instance, was informative about India's licensing policies and represented a useful addition to the staff descriptions of other structural aspects of the Indian economy.

Even so, Mr. Erb stated, it remained difficult to assess the extent to which the authorities had succeeded in moving in the direction of their original objective, as outlined in their letter of intent. He was rather disturbed to find that more aggressive actions had not been taken during the first years of the program. In particular, he was concerned that insufficient progress had been made toward liberalizing a quite complicated regime of import and export restrictions, especially in view of the large volume of Fund resources made available to support the effort.

A considerable part of India's near-term balance of payments improvement seemed to be due to a strengthening of the terms of trade beyond the expectations set out in Chart 3 on page 24a of EBS/83/276, Mr. Erb mentioned. Moreover, the Indian economy appeared to be less open at present than before the second oil shock, at least if measured by the ratio of exports and imports to GDP. By that measure, in 1983/84 the external sector had represented 12.6 percent of GDP compared with over 13.3 percent of GDP in 1978/79 and an average of slightly over 14.4 percent in the intervening years, notwithstanding the upward pressure on the ratio caused by the rise in the price of oil imports.

On India's external policies, Mr. Erb observed, it was difficult to see whether the authorities had been successful in achieving a realistic pricing of foreign exchange because the real effective appreciation of the rupee during most of 1983 had raised the rate above what it had been when the Fund program had started in November 1981. First, it would be interesting to have a clearer exposition of the staff view on the present competitiveness of Indian exports. The rise in the real effective exchange rate might be of less concern if there had been a more robust growth of exports in the intervening period. Second, his authorities had noted India's efforts to liberalize imports, and he urged that such efforts should be continued. Third, he had some difficulties with the export incentives used by the Indian authorities. In general terms, export subsidies had a negative effect on the world trading system and the resources of the subsidizing countries. Fourth, there had been increases in the cash compensatory scheme for Indian exports during the course of the program. He hoped that those increases were justified by parallel increases in internal tax payments on the products in question. If not, they could be considered new export subsidies.

It was also difficult to evaluate the impact of structural changes on domestic pricing and regulations, Mr. Erb considered. Progress had been made in simplifying industrial licensing and pricing policies, but direct controls remained widespread, and the adjustments appeared to be more discrete and less flexible than might have been expected. For instance, while the recent increase in coal prices had been desirable, profits having become negative, the long lag since the previous price change meant that the recent movement had had to be much larger than would have otherwise been necessary. It would be interesting to see in future whether there was any discernible increase in the efficiency of the Indian economy as measured by rising productivity or other symptomatic progress toward that goal. A reading of the staff report had given him the impression that the Indian authorities continued to think of their economy in terms of a domestic sector and of an external sector with little interaction between the two. For example, much of the import liberalization appeared to be linked directly to export development. And he wondered whether the authorities' legitimate desire to avoid the consequences of monopoly power in their domestic economy might not be better served by making the whole economy more open than by restricting the size of productive entities.

Speaking on India's midterm prospects, Mr. Erb noted that the conclusion of the staff analysis seemed to be that under the conservative scenario of 8 percent real growth in exports and 5 percent growth in imports, it would still be necessary for the authorities to follow policies aimed at further strengthening the external sector. Another conclusion was that a somewhat faster growth strategy, involving a 7 percent real growth of imports, would require greater use of foreign borrowing, including commercial borrowing, leading to a debt service ratio of over 20 percent by 1989/90 and a continued rise in the ratio throughout the 1990s. Such an outlook must be rather sobering for a country that would have reduced the ratio of its current account deficit to GDP from a recent maximum of 2 percent to an estimated 1.6 percent for 1984/85, and that was also the beneficiary of continued concessional financing assistance.

One conclusion, Mr. Erb observed, might well be that resort to additional commercial financing would be a risky way of covering deficits. Another might be that further improvement was necessary in the underlying structure of India's current account and economic position. The continued small ratio of exports to GDP was clearly a limiting factor in servicing foreign debt; the absence of any significant amounts of foreign equity investment was another. Questions could also be raised about the efficiency and productivity of domestic investment. Such considerations suggested that the authorities would need to make continued efforts to reduce structural rigidities and to make the economy more open. In so doing, they would improve India's ability to attract large inflows of capital without running into external financing problems in the future.

He looked forward to following the progress of the Indian authorities in strengthening their macroeconomic policies and reducing structural rigidities, Mr. Erb stated. A continued effort would be in India's own interest; it would improve its great growth potential and strengthen its external payments position in a volatile world economy. He admired the efforts of both the staff and management throughout the program as well as those of Mr. Malhotra, who had been on both sides of the program, first in India and then in the Fund.

Mr. Clark stated that he endorsed the staff appraisal and supported the proposed decisions. While he commented with some caution on an economy as complex as India's, he would endorse Mr. de Vries's analysis of the importance of developments in the oil sector as a key to understanding some of the improvement in the external position.

The extended arrangement for India could be considered a success, especially as one of the primary requirements for an extended arrangement, namely, balance of payments viability at the end of the program, seemed to have been met, Mr. Clark commented. The wisdom of the authorities' decision to come to the Fund early in 1981 had been borne out by events and could be considered exemplary. Equally reassuring had been the progress that had resulted from economic management in the past and the undertaking that the authorities would continue to pursue the program targets with determination. He warmly welcomed the Indian Government's decision not to draw further under the program, a gesture that would assist the Fund's liquidity position considerably. He would however be interested to know why the Indian authorities had opted not merely to forgo the drawing but also to announce their intention of canceling the program.

Nevertheless, a number of major difficulties still remained, Mr. Clark noted. There was still a long way to go to increase the flexibility of the pricing system and to remove trade restrictions. He would endorse Mr. Erb's observations about the imprecision of the original program objectives in connection with structural change.

On the fiscal policies of the Indian authorities, Mr. Clark considered it rather disturbing that the forecast for the central government deficit had again been an underestimate. Part of the deficit on current account must reflect the general difficulty of raising domestic revenues, and he wondered whether the authorities would consider a further increase in petroleum excise taxes, for instance. On the expenditure side, he recognized the arguments as to why some subsidy on fertilizer was probably needed, but for general budgetary reasons the item should be kept under close control.

The need for improved fiscal performance by the states had been commented on regularly by the Executive Board for the past two years. It was rather disappointing that the staff should still find that there had been little discernible progress in that field.

In the public sector, Mr. Clark went on, electric power generation had emerged as one of the main industrial bottlenecks. It would be interesting to know how responsibility for the development of electric power generation was divided between the states and the Central Government. His authorities wondered whether central control ought not to be extended if output were to increase at a reasonable rate. It would be useful to hear comments from Mr. Malhotra or the staff on that point.

He congratulated the authorities on the measures taken to contain inflation, Mr. Clark continued. A tight credit stance would have to be maintained and he commended the authorities for bringing M-1 back within the target range. It would also be important to secure positive real interest rates if the already high savings ratio were to be sustained.

He welcomed the authorities' determination to pursue a realistic exchange rate policy, something that would clearly be essential for achieving adjustment, Mr. Clark remarked. Unfortunately, he had been unable to discover either whether the staff considered the real effective exchange rate to be appropriate, or whether the staff had given any explicit consideration to the factors influencing the rate. For instance, seeing that imports represented only about 8 percent of GDP, a modest depreciation of the rupee would not have excessively unfavorable inflationary implications. More important, he wondered whether the staff thought that the present real exchange rate was likely to secure the export growth of 8 percent that was assumed in both medium-term scenarios.

As to the medium term, Mr. Clark recalled that several Executive Directors, including his own chair, had in the past asked for projections of the sort that had now been prepared by the staff. The main difference between the two projections offered was that, in one imports would grow by 5 percent annually while, in the other, they would grow by 7 percent annually. The 5 percent growth rate was said to be consistent with a GDP growth rate also of 5 percent which, with a population growth of 2.2 percent, would appear to allow for a sustainable and modest real per capita growth. The two scenarios also showed that, in a number of different circumstances, debt servicing could all too easily become a constraint on future economic growth; it would certainly be higher than the maximum debt service ratio foreseen when the arrangement had originally been approved. In those circumstances, he endorsed the authorities' continued cautious approach to increasing external indebtedness. Their policy of permitting commercial borrowing "for projects for which concessional financing was not available and whose viability and ability to service the debt was assured" seemed entirely warranted. He agreed with the authorities that more investible resources could be made available without affecting the debt servicing profile if there were greater recourse to foreign equity investment. Nonetheless, he considered the staff to be right in pointing out that gross capital formation had risen from about 12 percent of GDP in the 1950s to about 20 percent by the mid-1970s, and that it was now over 25 percent, supported by a savings ratio of almost 25 percent. The staff conclusion that the focus of policies must shift to improving the efficiency of investment was surely correct.

In brief, Mr. Clark concluded, in major respects the extended arrangement seemed to have been a success. There had been a measure of structural adjustment accompanied by demand restraint and reduced inflation, and there seemed to be a reasonable prospect of reaching viability in the balance of payments, despite the hardening of the terms of concessional and external assistance--which accounted for one sixth of foreign exchange receipts--and adverse swings in the terms of trade. India's decision to come to the Fund early and to adopt tough policies had been correct; indeed, India's best hope for the future lay in continued timely action in connection with its policies. Nevertheless, it was not certain that debt servicing problems could be forgotten; of the staff's two scenarios, he urged that the adjustment oriented scenario be given the most careful consideration as offering significantly better outcomes for the current account, foreign borrowing, and debt service.

Mr. Sangare considered that the Indian authorities deserved commendation for their efforts to bring the economy back onto the path of recovery. There was every evidence that continued implementation of the adjustment measures would lead to a more sustainable rate of economic growth. Projections for the immediate future indicated that growth in real output would be strong in 1983/84, and that inflationary pressures that had been kept in existence by uncertainties with regard to the food supply would subside in the wake of the recovery in the agricultural sector following the return of favorable weather. He had been glad to hear Mr. Malhotra explain that the authorities had decided to forgo the purchase of the remaining SDR 1.1 billion available under the extended arrangement, in order to release those resources for use by the Fund in assisting countries with more acute balance of payments problems. The Indian authorities nevertheless intended to continue with the adjustment process, and he was confident that they would bring it to a successful conclusion.

The review of the Sixth Plan had enabled the authorities to pinpoint some of the main difficulties of implementation, Mr. Sangare noted. He agreed both with the authorities and with the staff that there was a need to protect investment in the priority sectors--electric power generation, transportation, and irrigation--which had been scaled back as a result of a lack of financial resources. The importance of irrigation to the overall development of the agricultural sector in India could not be overemphasized.

As for the Seventh Plan, Mr. Sangare commented that it was impossible at the present stage to prefer one scenario over another in the absence of a clear set of policies for the period in question. Nevertheless, the broad objective of maintaining policies aimed at achieving a sustainable balance of payments position while pursuing the stated development of social goals had a great deal of merit. The extent to which the Indian authorities succeeded in that task would depend not only on how well domestic policy measures were implemented but also on how strong the recovery in the world economy turned out to be. It would certainly be important for India to have freer access to markets for its exports. The Indian authorities themselves had taken bold steps to open up their own economy by liberalizing imports. In conclusion, he would support the proposed decisions.

Mr. Ismael observed that there was no doubt that India had made substantial progress in its efforts to adjust. The staff had described the fundamental changes that had already taken place, particularly in the policies governing pricing, the liberalization of imports, and the creation of a better environment for business investment. The measures had been introduced at an especially difficult time for India, which had been facing one of the most severe global recessions. He encouraged the authorities to persevere with their attempts to carry structural adjustment to its conclusion.

It was indeed good news, Mr. Ismael considered, that the agricultural sector was expected to register a record harvest in 1983/84, especially coming so soon after the disappointing outcome of the previous year brought on by the severe drought. The agricultural sector represented 40 percent of gross domestic product, compared with 15 percent for the manufacturing sector, and a large proportion of the population depended entirely on it for its livelihood. It was evident that the authorities were bound to make every possible effort to end the almost complete dependence of the agricultural sector on the vagaries of weather. In that connection, he strongly supported the authorities' agricultural policies, particularly those relating to the use of modern agricultural techniques, including the extension of irrigation, rural electrification, and agricultural extension services. The increase in agricultural output, particularly in foodgrains, over the past 15 years had indeed been impressive. It testified to the success of past policy, which had emphasized the use of fertilizers, higher-yielding seeds, agricultural credit, and--most important of all--irrigation. He had been rather disturbed to see the reduction in real investment in irrigation for 1983/84 reported in EBS/83/276. The staff had said that investment both in irrigation and in electric power generation was inadequate. While recognizing that the shift might well be due to national priorities involving a re-examination of the main focus of investment, he would like to urge the authorities to continue to stress the importance of those sectors, particularly at the state level.

As to support prices, Mr. Ismael said that, coming from another developing country, he could understand the rationale for the policies adopted by the Indian authorities. After all, some 250 million people in India were said to be living below the poverty level, and a fixed support price could be regarded as, in some way, a guaranteed income. The policy would also be in line with that of achieving food self-sufficiency for India. On the other hand, it would certainly be necessary to act with prudence in view of the burden of subsidies on the Treasury and the need to promote efficiency in investment. The authorities should perhaps concentrate on modernizing agriculture and at an appropriate time abandon both procurement and price supports. He was encouraged to note that in more general terms the authorities were moving toward less control in their pricing policies.

He had been disappointed to learn that the industrial sector had not performed as well as agriculture, Mr. Ismael stated. Naturally, the reduction in farm incomes caused by the previous year's poor harvest was bound to have lowered demand, but it should begin to recover in the course of 1983/84, since there had been a strong surge in agricultural income. He wondered however whether the economy would be able to respond adequately to the expected increase in demand. The staff had reported possible supply constraints in key sectors like electricity generation, coal, steel, and freight transport by rail. He would appreciate a comment from the staff indicating how serious the constraints might be. Table IX on page 90 of SM/84/15, dealing with seven selected industries, seemed to indicate that they had not been running at anywhere near full capacity, except for integrated steel plants of the private sector. What appeared to be needed was a type of credit policy designed to encourage the main industries to make fuller use of existing and new plant capacity. Such measures seemed to have been taken in general terms, and he hoped that they could be brought to fruition. He also wished to commend the authorities for their attempt to move toward more freedom in industrial policy. He had been encouraged to note the increase in administered prices and the decision to allow prices in certain industries, such as steel, to be fixed by the market. The increase in petroleum prices had certainly contributed significantly to financing the public sector deficit. He would encourage the authorities to dismantle other forms of price control at an appropriate moment.

Commenting on inflation in India, Mr. Ismael said that he agreed with the authorities that one of the major sources of inflation was the supply side in agriculture. He expected such pressures to ease substantially in the near future, with the arrival of better supplies of foodgrain. Nevertheless, the reported supply constraints in industry were worrying, as they might become more intense in the coming months. The authorities should certainly give priority to trying to prevent the continuation of the recent strong rise in wholesale prices. They would of course have a difficult task, as the expansion of growth had not been accompanied by a similar rise in industrial activity.

The adoption of an expansionary fiscal policy would be quite inappropriate at the present time as a means of promoting investment and industrial activity, Mr. Ismael considered. All that would happen would be an increase in price pressures. He would encourage the authorities to concentrate investment in key sectors such as electric power generation, irrigation, and other support services. He would also like to see selective credit exercised as a means of encouraging sectors where there was unused capacity. At the same time, the authorities would have to be careful to prevent an excessive buildup of liquidity due to an inflow of revenue from abroad following a stronger than expected pickup in exports. Paradoxically, they should also monitor closely leakages in the demand for imports, especially at a time when imports had been significantly liberalized. The outcome might be to tighten credit more than had been expected, at a difficult moment. The authorities should therefore exercise the greatest flexibility in their conduct of monetary policy. He wished to commend them for their decision to forgo the SDR 1.1 billion mentioned by Mr. Malhotra, and for their commitment to continue with the adjustment effort on their own. He fully supported the two proposed decisions.

Mr. Robalino commented that, despite the world recession and the drought that had affected India's foreign trade, the authorities had in general been successful in bringing about adjustment in line with the extended arrangement. The financial program had remained on track, and he commended the authorities for showing that demand management policies did not necessarily mean a fall in economic growth. The staff seemed to be dissatisfied with the central government deficit and with the excess of industrial regulations in India. In particular, the staff was worried that the government deficit was absorbing an increasing share of net private savings. While such comments were of course valid, it was possible to look at the matter rather differently. There was no question that the ratio of the central government deficit to net private savings at 58 percent in 1981/82 was higher than in the average of industrial countries. He himself did not see that the position would cause any great problem, because most of the country's capacity for generating investment and growth was centered in the public sector. Indeed, state enterprises had been able to increase their share of rising public sector savings. He did not agree with the staff conclusion on page 47 of SM/84/15 that the licensing system and restrictions on entry could potentially hinder competition and inhibit economies of scale. On the contrary, a policy of reserving specific fields for small business was one of the best ways of stimulating competition and employment, particularly in a country where capital resources were scarce and where the mobility of factors was not high.

On the other hand, he agreed with the staff that the small domestic demand was one of the principal causes of the relatively low level of industrial activity, Mr. Robalino went on; he therefore believed that the expansionary fiscal policies recently followed had played an important role in preventing recession and curtailing unemployment. In any event, the staff had made a thorough analysis of the authorities' fiscal policy; he hoped that the same technique, which had also been applied to the 1983 Article IV consultation with Korea, could be used for less developed countries' possessing the relevant data.

On the export side, Mr. Robalino commented, he was glad to see that exports were well above the original target and that India had reduced its dependence on bilateral agreements. The import liberalization policy, if somewhat subdued, had nevertheless been continued in 1983. No doubt the exchange rate policy followed by the authorities had been instrumental in stimulating exports. He hoped that in future a realistic policy would be followed as a means of maintaining the competitiveness of Indian industry.

He had been particularly impressed by the way in which the authorities had handled the drought of 1982/83, Mr. Robalino observed. They had adopted a strong commodity price policy, improving extension services for farmers, encouraging greater use of fertilizers and pesticides, and following an aggressive policy of stock formation by expanding imports of foodgrains. The continuing abatement in price rises throughout 1983 showed that appropriate agricultural policies combined with a tight demand policy could significantly reduce inflationary pressures if applied at the right time and with prudence. By contrast, monetary policy seemed to have been more expansionary than it ought to have been up to October 1983. He was glad to have heard Mr. Malhotra say that the necessary restraint had been applied and that monetary policy had become more moderate in recent months. He hoped that the authorities would continue to follow a tight monetary policy to avoid any resurgence of inflationary pressure. In conclusion, he supported the proposed decisions.

Mr. Delgadillo recalled that in November 1981 there had been considerable discussion in the Board on the size of the extended arrangement with India and on the considerable adjustment effort required. Since then, the authorities' performance had been impressive, and he was glad that most of the program targets had been met. The overall balance of payments developments had been more favorable than expected, enabling the authorities to carry out their stabilization program with some success. Despite the weak performance of some industrial sectors, the Indian economy as a whole had grown at a fairly high rate for the third consecutive year. During 1983/84, the agricultural sector had made a particularly strong showing, with foodgrain production reaching record levels, and the output of other major crops following a similar trend. It would be interesting to know the extent to which the recovery in agriculture was the result of more favorable weather or the consequence of better pricing policies.

Although the credit ceilings under the program had been met, Mr. Delgadillo went on, there was room for improvement in the fiscal sector, both in the Central Government and in the states. The surplus accumulated by the oil sector and used in part to finance government expenditure ought not to be considered a permanent source of revenue. A further reduction in the fiscal imbalance was needed if the present efforts were to be consolidated into a noninflationary recovery. He therefore welcomed the set of measures described by Mr. Malhotra.

Commenting on the allocation of domestic resources, Mr. Delgadillo said that he supported the policies adopted by the authorities, particularly the removal of import restrictions and of disincentives to export-oriented industries. There were however some remaining rigidities that could lead to bottlenecks in industrial output. The authorities should therefore continue to introduce flexible pricing policies, like those that had produced such satisfactory results in steel and cement.

Taking up India's external policies, Mr. Delgadillo said that he agreed with the staff on the dangers of relying too heavily on bilateral payments agreements. The authorities could strengthen the export sector by improving domestic supply conditions and by finding more export markets. He welcomed the balance of payments developments, which had been more favorable than expected in the first half of 1983/84. As to the medium-term perspective, he encouraged the authorities to monitor closely all their financial policies in order to consolidate their achievements. The program adopted by the Indian authorities in conjunction with the extended arrangement had by and large provided a sound basis for the recovery of the economy. It therefore deserved the strong support of the Executive Board, and he could approve the two proposed decisions.

Mr. Zhang stated that he agreed with the staff that, taken over all, the Indian authorities had made considerable progress toward the objectives set out in the extended arrangement. The arrangement had been granted in support of a medium-term adjustment program directed toward overcoming the balance of payments difficulties that had emerged following a deterioration in the terms of trade resulting mainly from the second oil crisis. In the external sector, steps had been taken to open India's markets more fully to imports, and to boost exports and other economic ties with the rest of the world. Domestically, the program had envisaged the adoption of a balanced combination of policies as part of a Five-Year Plan to deal with both short-term and structural problems. Special measures were to be taken to deal with demand and supply, infrastructure, economic efficiency, and savings. The main objective of the program was to strengthen the development process, thus enabling India to obtain a position of economic strength from which it could stand firmly on its own and reduce its reliance on external assistance.

During the first two years of the program, 1981/82 and 1982/83, the performance of the various sectors of the economy had been generally favorable and closely in line with the track laid down in the program. The intention in 1983/84 had been not only to assist the country to recover from the difficulties of 1982/83 but also to continue with the work of structural adjustment, particularly in the external sector. In that sector, the staff estimated that both the current account and the overall deficit for 1983/84 would be lower than had been projected when the program had been approved. Foreign exchange reserves had already been built up to a comfortable figure, and the external deficit for 1984/85 was also expected to be lower than the original target. External performance, weakened considerably in 1982/83 by unfavorable factors both at home and abroad, was expected to continue to be sluggish for the entire year 1983/84. However, the Government had already adopted measures intended to stimulate exports, such as the recent adjustment of the exchange rate, and had also recognized the need for further measures in the same field when appropriate. At home, the rate of increase in GDP had been high in 1983/84 and was expected to rise still further, so that most of the domestic targets had been met.

In the light of such an improvement in the economic situation, Mr. Zhang went on, the Indian authorities considered that they had reached a position in which they could carry out that part of the adjustment program originally envisaged for 1984/85 without the need for calling on the same volume of external resources as had been used in 1981/82 and 1982/83. They had therefore decided not to draw on the Fund's resources for 1984/85 under the extended arrangement. The Indian economy had indeed emerged from the adjustment of the past several years with new maturity. That decision to forgo further drawings under the 1981/82-1984/85 extended arrangement was an important signal of the growing underlying strength of the Indian economy and its success in achieving economic growth under the successive Five-Year Plans.

From the Fund's point of view, Mr. Zhang observed, the decision was welcome and came at a time when the Fund's liquidity position was hard pressed, as a result of increasing demand for resources from other member countries. He joined his colleagues in expressing his appreciation of the action by the Indian Government, and he supported the two proposed decisions.

Mr. Orleans-Lindsay commended the Indian authorities for the determination with which they had carried out their adjustment program, adopted in connection with an extended arrangement from the Fund, and for the progress that they had made in meeting most of the targets for 1981/82 and 1982/83. Estimates for 1983/84 indicated that the authorities were succeeding in consolidating their progress, which had been broadly in line with the selected adjustment path, despite the drought of 1982/83 and the world recession.

He commended the Indian authorities on their decision to release SDR 1.1 billion to enable the Fund to meet the requirements of other countries whose balance of payments needs were perhaps greater than those of India, Mr. Orleans-Lindsay stated. He greatly appreciated the action by the Indian authorities in view of the pressures on the Fund's financial position. He endorsed the staff appraisal and supported the proposed decisions. His chair, but not his chair alone, had a great deal to learn from the Indian experience. He hoped that the authorities would have success in completing their adjustment program.

The staff representative from the Asian Department, replying to questions, commented first on inflation and monetary policy. Clearly, the continuation of inflation at higher than expected rates was a matter of concern. However, the staff had been surprised that inflation had remained so low in 1982/83 despite the severity of the drought. Experience would have suggested that prices would surge considerably, led by the prices of key consumption items. Normally, the effect of a drought would be felt with a lag persisting until well after the return of favorable weather. Although inflation had risen in line with expectations in the early months of 1983, the price surge had been relatively subdued. The main reasons had been the strong stock position, reflecting timely imports of several commodities; restrained demand management had also played an important role. Moreover, as described in Part III of SM/84/15, there had clearly been a fundamental improvement in agricultural productivity, implying increased resistance to drought. The authorities and the people of India had indeed achieved outstanding success in raising the productivity of foodgrain farmers. As a result, the deprivations that some 250 million people living at or below the poverty level would be forced into by predictable periodic droughts would be substantially eased.

When the staff had been in India in November 1983, the crops from the current harvest had just begun to reach the market, the staff representative considered. The authorities had felt that the harvest would have a considerable effect on prices and had expected that prices would fall toward the end of the year. At that time, neither the staff nor the authorities had been prepared to assign an important role to monetary developments in the price situation. They had been aware that monetary growth had been somewhat faster than had been intended, but the more rapid rate of growth had been a very recent development. Both authorities and staff had however agreed that action would have to be taken in the monetary field sooner or later in order to prevent a rise in prices. The staff would now take a different view. The fact that inflation had remained high, or had even increased, after the supply position had improved and well after there had been a general expectation that it would improve, seemed to point to the importance of monetary developments in 1983. The revised view was reinforced by the evidence presented in Part IV of SM/84/15, where it was suggested that the money supply had a significant impact on prices with a lag of as short as one quarter. By comparison, the lags with which other important variables affected inflation were considerably longer.

In brief, the staff representative went on, the staff believed that while the drought of 1982 had been the cause of the inflationary surge that had begun early in 1983, monetary developments in 1983 were an important factor in explaining the persistence of inflation. Sustained success in reducing the rate of growth of money in line with the targets for the financial program would be needed if inflation were to be cut significantly in the period ahead. The recent strong policy measures taken by the authorities in both the fiscal and monetary fields indicated that they shared that view.

Some speakers had asked a question relating to the level of interest rates, the staff representative recalled. All lending rates would remain positive, even at the present high rates of inflation. On the other hand, many deposit rates would not be positive. Throughout the program, the authorities had taken the view that interest rates had to be judged in the light of price developments. When inflation had been high early in the program period, the authorities had raised interest rates in several steps. However, they believed that there should be a substantial degree of stability in interest rates. The authorities would therefore be well advised to pursue their anti-inflationary policies first, and to consider introducing a more active interest rate policy if it appeared that success in slowing inflation was going to be delayed.

A number of speakers had expressed concern about the rise in the budget deficit, the staff representative recalled. The staff had focused strongly on public savings developments on the understanding that the potential for borrowing from nonbank, nonmarket sources was limited. However, the authorities had recently had much more success in attracting funds into special types of instruments issued by the Government, so that the Government had obtained greater freedom of access to nonbank financial resources and had been able to finance large deficits. The staff would therefore be more concerned about the deficit at the present time than it had been when the program had originally been constructed. He was encouraged by the measures that the Government had announced two weeks previously to reduce expenditure in the current year. The authorities had announced an ambitious program to cut back on both current and capital expenditures in 1983/84. The staff had no clear indications of the extent of the impact of those measures, but it could be substantial, even at the present late stage in the budget year. Similar reductions would be reflected in the budget for 1984/85, which would be presented at the end of February 1984.

On the fertilizer subsidy, the staff representative commented, a number of Executive Directors seemed to have been taking a view similar to that of the Indian authorities, to the effect that there was a distinct tradeoff between the cost of subsidizing fertilizer and the benefit of making fertilizer more widely available. The staff did not have any real indication of the effect of reducing fertilizer prices early in 1983/84 either on the output of foodgrains or on the consumption of fertilizer. The World Bank staff was inclined to attribute the increase in agricultural output to other factors, such as weather. Naturally, there could be an increase in the use of fertilizer when the weather improved; farmers would not spend money on fertilizer when there was a drought at the time of planting. Nevertheless, there was a strong presumption that the lower price of fertilizer was closely related to the increase in fertilizer consumption. At the same time, the traditional approach would indicate that the costs of the fertilizer program were a major factor in the public sector deficit, and that the authorities would be well advised to make sure that they became no larger.

On the question of price controls, the staff representative remarked that there had been little change. When the staff had made an estimate at the beginning of the program, it had stated that about one quarter of domestic industry was subject to price controls, which were applied to agriculture, goods sold through publicly owned fixed-price shops, intermediate goods such as fertilizers, copper, aluminum, paper, energy (including coal and electricity), and rail and other transport charges. Cement and steel had at least partially been removed from the list, so that the scope of price controls had been reduced.

There had been a major increase in central government influence in the electric power sector, the staff representative observed, to such an extent that central government involvement had risen to 28 percent of the total investment program in the power sector for 1983/84. Certainly, an effort was needed at every level in that sector, but it was difficult to find ways and means of transferring money to the states for that purpose; the financial aspects of the electric power program were only a part of the whole issue of the relations between the Central Government and the states in financial matters. To answer Mr. Clark, the staff did believe that greater involvement by the Central Government in the power sector was probably desirable.

In reply to Mr. Ismael, the staff representative from the Asian Department remarked that the bottlenecks had been less severe in 1983/84 than in 1980/81, but more serious than in 1982/83. There had been some slippage in investment, particularly in the power sector, but perhaps also in the coal sector, where production had been slow early in the year. Shortages of coal had led to problems in other parts of the economy, so that a falling off in investment would be a matter for considerable concern, especially if domestic production gained momemtum during the rest of 1984. As output of coal was quite responsive to investment in the short run, the authorities should be watching that sector very closely.

The Executive Directors agreed to continue their discussion of the 1984 Article IV consultation with India and the review under the extended arrangement at 3:00 p.m.

2. EIGHTH GENERAL REVIEW OF QUOTAS - EXTENSION OF PERIOD FOR CONSENT

The Managing Director made the following statement:

> Executive Directors will have seen the latest status report on the consents to increases in quotas, circulated as EBD/84/23. By the close of business on January 26, 1984, 138 members, accounting for 97.40 percent of total quotas, had consented to increases under the Eighth General Review.
>
> The period for consenting to increases in quotas expires on January 31, 1984. In this connection, management and staff have been approached by two Executive Directors, who asked them to consult the Executive Board about the possibility of a further extension of the period for consent. Seven countries have not yet consented to increases in quota.
>
> It has been pointed out to me that on the occasion of previous quota increases, the Fund has usually granted several extensions in order to enable as many member countries as possible to complete the necessary national legislative and related procedures. This is a matter for the Executive Board to decide. In the circumstances, I ask Executive Directors whether they wish to discuss the matter this afternoon or on Monday, January 30, 1984.

After a short discussion, it was agreed to take up the matter of the extension of the period for consents to quotas as the first item of the Executive Board meeting to be held at 3:00 p.m. the same afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/15 (1/25/84) and EBM/84/16 (1/27/84).

3. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the proposal set forth in EBAP/84/14 (1/23/84).

Adopted January 26, 1984

4. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 83/108 are approved. (EBD/84/17, 1/20/84).

Adopted January 26, 1984

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/15 (1/24/84) and EBAP/84/17 (1/25/84), by an Advisor to an Executive Director as set forth in EBAP/84/15 (1/24/84), and by an Assistant to an Executive Director as set forth in EBAP/84/16 (1/23/84) is approved.

APPROVED: July 11, 1984

JOSEPH W. LANG, JR.
Acting Secretary