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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/31

10:00 a.m., February 18, 1983

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

Executive Directors	Alternate Executive Directors
	M. K. Diallo, Temporary
	C. Taylor
	G. Ercel, Temporary
	A. Le Lorier
	M. Teijeiro
	C. Dallara
M. Finaish	T. Alhaimus
	Jaafar A.
T. Hirao	T. Yamashita
R. K. Joyce	
	J. R. N. Almeida, Temporary
	H. A. Arias, Temporary
G. Laske	G. Grosche
G. Lovato	
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
F. Sangare	E. I. M. Mtei
	S. E. Conrado, Temporary
J. Tvedt	
	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, I. S. Kim, M. R. P. Salgado, B. J. Smith, G. Szapary. Central Banking Department: D. R. Khatkhate. European Department: S. Mitra. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; D. K. Palmer, Deputy Director; H. Hino. Fiscal Affairs Department: V. Tanzi, Director; P. S. Heller, C. A. Sisson. IMF Institute: M. K. Goshal, Participant. Legal Department: S. A. Silard. Middle Eastern Department: R. H. Floyd, M. Shadman. Secretary's Department: A. P. Bhagwat. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, C. J. Batliwalla, L. Ionescu, M. A. Janjua, P. Kohnert, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: L. Barbone, T. A. Connors, M. Hull, J. M. Jones, M. J. Kooymans, P. Leeahtam, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, J. G. Pedersen, G. W. K. Pickering, E. Portas, J. Reddy, J. Schuijer, H. Suzuki, P. S. Tjokronegoro, A. Yasseri, Zhang X.

1. INDIA - 1983 ARTICLE IV CONSULTATION AND REVIEW OF EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1983 Article IV consultation with India and the review of the extended arrangement (EBS/83/16, 1/20/83; and Sup. 1, 2/17/83). They also had before them a report on recent economic developments in India (SM/83/28, 2/7/83).

Mr. Malhotra made the following statement:

On behalf of my authorities, I wish to express my deep appreciation to the staff for the clear and comprehensive reports on the 1983 Article IV consultations and the extended arrangement, which give a balanced assessment of the Indian economy and with which my authorities are in broad agreement. This statement will therefore deal only with a few important developments.

The economy performed well in fiscal 1981/82, the first year of the extended arrangement when real GDP expanded by 5 per cent, foodgrain production rose to a record level, and industrial output grew by more than 8 per cent due to improved supply conditions and the easing of infrastructural bottlenecks. As a result of the improvement in the real sector of the economy and appropriate monetary, fiscal, and trade policies, inflation decelerated sharply from 16 per cent in 1980/81 to about 2 per cent over 1981/82. All performance criteria established under the 1981/82 program were met. In some cases, the real and financial targets of the program were exceeded.

The objective of the 1982/83 program was to push ahead with the adjustment effort by consolidating the gains of the previous year. However, contrary to expectations, the economic environment in 1982/83, both domestic and external, has been much less favorable. There was a severe and widespread drought characterized by the late onset of rains, erratic precipitation, and early withdrawal of the monsoon. The severity of the drought is only slightly less than that of the 1979/80 drought, which was one of the worst on record leading to a drop of 22 million tons in output of foodgrain and inflation rates above 20 per cent. A major concern of the Indian authorities in the current fiscal year, therefore, has been to minimize loss of agricultural production, and improve supplies and distribution of essential commodities so as to keep inflationary expectations in check.

Substantial additions to irrigated areas over the last few years, larger use of fertilizer and high-yielding seed varieties, and efficient functioning of the infrastructure should help achieve foodgrain production of 125 million tons, some 8 million tons below the 1981/82 crop. Discouraging progress of the monsoon did initially result in an increase in foodgrain prices but this situation was quickly brought under control. The foodgrain buffer stock was strengthened through large procurement and by contracting additional precautionary imports of 4 million tons of wheat. Availability of record stocks of sugar enabled increased releases into the market. Edible oil imports were maintained at a high level. These steps have dampened price expectations. In early February, the annual rate of inflation, based on the wholesale price index, was about 2 per cent. Inflation in fiscal 1982/83 is likely to be lower than that assumed in the program.

The decline in agricultural production will, however, have a serious impact on GDP growth projections, which have now been revised downward from 5 per cent to 2 per cent.

Industrial production, which had shown a healthy growth of over 8 per cent in 1981/82, continued to increase but at a lower rate. Industrial output during 1982/83 is now estimated to grow by 4-5 per cent. On the supply side, the position remained satisfactory due to easy availability of essential inputs of basic and intermediate goods, power, and transport. The main constraint emerged from the demand side, mainly on account of adverse agricultural developments, weak demand for exports, the effects of a liberalized import policy, and tight monetary conditions. There was a distinct slack affecting several industries, such as motor vehicles, agricultural tractors, jute manufactures, aluminum, and steel. There was a substantial decline in textile and yarn production due to a prolonged strike in Bombay, which depressed the overall index of industrial production by as much as 1.8 per cent. The authorities have tried to alleviate difficulties in specific sectors by providing more credit and other help where necessary. Production of salable steel, aluminum, and jute manufactures, which had either declined or stagnated in the first half of fiscal 1982/83, has since picked up. The stagnation in the production of commercial vehicles is essentially due to a very substantial improvement in the performance of the railways. The authorities have been keen that the current slack in several industries should not discourage investment. They have, therefore, maintained a supportive framework of industrial, trade, and financial policies. Total capital raised by private sector companies increased from Rs 2.8 billion in 1980/81 to Rs 5.25 billion in 1981/82 and is estimated to grow further by 25 per cent in 1982/83. Disbursements of long-term finance for industry in 1981/82 by financial institutions rose from Rs 16 billion in 1980/81 to Rs 21 billion in 1981/82, i.e., by over 30 per cent. Such disbursements during 1982/83 are expected to register a further growth of 25 per cent. Commitments of fresh loans have also maintained an upward trend. Thus, interest in, and prospects for, industrial investment remain satisfactory.

The drought, as well as the slack in several industries, has inevitably affected public savings. Revenues have been less buoyant and additional inescapable expenditures have had to be incurred on providing relief through employment creation in the rural areas. Public savings as a proportion of GDP had increased substantially from 3.7 per cent in 1980/81 to 4.3 per cent in 1981/82. Assuming normal weather conditions and undiminished activity in the industrial sector, this proportion was expected to go up to 5 per cent in 1982/83, well above the target of 4.8 per cent set in the original program. However, due to the serious setback already noted, public savings will be well below the target for the year though they would still be higher than the proportion achieved in 1981/82. Steps have been taken to tackle the resulting budgetary gap by adjusting expenditure levels and raising additional revenues in the budget period. It is important that the budgetary difficulties of the current year should not be permitted to hamper resource mobilization for 1983/84. Accordingly, important measures have been adopted since the end of November 1982, which while yielding additional revenue of Rs 2.6 billion in the current fiscal year, will increase revenues in 1983/84 by Rs 12.5 billion. These include substantial increases in several petroleum products, such as diesel, furnace oil, and kerosene, and increases in the rates of excise duty on cigarettes and auxiliary duties of customs. With these revenue-raising measures in place, it should be possible to maintain the tempo of development expenditure in 1983/84 at a reasonably high level, especially in sectors that are of crucial significance to the adjustment program.

As noted in the staff papers, the states have made substantial efforts at additional resource mobilization. In particular, electricity tariffs have been raised by about 30 per cent. However, these have not been enough to avert shortfalls in funds for the irrigation and electricity sectors at the state level. By the end of 1982/83, there will be a marginal shortfall in the additional area brought under irrigation compared with the target set for the first three years of the current development plan. The paucity of funds for irrigation has to a certain extent been alleviated by shifting the stress from large irrigation works to minor irrigation, which is predominantly in the private sector, attracts household savings, and yields quicker results. While new capacity creation for electricity generation in 1982/83 will be about one third higher than that achieved in 1981/82, it would appear that scarcity of resources as well as other constraints would retard achievement of the ambitious target for the current five-year plan. Steps have been taken to involve external financing in support of large thermal stations in the central and state sectors. At the same time, efficiency of the power sector has been improving steadily. The plant load factor of thermal plants increased from 44.5 per cent in 1980/81 to 46.5 per cent in 1981/82 and is expected to grow by another 2 per cent in 1982/83. The stabilization period needed for new power generation units has been reduced considerably. The electricity generation target of 132 billion kilowatt hours for 1982/83 is expected to be achieved.

An important scheme was introduced in 1982 for restraining overdrafts by the state governments on the Reserve Bank of India. This scheme has worked satisfactorily so far and should contribute greately to more orderly fiscal arrangements.

As elaborated in the staff papers, there have been important developments over the past two years that should promote the objective of structural adjustment. Production of crude oil has doubled in three years as a result of the implementation of the accelerated program. This should substantially reduce the country's reliance on imports. Similarly, large investments and increasing mechanization have raised productivity and output steadily in the coal sector. Significant increases in capacity have been achieved in fertilizers, cement, and newsprint. Efficient import substitution is thus well under way and should help restore a viable balance of payments in the medium term. The functioning of the infrastructure has continued to improve. Mention has already been made of improvements in the power and coal sectors. Capacity utilization and efficiency have also shown notable improvements in the railways over the past three years.

Finally, the comprehensive set of policies that India has been pursuing would appear to have yielded satisfactory results so far. Monetary aggregates have remained within reasonable limits. Performance criteria for domestic credit including bank credit to the Government sector and for external borrowing have been met. Investment levels under the current development plan have been sustained through large resource mobilization. Flexible price policies have improved profitability of both the public and the private sectors and promoted rational resource allocation. Price policies have proved especially effective in the area of energy by restraining demand and providing funds for development. Interest rates continue to be positive. Growth in aggregate bank deposits in 1982/83 so far has been 15.2 per cent, against 14.1 per cent in the corresponding period last year. Exchange rate movements have been supportive of exports. Despite the continuing weak world demand, the volume of exports is likely to grow by 5 per cent in 1982/83. Adverse weather conditions have necessitated sizable imports of foodgrains. Nonetheless, the balance of payments outcome is likely to be in conformity with the program estimates. Import liberalization has generally worked well and improved the supply of industrial raw materials, components, and capital goods. Accordingly, I would request the continued support of the Board for India's extended arrangement with the Fund.

Mr. Laske considered that the recession in the world economy had left its mark on India as well as on other countries. It had adversely affected growth and the adjustment efforts undertaken by the authorities.

In addition, poor weather conditions had exposed agriculture, and thus supplies of foodstuffs, to considerable strain. The Indian authorities had responded flexibly and rapidly. They had succeeded to a considerable extent in maintaining the momentum of their adjustment and development efforts.

When it had approved the extended arrangement for India in November 1981, Mr. Laske went on, the Executive Board had recognized that the plan adopted by the Indian authorities was very ambitious, and that its implementation would stretch available resources to the limit. The experience of the past year had shown that India had set its goals rather high in the light of the vagaries of the world economy. Unforeseeable events could cause some slippages in the execution of the plan; but, by and large, the Indian authorities deserved commendation for the manner in which they had handled the situation.

The current account deficit had been larger than envisaged under the program, both in nominal terms and as a percentage of gross domestic product, Mr. Laske noted. Although exports had risen substantially and imports had declined, the increase in the deficit had been due to a disappointing showing in the services account. Although the performance of foreign trade had been quite satisfactory, important structural weaknesses remained, and the authorities should be expected to work toward overcoming them. First, exports continued to be rather extensively subsidized, and they had increasingly been directed toward countries with which India maintained bilateral payments agreements, involving the provision of sizable amounts of credit by India. Second, import protection was still rather large, even after the significant liberalization measures taken at the beginning of the second year of the program. The adjustment of the Indian economy had clearly benefited from the liberalization of imports, and bolder action by the authorities would help to improve competitiveness while making better use of the available resources and strengthening the resilience of the economy against external shocks.

Third, Mr. Laske observed, the real effective exchange rate of the rupee had fluctuated considerably during the period. After an initial appreciation, the real effective exchange rate had undergone a corrective depreciation, which had brought the rate back to that of the early part of 1982. More recently, as he understood it, depreciation had continued and the competitive position of the economy had been restored. Although the authorities had tackled the exchange rate problem flexibly, their actions had been too protracted and too timid at a time when international competitiveness had been slipping. He noted from Table 1 of EBS/83/16 that the real effective exchange rate was expected to appreciate by 3.9 per cent during 1982/83. He wondered whether such a movement would be appropriate, or indeed whether it could help to strengthen the balance of payments position.

Both a slowdown in economic growth and the poor weather conditions of 1982 had, not unexpectedly, adversely affected the budget situation, Mr. Laske remarked. Not only had revenues been smaller than projected, expenditures had overshot budgetary allocations. There had in particular been a rather strong rise in subsidies on fertilizers and increased transfers to public sector enterprises. The result had been a fairly substantial financing gap. The authorities were already taking measures to raise additional revenue and to economize on expenditure. However, he had understood from EBS/83/16 that the Government's actions would not have been sufficient to close the gap. Even the additional information contained in EBS/83/16, Supplement 1, only gave reason partially to change that impression. While the resource mobilization measures adopted in November 1982 would bolster revenues in fiscal year (FY) 1983/84 quite substantially, it was still doubtful whether the gap for FY 1982/83 had been closed. He could endorse Mr. Malhotra's view that the present year's budget difficulties should not be allowed to hamper the mobilization of resources in the next fiscal year; but care should be taken to keep the overall deficit for 1982/83 down to the projected level of Rs 96.2 billion, which would be slightly above the program targets in both nominal and GDP terms.

More worrying than the situation of the Central Government's finances was that of the states' fiscal affairs, Mr. Laske commented. To finance their budget deficits, the states had had to resort to Reserve Bank overdraft facilities in larger amounts than in the previous year. The staff had not stated very clearly how much excess borrowing the states had undertaken, or by how much they had overshot their normal credit facilities. As he understood it, in order to bring some relief to the states, the Central Government had repaid the outstanding overdrafts and consolidated them on a medium-term to long-term basis. While such a procedure might be appropriate as a temporary solution, care should be taken to prevent the states' budgets from again reaching a position in which such exceptional financing was required. He wondered to what extent the fiscal situation of the Central Government had been affected by the rescue operation, and whether it had remained within the credit ceilings laid down in the program. Finally, he had noted that the limits for future central bank advances to the states had been doubled, an action that seemed to allow rather generous deficit financing. He would be interested to learn what rationale there was for that particular decision.

Commenting briefly on public sector savings in India, Mr. Laske noted that in FY 1982/83 they would be higher than in 1981/82, both in rupee terms and as a percentage of GDP. Nevertheless, Table 4 of EBS/83/16 seemed to show that savings would be below the program target, leaving some 5 per cent less available for investment financing than had been planned. The staff had emphasized the authorities' intention to cut back on investment expenditure if sufficient financial resources could not be mobilized. As the successful execution of the investment effort was a prerequisite for the envisaged improvement in the external side of the economy, he wondered what effect a scaling down of investment would have on the program's balance of payments objectives. Only a marginal reduction in the current account deficit in relation to GDP had been envisaged. It would be disappointing if the less favorable prospects for investment meant that external progress would be even slower than in the past.

Progress in investment and in structural improvement in the most important sectors of Indian industry would be essential for the satisfactory outcome of the adjustment process, Mr. Laske remarked. The steel industry had so far not performed as well as expected. In view of the worldwide excess capacity in steelmaking and the difficulties of large steel companies, a delay in the introduction of new capacity in the Indian steel industry did not worry him. At the time when the Executive Board had approved the extended arrangement for India in 1981, he had already warned against the dangers of adding to existing overcapacity. In view of recent developments, the steel industry seemed to be an area in which some slowing down could be accepted as a means of matching overall savings with overall investment.

The section of the staff report dealing with the railways seemed to be somewhat ambiguous, Mr. Laske observed. When the program had been launched the railways had been showing disconcerting shortcomings. However, the staff, which had referred to underperformance by the railways on page 17 of EBS/83/16, had on page 19 stated that substantial improvements had been achieved and that the needs of the economy were being met by the transportation facilities at present. Some clarification would be useful. Most disappointing had been the slow progress in expanding power generating capacity. Power shortages were apparently fairly frequent occurrences in India. While, in the past, difficulties with project implementation had been the cause of poor performance in the power generating industry, more recently financial constraints seemed to have emerged. A redirection of investment funds from steel, for instance, to power generation might be advisable. The staff had also mentioned that the financial position of state electricity boards was rather weak, and that in an effort to deal with the problem, some tariffs had been adjusted. It would be interesting to know whether the difficulties had been overcome, and whether the boards were now on a sound financial footing.

Investment in irrigation schemes, especially those run by the public sector, seemed to be suffering from difficulties, Mr. Laske observed. In view of the ever present danger of drought in India, the expansion of irrigation was of the utmost importance. It was regrettable that the shortfall in savings by the states had adversely affected the investment effort in that sector.

The importance of consolidating the financial position of the states had been repeatedly stressed by Executive Directors, and the Central Government, as the negotiating partner with the Fund, had been requested to pay increasing attention to the matter, Mr. Laske noted. Once again the states' financial performances had fallen short of what was expected. If the transfer of the states' exceptional liabilities from the Reserve Bank to the Central Government was not to be merely a palliative, the Central Government would have to take stronger action to bring the states' finances on to a sounder footing. While the matter was certainly a delicate one, procrastination could grow into a major threat to the successful completion of the program.

He had been impressed by the determination displayed by the Reserve Bank in the pursuit of anti-inflationary policy, Mr. Laske remarked. The bank had reacted swiftly and flexibly to changes in the situation. It was the efforts of the bank that had prevented inflationary pressures from making it impossible to achieve one of the central objectives of the program. It was remarkable that the quantitative performance criteria had been observed in a situation where the financing requirements of the public sector had been higher than envisaged and credit demand from the private sector had been strong. In the circumstances, it might be worth asking whether the credit ceilings had not been set somewhat loosely. Slightly tighter ceilings could have made it even easier for the Reserve Bank to pursue its restrictive course.

He was glad that interest rates had become positive in real terms, Mr. Laske stated, especially because for Indian savers the interest rate appeared to be more important than the maturity of the investment. That attitude seemed to show that interest rates could be an effective instrument of resource mobilization even in a developing country with a low per capita income.

He had been somewhat surprised by the figures in Table 1 of EBS/83/16 for gross domestic savings and public sector savings, Mr. Laske stated. The actual figures for 1981/82 and the estimates for 1982/83 seemed to suggest that private sector savings as a percentage of GDP had declined over the past year, since the ratio of gross domestic savings had fallen while the ratio of public sector savings to GDP had risen. If that were so, the implication would surely be that interest rate policy should be used even more actively. Alternatively, of course, private sector businesses might have been exposed to a profit squeeze because of weak demand, persistent wage pressures, and overregulation.

He had also been surprised by the 15.5 per cent increase envisaged for M-3 in the current fiscal year, Mr. Laske remarked. That figure was well above the expected rate of inflation and seemed high in relation to the low growth prospects, and particularly to the latest information on changes in price. He hoped that the figures did not imply a continuing easing of monetary tightness which might, even in circumstances of slow growth, provide leeway for the re-emergence of inflationary pressures.

Stating that he would support both the proposed decisions, Mr. Laske recalled that when the request by India for an extended arrangement had been discussed (EBM/81/138 and EBM/81/139), he had expressed some uneasiness about the size of the proposed arrangement. The present staff report had done little to assuage that feeling. For instance, the overall deficit in the balance of payments was expected to be significantly smaller in 1982/83 than had been envisaged in late 1981, and he looked forward to further achievements in that field. He also noted that India had so far made use of nonconcessional borrowing very sparingly and that external reserves could not be said to be uncomfortably low. He would therefore expect the question of balance of payments need in the third program year to be looked into with exceptional care, while the allocation of funds for disbursement that year should be regarded as an upper limit, not a target. Finally, the performance criteria for the third year of the arrangement should include a strengthening of the adjustment effort, particularly in connection with resource mobilization in the public sector at both central government and state government levels.

Mr. Hirao stated that he was in broad agreement with the thrust of the staff appraisal, and that he could support both the proposed decisions.

In the program under the extended arrangement, Mr. Hirao went on, 1982/83 had been envisaged as the year during which the considerable progress achieved in the first year would be consolidated and expanded. In particular, economic growth had been expected to be 5 per cent a year. Unfortunately, the economic performance in 1982/83 would fall short of the projection. Mainly due to the impact of adverse weather conditions on agriculture, it was likely to be no more than some 2 per cent, rather less than half the original estimate. However, despite the tighter supply position, inflation had remained under control. Moreover, balance of payments developments seemed broadly in line with the program estimates, and the overall deficit was expected to be reduced during the current year. He could agree with the staff that, by and large, the economy was withstanding the present pressures well, especially in connection with prices and the balance of payments.

Much slower growth in the economy and the need to counteract some of the effects of bad weather had created difficulties for the budget in 1982/83, Mr. Hirao noted. The overall deficit for 1982/83 was estimated to amount to Rs 96 billion or 6.2 per cent of GDP, compared with 5.6 per cent of GDP envisaged in the program. While the gap might not be inconsistent with the attainment of the program objectives, it did seem to suggest that continued vigorous efforts would be needed to keep the program on track and to achieve progress toward adjustment in the medium term. He agreed with the staff in feeling that the authorities would have to make substantial efforts on both the revenue and the expenditure sides to close the budget gap in the months ahead. In view of the prospect that public savings would continue to be well below those envisaged in the plan, additional resource mobilization would be increasingly important, especially at the state level and in the nonfinancial enterprises. Additional cuts in investment expenditure might be necessary and steps toward revenue increases would have to include price adjustments and reductions in subsidies.

The cautious stance currently taken by the authorities in monetary and credit policy seemed to be broadly appropriate, Mr. Hirao commented. Tight monetary conditions during the first half of 1982 had no doubt been one of the most crucial factors contributing to the containment of inflation. The authorities had liberalized the credit authorization scheme, a move in the right direction. With the increases in interest rates and continued low inflation, bank interest rates were generally positive in real terms. The staff had noted that the authorities were well aware of the possibility of a surge in inflation as the supply position tightened.

As the overriding objective of credit policy was to prevent the re-emergence of inflationary expectations, he agreed with the staff that price developments should be carefully watched, and that budgetary policies would have to be adjusted flexibly if the outlook for inflation became unsettled.

The staff had indicated that the investment program had been well implemented, Mr. Hirao observed. He had noted that for the railways improved management, rationalization of operations, and increased investment had paid off in strong performance, alleviating previous concerns that transportation bottlenecks would arise to hamper the adjustment effort. However, like Mr. Laske, he was rather confused by the apparent contradiction in the staff's assessment of the transportation sector. In view of the existing constraints due to the availability of only limited savings, a pragmatic approach in the choice of priorities was likely to become increasingly important.

The import liberalization measures introduced in 1982/83 appeared to be producing the intended beneficial effects, Mr. Hirao commented. In particular, increased access to imports was contributing to efficiency in export industries. On page 29 (EBS/83/16) the staff had stated that import liberalization should be matched by an active tariff policy and that the authorities should recognize the budgetary revenue gains that were likely to emerge as quantitative import restrictions were relaxed. It would be interesting to have further information on the effects of tariff policy on budget revenue. Tariff policy should in any event be used in such a way as to support the long-run benefits to be derived from relaxing quantitative import restrictions.

In view of the sharp decline in remittances from Indian workers abroad in 1981/82, the authorities had taken several steps to encourage the repatriation of foreign exchange, Mr. Hirao noted. The increase in interest rates and the liberalization of controls on direct and portfolio investment by nonresident Indians were both certainly welcome steps. He would be interested to know whether the staff had any figures to indicate the impact of those steps on the flow of private transfers in recent months. The improvement in export competitiveness as a result of the effective implementation of exchange rate policy in 1981/82 had been partly reversed in 1982/83, although recent developments had been in the right direction. The authorities would need to monitor exchange rate policies closely to avoid unintended shifts in the competitive position of Indian exports.

Regarding bilateral payments arrangements, Mr. Hirao observed that the staff had noted a sizable buildup in claims under such arrangements in 1982/83. While the availability of markets in countries with bilateral arrangements might have been of considerable benefit to India, like the staff he believed that less reliance on bilateral payments arrangements would be desirable in future.

Mr. Suraisry stated that he could support the proposed decisions and that he was in general agreement with the analysis and conclusions reached by the staff. A mid-term assessment of the progress made toward the main objective of the three-year arrangement was most helpful. He hoped that analysis of the same sort could be included more often in future staff papers.

During the discussion for the second-year program, Mr. Suraisry went on, his chair had observed that India's experience with a Fund-supported program had been an example from which other countries could benefit. Despite weaknesses in certain areas, recent developments in the Indian economy had reinforced that view and confirmed the Executive Board's earlier confidence. Real growth was expected to be lower than projected, but India was not unique in that respect. Much of the shortfall could be traced to unfavorable weather conditions and weak external demand, factors beyond the authorities' control. Inflation had been reduced to a remarkably low level, particularly by current standards. Public sector savings had increased significantly, and the higher yield of investment in key sectors was starting to give results. The underlying balance of payments position had been strengthened despite the difficult savings conditions in the world economy. There was a good chance that the current account deficit would be reduced as planned to the equivalent of less than 2 per cent of GDP by 1984/85, and he was confident that the authorities would continue to follow well balanced and pragmatic policies.

On the demand side, cautious monetary policy had been a major factor in keeping inflationary expectations down, Mr. Suraisry considered. Although there had been slippages in budget performance, the recent drought and consequent decline in agricultural income must bear most of the responsibility.

The revenue shortfall had been explained in part by a legal dispute about excise taxes, Mr. Suraisry noted. More important, the authorities had acted with commendable speed to close the budget gap through a combination of revenue measures and price increases.

A central element of the program was resource mobilization by the public sector, Mr. Suraisry noted. It was therefore encouraging that public sector savings were again likely to increase significantly in 1982/83. He also welcomed the move to rationalize state finances outlined on page 13 of EBS/83/16, thus strengthening their financial base and allowing them to contribute more to the investment effort. So far, investment performance under the Sixth Five-Year Plan had been impressive. The benefits that were starting to emerge, notably in the form of increased oil and coal production, should underpin the twin objectives of adjustment and growth. He did, however, agree with the staff on the need to give priority to increasing power generating capacity if bottlenecks in development were to be avoided. More generally, the moves to reduce regulation in industry and to decontrol prices were appropriate. In the external sector, measures to promote exports, to liberalize imports, and to simplify import procedures were also having their intended effect. While there might be scope for further liberalization, a point that applied to India's trading partners as well, he endorsed the staff view that the authorities had shown courage in going against the present protectionist trend. In brief, India's solid achievements deserved continuing Fund support. The second-year program was on track, and he was sure that the authorities would show the same realistic and flexible approach in the forthcoming discussions for the third year of the program.

Mr. Dallara said that he too had found the section of the review, dealing with achievements so far during the extended arrangement, to be especially helpful; he hoped that similar sections might be included in other reviews under extended arrangements.

Before commenting on performance under the program, Mr. Dallara recalled that at the time of its inception, his authorities had had some reservations about the extended arrangement. It was important to refer to some of them since they continued to be an important part of their overall view of the program in its relation to Fund policies and Fund resources.

His authorities had had serious doubts whether India's balance of payments position and prospects clearly justified it having enlarged access to the Fund's resources in the amounts provided for in the program, Mr. Dallara continued. Under the policy of enlarged access, the Fund stood prepared to provide balance of payments assistance to members "facing serious payments imbalances that are large in relation to their quotas." It was their judgment that the arrangement interpreted the terms "serious" and "large" with regard to payments imbalances too liberally. It remained difficult for his authorities to reconcile the size of the program and the requirement that the member be facing payments balances that were both serious and large in relation to quota with the projected and actual balance of payments developments in India. The program had never envisaged any significant improvement in either the current account or the overall external balance as a percentage of GDP. Performance had been roughly in line with projections, with the current account deficit for 1982/83 expected to be 2.2 per cent of GDP, compared with 1.9 per cent in 1980/81, the last year before the program began, or with the 2.1 per cent earlier projected for FY 1982/83. And he would note that the overall balance for 1982/83 now appeared likely to be somewhat better than had been forecast. If India was facing and continued to face serious and large payments imbalances, why did the program not provide for a significant reduction in external imbalances?

There were three points, and perhaps others, that might lessen the concerns of his authorities, Mr. Dallara conceded. First, the structural composition of a country's balance of payments could be improved without a substantial reduction in the deficit. That seemed to be happening in India, and he commended the authorities for their success in that field. Second, it could be argued that India's payments position might have been much worse had it not been for many of the policies that had been implemented under the program. Third, it was desirable for members to deal with their payments problems at an early stage. However, even taking those factors into account, his authorities continued to have serious doubts about the appropriateness of the use of the enlarged access policy and about the size of the program relative to quota. Although India had experienced balance of payments pressures, there were ways in which it could reduce its purchases through the Fund while continuing to carry out its structural reforms.

Apart from borrowing from the Fund, there were two other courses that India could have taken, Mr. Dallara considered. First, it could have reduced the sizable capital outflows associated with large exports covered by bilateral payments arrangements, if only by shifting some of the exports from the nonconvertible area to the convertible area. Second, India could have borrowed more in the international capital markets. While many countries had certainly overborrowed, India still seemed to have room for additional commercial borrowing without departing from its cautious and prudent policies. Table 6 in EBS/83/16, dealing with the balance of payments, showed that for 1982/83 the Fund was by far the largest source of financing for the current account deficit. Commercial borrowing was only 20 per cent of Fund financing and it was significant that the Fund's commitment exceeded net aid disbursements by almost 25 per cent. In the circumstances, the Fund's financing seemed excessive, and he wondered whether it was either necessary or appropriate for India to draw the full amount envisaged under the program. Should unexpected needs arise, undrawn amounts could remain available on a contingency basis, always assuming that India continued to carry out the program. In that connection, he associated himself with Mr. Laske's earlier comments.

Despite his authorities' concerns about the program itself, Mr. Dallara said, he could accept the proposed decisions, since India's performance had been broadly in line with the arrangement. The authorities were to be commended for their efforts in reducing inflation despite a poor harvest. He agreed with the staff that the tighter than planned credit stance had been a major factor in bringing about the satisfactory inflation performance. He would be interested to know what implications the relatively significant change in inflation rate expectations might have for possible adjustments in credit policy. The authorities seemed to be taking the right steps in connection with interest rates. Nevertheless, the staff had stated that deposit rates were generally positive in real terms, and he wondered whether the implication was that some rates were still negative in real terms. He would be interested to have further information regarding the general review of the instruments and processes of monetary policy in India, and the review of the effectiveness of the credit authorization scheme, both of which the authorities would apparently be conducting shortly.

The Central Government's budget situation was worse than had been expected, largely due to poor weather, Mr. Dallara noted. He commended the authorities for the actions they had taken in attempting to deal with the situation. In particular he welcomed the information regarding the increases in petroleum prices. Nevertheless, he was disturbed that one of the steps taken to address the fiscal problem was the imposition of auxiliary customs duties of 5 percentage points on most imports. In fact, the auxiliary duties appeared to have been raised twice in recent months and the basic import duty to have been raised substantially as well. Such steps were inconsistent with the goal of trade liberalization written into the arrangement with the Fund.

The financial situation of the states was also disturbing, Mr. Dallara considered. Resource mobilization had fallen short of the planned figures, and he would be interested in hearing what the states intended to do to address the problem. The authorities should also be commended for taking steps to deal with the overdrafts contracted by the states on the Reserve Bank of India. The staff had made it clear that public sector savings had fallen short of expectations, again largely due to adverse weather conditions and slow economic activity. Resource mobilization was clearly central to the purposes of the whole program and some states' savings were likely to be much lower than projected. He would be interested to hear whether any corrective course had been mapped out in that field. Meeting the savings targets seemed to be crucial for both the Central Government and the state governments. The authorities ought to make further changes in public sector prices, as well as in other areas, if they wished to reach their basic savings objectives.

In the external sector, Mr. Dallara said that he commended the authorities for implementing policies intended to liberalize imports, and he urged them to continue along the same course. The increased competition that Indian domestic producers were facing, while obviously causing temporary difficulties, would undoubtedly help to move the country toward a more efficient economy. Despite the liberalization that had taken place, more needed to be done. While he realized that it was difficult to open up the import sector in the present world economic environment, it was important for India to make further progress along that road. The Executive Board had recently endorsed management's proposals to focus more intensively on trade restrictions within the context of Article IV consultations, appropriately so in his view. It was quite clear that trade liberalization should receive more attention under extended arrangements that sought to make structural changes in the external sector of the country concerned. If the Fund could not demonstrate that substantial progress could be achieved under programs like the present one, questions would evidently be raised about the capacity of the Fund to undertake useful action in the area of trade liberalization.

The balance of payments outcome for 1982/83 seemed likely to be broadly in line with the intended program, Mr. Dallara commented. He was glad that India's competitive position had improved as a result of exchange rate changes. In the circumstances, the authorities should be able to reduce further their cash compensation schemes for exports. Exports to the nonconvertible area seemed to account for more than half of the country's exports for 1981/82 and 1982/83. Such bilateral arrangements were more limiting for India than trade conducted in convertible currencies since they did not contribute to the strengthening of India's external hard currency position. Exports to the nonconvertible area had risen from 10 per cent of total exports in 1979/80 to 27 per cent in 1981/82, while imports had increased only from 10 per cent to 12 per cent of the total. If the two trends continued, they could have serious implications for India's medium-term payments position.

In conclusion, Mr. Dallara stated that some of his authorities' earlier concerns about the program still remained. Nevertheless, he supported the proposed decisions. While progress in a number of important areas had been impressive, particularly in the circumstances, still greater efforts would be required during the next year of the program in connection with budget performance, public sector savings, and certain parts of the industrial sector, particularly in the states.

Mr. Lovato stated that he supported the two proposed decisions; the extended arrangement was basically on track, and the Indian authorities were managing their affairs with skill. However, India was probably at a critical junction in the implementation of its development plan, and it would need to redouble its efforts lest the unfortunate external events caused unwanted changes in the growth path. The first year and a half of the program had been marked by considerable success in many areas, and all performance criteria had been met. The growth of GDP had exceeded the target, and inflation had fallen more than had been expected. The effort to mobilize domestic resources to allow orderly financing of the development plan had been largely successful, so that public sector savings, which had amounted to 4.3 per cent of GDP in 1981/82, were forecast to rise to 4.8 per cent of GDP in 1982/83. Nevertheless, the performance of the states had been far less satisfactory than that of the Central Government, and it might indeed constitute a substantial threat to the overall performance. Although the staff had mentioned a number of steps that the authorities intended to take, he would like to hear further comments on the reasons for the larger than anticipated deficit. He wondered, for instance, whether it had been generated by higher expenditure or lagging revenue, or both. Did the staff believe that the measures so far undertaken, together with those that the authorities were planning, would be sufficient to redress the situation?

Table 1 in the staff report showed that, after increasing marginally in the first year of the program, private sector savings were expected to fall by 0.8 per cent in FY 1982/83, Mr. Lovato said. The decline more than offset the public sector performance, thus resulting in a scaling down of gross capital formation. He would be interested to hear comments from the staff on the causes of the fall in private sector savings; in particular, data on disposable income might help to clarify the behavior of savings, which was distinctly puzzling in view of the increase in interest rates on various financial instruments in the recent past. He wondered, for instance, what the effect of the drought was on the phenomenon. Did the staff expect that households would reduce their savings rate in order to maintain the desired present level of consumption in view of uncertainties for the future?

The Indian authorities were to be commended for their achievement in implementing their development program, Mr. Lovato stated. Chart 10 on page 106a of SM/83/28 showed that considerable progress had been made in many key sectors, and there seemed to be good chances of overcoming the structural balance of payments problem, which was the very purpose of the extended arrangement. On the other hand, the introduction of capacity in the power generating sector was well behind schedule, and the lack of electricity was increasingly becoming a constraint on expansion in other industries; what was worse, the output of electricity was not expected to reach the planned figure during the program period. The staff had said that the main difficulties were those arising from financial constraints. He would like some clarification on the point, and in particular a description of current pricing policy in the electricity sector. He would also like more information on the pricing policy being followed for oil products. For instance, it would be interesting to know the price, expressed in dollars, for oil products in the Indian domestic market.

While he sympathized with the authorities' argument that it was difficult to raise fertilizer prices at a moment of falling incomes and production, Mr. Lovato went on, once the situation improved, the matter should be studied carefully since the rate of growth of the subsidy was quite disturbing.

He agreed with the staff judgment that the competitiveness of the economy had remained more or less constant during the past year, and he certainly appreciated the flexibility shown by the authorities in that respect, Mr. Lovato observed. The staff seemed to regard the 7 per cent growth rate in export volumes forecast for FY 1982/83 as feasible. He hoped that the staff was correct, but he was hardly impressed by one of the arguments put forward, namely, that the low growth of exports by other less developed countries would leave more room for Indian exports. The low export growth in less developed countries was surely due to demand conditions rather than to supply constraints; it was therefore not certain that India would find it easy to expand its exports by a substantial amount in a shrinking market. He would also like further comment from the staff on the continued low level of workers' remittances from abroad. In particular, he wondered whether the staff felt that further steps could be taken to increase the attractiveness of domestic financial instruments. Nevertheless, he did note that the Indian authorities had made some progress in diversifying the types of investment available. As the country was probably in a period of transition, it would be difficult to pass judgment on the appropriateness of particular instruments. On the whole, with the abatement of the rate of inflation, the interest rate structure appeared to be broadly appropriate to current needs. In any event, he agreed with the staff that a cautious monetary policy stance should be maintained, even though he would play down the danger of inflationary expectations. The authorities should avoid becoming excessively restrictive if industrial activity increased and inflationary pressures did not reappear.

The authorities had kept the program on track; Mr. Lovato concluded even if corrections seemed necessary in some areas, he was confident that they would eventually attain their objectives. It was disappointing that external factors had resulted in a rate of growth of output that would be lower than the rate of increase in the population; nevertheless, he was confident that the development effort would be rewarded by rising standards of living in the years ahead.

Mr. Joyce observed that the extended arrangement with India was of particular importance because of its size, because of the significance of the Indian economy itself, and because of some of the unique features contained in the adjustment program. Both the Indian authorities and the Fund had a large stake in the success of the program, as did other potential users of the Fund's enlarged access facility. He commended the authorities for meeting all the performance criteria despite adverse economic circumstances. Unfortunately, the performance for FY 1982/83 was turning out to be less favorable than anticipated, and considerably less favorable than that during the first year of the program. Agricultural output had been affected by the lack of rainfall; and industrial production had slowed, largely as a result of weak demand arising in part from tight domestic monetary conditions and in part from weaker than anticipated world demand. In consequence, real GDP was expected to grow by only 2 per cent in FY 1982/83, or rather less than half the earlier projection. On the other hand, public sector savings were expected to increase during the year, although they would grow more slowly than had originally been hoped. Moreover, despite the poor harvest, the projected increase in wholesale prices was still expected to be no more than 8 per cent. The Indian authorities were to be commended for the actions they had taken to offset upward pressures on prices, and particularly the inflationary expectations occasioned by the weak monsoon.

Commenting on fiscal policy, Mr. Joyce remarked that the current projections for public finances gave conflicting signals about the success of the adjustment program. The Central Government's overall budget deficit was expected to be 12 per cent higher in FY 1982/83 than in FY 1981/82, although recent measures to raise additional revenue might reduce the figure to some extent. Slower economic growth and increased expenditures arising from the adverse weather conditions had contributed to the deterioration. Nevertheless, some of the deviations from the program seemed to be attributable to other factors. For instance, of the increase in supplementary expenditures of Rs 9.9 billion in 1982/83, only Rs 4 billion were directly attributable to flood or drought relief. The implication was that some slippage had taken place in expenditure control.

The major issue in the fiscal area continued to be the state finances, Mr. Joyce considered. It would have been helpful if the staff could have described the situation in greater detail. Despite the increased resource mobilization efforts by the states, their budget deficits had risen sharply in FY 1981/82. In view of the actual outturn for that year, he wondered whether the further efforts that had been initiated for the present year would be sufficient to bring about the needed improvement. There seemed to be a need for a more concerted effort to curb expenditures at the state level. In FY 1981/82 the states had accumulated considerable aggregate overdrafts with the Reserve Bank of India. He wondered whether the staff felt that the recent steps to avoid a repetition of overdrafts were sufficient. While he appreciated the political problems faced by the central authorities, he was forced to conclude that stronger measures at the state level were essential.

Although central government savings would have to increase sharply to return to the forecast figure, the initial target seemed to be achievable, Mr. Joyce observed. However, the savings of the states were well below program projections, and the outlook for improvement was not promising. If the government sector experienced a savings shortfall, it would be necessary to reassess all expenditure intentions under the Sixth Five-Year Plan. It was disappointing that only limited information was available on where the review of the plan now stood. It did however seem inevitable that some substantial cutbacks would be required, particularly at the state level. He hoped that any reductions in the investment program would not touch the power and transportation sectors. A large part of the shortfall in central government public savings occurred because of low surpluses in the nonfinancial public enterprises. He was therefore pleased by the recent increases in steel prices and in rail freight charges.

He wished to commend the Reserve Bank of India for success in restricting monetary growth since mid-1981, Mr. Joyce stated. The tight monetary policies had undoubtedly contributed to a sharp curtailment in credit expansion during the summer of 1982, although the staff had noted that the impact on business as a whole had been softened by the continuing activity of cooperative banks and other devices. The policy initiatives of October 1982 seemed to be reasonable. It was satisfactory that the cash and statutory liquidity requirements of banks would not be changed in the coming months. On the other hand, the tightening of policy requirements in the second half of 1981 and the subsequent easing in April and June 1982 might have provided rather conflicting signals on the general stance of monetary policy. He noted that the authorities had introduced credit support for selective industries, and he urged some caution in that field since the overriding aim of credit policy should be to prevent any re-emergence of inflationary expectations. The anticipated emergence of sizable additional credit needs later in the year would have to be closely monitored. The measures recently introduced to loosen the degree of central control under the Credit Authorization Scheme and to assist smaller ailing industries could result in an unintended expansion of credit.

The steps taken during the past year to increase real interest rates and to encourage long-term private savings were also welcome, Mr. Joyce remarked. Bank interest rates were now generally positive in real terms, and he hoped that the authorities would continue to maintain a flexible approach to interest rate determination. The monthly pattern of net domestic credit to the Government gave some cause for concern since the performance criterion was set on an "end-of-period" basis. For instance, net bank credit to the Government seemed to have been above the September ceiling immediately before the end of September and above the December ceiling immediately before the end of December. While he welcomed the success of the authorities in meeting the criteria, he wondered whether there might not be some alternative to end-of-period ceilings for such programs.

He was concerned, Mr. Joyce went on, about the apparent inadequacy of investment in some sectors of industry, including in particular rail transportation, power generation, and irrigation. He had raised some questions in July 1982 (EBM/82/95) about the possibility of bottlenecks in the transportation system and the lack of central government control over the pricing changes that were needed to encourage investment in power generation and irrigation. He welcomed the progress made in improving the performance of the railways, and there had certainly been substantial gains in irrigation in recent years. However, the shortages continued in the power generation sector. Indeed, power shortages had become the single most important constraint on growth. More generally, there seemed to have been no major changes since the measures introduced in April 1982 for the purpose of reducing some of the regulatory restrictions on large companies. He would have welcomed some comment on the effectiveness of the measures so far.

The Indian authorities were to be commended on introducing import liberalization measures with a view to promoting exports and improving the efficiency of domestic industries, Mr. Joyce considered. There had inevitably been public pressures to restrict imports or to slow down the liberalization process. He encouraged the authorities to continue to resist those pressures and to pursue their main strategic objective. The overall level of protection in India remained high, and it was important that Indian producers should be exposed to more competition from outside. It was rather disappointing that the staff believed that the basic framework of import restrictions remained largely intact. It was essential that access to imports should be as liberal as possible. A great deal still needed to be done in the deregulation of prices. The staff had described the successes relating to the partial liberalization of the cement and steel industries, but the scope for reduction in other sectors remained large. Although the increase of 30 per cent in electricity tariffs was welcome, he agreed with the staff that more needed to be done both for coal and for electricity prices. The recent increases in consumer prices for petroleum were a step in the right direction.

The lack of progress in the export field largely reflected temporary adverse factors beyond the control of the authorities, and the underlying trend was encouraging, Mr. Joyce commented. The volume of exports was expected to increase by 3-4 per cent in FY 1982/83, compared to an increase of only 1 per cent in the volume of imports. It was to be hoped that, after four successive years of deterioration, India's terms of trade would remain unchanged during the year. Nevertheless, the difficulties encountered by Indian producers in world markets were not solely attributable to the world recession, or to increased protectionist measures in other countries. Indeed, the export competitiveness of Indian producers was still a matter of doubt, and the authorities ought to devote considerable attention to bringing about the needed adjustment. In the same vein, further action might be needed to encourage the inflow of workers' remittances. Domestic interest rates might have to be raised and controls on investment by nonresident Indians might have to be further liberalized. The current system of pegging the rupee to a basket of currencies seemed appropriate. The depreciation of the rupee during the past few months had restored part of the loss of competitiveness that India had encountered during the past year.

He welcomed the planned increase in commercial borrowing during FY 1982/83, Mr. Joyce remarked. The countries in his constituency had been rather concerned about the excessive reliance on Fund resources for the financing of India's balance of payments. The Indian authorities might have relied more extensively on commercial borrowing in the past, a point already raised by his chair. He did not accept the view that the use of enlarged access resources and the tailoring of extended programs had been unduly biased toward development financing and not sufficiently toward balance of payments adjustment. But it was essential that more progress toward a sustainable balance of payments position should be achieved if the Indian program was to be considered a success. In the present difficult circumstances in the international capital markets, it might be doubted whether much increase in commercial borrowing could be achieved during 1983. Furthermore, India might find it more difficult to obtain access to the funds of the International Development Association (IDA) in the light of the rather weaker dedication of certain industrial countries toward the replenishment of IDA. Nevertheless, the Indian authorities were correct in seeking comparatively large amounts of supplementary resources over and above those available to them from the Fund.

He fully supported the proposed decisions, Mr. Joyce stated. The Indian economy had shown signs of improvement in many areas, and he hoped that renewed efforts would be made to increase public savings, to press forward with key investments, and to increase productive efficiency through more liberal trade measures.

Mr. Salehkhou commented that, after an impressive performance during 1981/82, the economy had continued to perform well during the present financial year, despite adverse weather conditions and a deterioration in the terms of trade. Severe drought could certainly undermine agricultural income as well as reduce the output of foodgrains, jute, groundnuts, oil seeds, and other products. Nevertheless, the Government had embarked on policies that were likely to prove sufficiently comprehensive to cope with cyclical or seasonal factors. The use of modern agricultural techniques and inputs, as well as of irrigation and fertilizers, had been expanded, and the areas under irrigation and cultivation had been enlarged. The authorities had been trying to provide financial incentives for farmers, and the procurement policies seemed to have been successful in maintaining adequate foodstocks in the public distribution system. He therefore expected that the effect of the adverse agricultural performance on costs and food prices would be marginal.

Industrial performance had also lagged slightly behind the original expectations, Mr. Salehkhou continued, and the growth in industrial production had been considerably lower in 1982/83 than in 1981/82. The problems seemed to be specific to each particular industry, although it was difficult to reach any hard and fast conclusion. The malaise in the electricity industry seemed to be profound and recurrent. In other industries, the confluence of weak domestic and external demand could have contributed to the relatively dismal performance. He was encouraged to see that steps had been taken to improve conditions in the industries concerned. With inflation firmly under control there seemed to be some scope for a more expansionary monetary policy, particularly with respect to easier credit allocations to specific industries, although the staff's caution regarding any general relaxation of the stance of monetary policy was understandable. Undue apprehension about the possibility of rekindled inflation might also have been producing an unfavorable climate for industry. He would welcome a comment on that point. In the circumstances, economic growth during the current financial year was expected to be no more than some 2 per cent, compared with the target figure of 5 per cent.

The authorities had consistently pursued structural adjustment in key sectors of the economy, Mr. Salehkhou noted. In so doing they had eliminated a number of regulations and reduced restrictions in industry and in international trade, and they had taken measures aimed at lessening price distortions. The import policy for 1982/83 contained liberalization measures for industrial and capital goods. The Government was understandably wary of the effect of a large volume of imports on foreign exchange resources, and it was mindful of the crucial role that industrial production and exports would have to play in any projected improvements in the balance of payments. Within those constraints, there had been substantial changes in industrial licensing and regulatory policies. He did not clearly understand the staff advice on page 26 of EBS/83/16 to integrate the changes into a comprehensive program aimed at improving industrial efficiency and competitiveness. He would welcome further comment.

The external sector, Mr. Salehkhou remarked, had not performed as well as expected, although there were recent hopeful signs. The current account deficit for FY 1981/82 had been higher than the target, and that for FY 1982/83 would also exceed the hoped-for figure. The deterioration in the terms of trade during 1981/82 had been almost inevitable. There had been a modest improvement in the terms of trade during the present year, and he hoped that it would continue. The Indian authorities were to be commended for vigilantly pursuing the adjustment program. They had generally observed the monetary, budgetary, and fiscal targets, thus showing their resolve to pursue the program to its ultimate successful conclusion. He supported both the proposed decisions.

Mr. Polak commented that the staff papers correctly conveyed an impression of a successful performance on balance, despite adverse circumstances both in India and abroad. The Indian authorities certainly deserved commendation. Fiscal policy, monetary policy, import liberalization policy, and industrial policy had all contributed to the balanced success of the Indian authorities' performance. The one exception was perhaps exchange rate policy, whose contribution had been rather uncertain, although the present position was not unsatisfactory. Each set of policies had run into difficulties, some of them of external, others of internal, origin. He was impressed by the way in which the authorities had met the difficulties by combining a willingness to counteract any unduly severe impact on the policies with sticking to their principles.

He hoped that the success so far achieved would encourage the Indian authorities to push even harder in future, because it was clear that a great deal remained to be done, Mr. Polak went on. In that connection, he subscribed to many of the observations made by Mr. Laske. The rationale of the program was after all not simply to improve the current balance of payments, but to create a structure that would fit better into the world economy. In particular, much work was still required on price adjustments, first, to improve the economic balance, and second, to raise public savings. Other fiscal measures were clearly needed to enable the authorities to meet the savings target and thus avoid a cutback in investment, which would clearly be unsatisfactory. While the staff had indicated that much had been done in the field of import liberalization, it concluded that the basic structure was still restrictive, and he agreed with everything that Mr. Dallara had said on that subject. The staff had admirably summarized its views on the reduction of regulation and on price liberalization on page 28 of EBS/83/16; much more needed to be done, and he strongly encouraged the Indian authorities to continue strong action in those fields. In conclusion, he endorsed the program and supported the two proposed decisions.

Miss Le Lorier recalled that in FY 1979/80, as in FY 1982/83, India had suffered a severe setback because of widespread drought. However, in FY 1979/80 the country had experienced a sharp deterioration in its external position, an inflation rate of 20 per cent, and a growth in domestic credit of 22 per cent, and it had been following an expansionary fiscal policy. By contrast, the projections for FY 1982/83 reflected a strong adjustment effort. Despite a downward revision of 3 percentage points in the rate of growth of GDP from the previous estimates, inflation had remained under control, financial policies had been restrictive, and the overall balance of payments deficit was likely to be reduced. In consequence, it seemed possible that the authorities would meet their original target of a current account deficit of no more than 1.8 per cent of GDP in FY 1984/85. They certainly deserved commendation for adapting their policies so well to the changes in economic circumstances.

Nevertheless, she had rather mixed feelings on the question of public savings, which was a key element of the program negotiated with the Fund, Miss Le Lorier stated. Savings as a ratio to GDP at the end of FY 1982/83 seemed likely to be near the original target. While such a result was no minor achievement, the absolute amount of public savings available for financing the program would fall short by Rs 10 billion, or 12 per cent. In view of the size of the investment program, which was crucial to the structural adjustment process and ultimately to the strengthening of the balance of payments, such a shortfall could not be ignored. The overall central government deficit of Rs 96.2 billion could be regarded as satisfactory both in absolute amount and as a ratio to GDP. It was perhaps worth noting that while additional contingent expenditures would be partly covered by mobilizing new resources, for the most part they would be met by shortfalls in other outlays, thus depriving the program deficit of Rs 94.6 billion--which would have represented a reduction of the deficit by nearly Rs 6 billion--of some of its meaning. If the shortfalls in expenditure were a regular feature of budget implementation in India, it might be useful to show the original central government budget in such a way as to indicate the extent of the built-in contingency reserve.

The state finances were clearly an area for concern, Miss Le Lorier considered, even though the financial weaknesses appeared to be concentrated in only a few of them. The scheme for restraining overdrafts by the state governments on the Reserve Bank of India was certainly a step in the right direction. However, she had been rather puzzled by the particular mechanisms chosen to deal with the situation. There must no doubt be a legal reason for deciding that the Central Government should take over the overdraft; but she wondered whether the payments that the Central Government would receive in the future from the states would be freely usable for financing central government expenditures or whether they would have to be remitted to the Reserve Bank to settle the consolidated debt. More fundamentally, if a rapid strengthening of the financial performance of the few states concerned was to prove out of reach and if in consequence the planned targets for such sectors as power and irrigation were put in jeopardy, she wondered whether it would not be possible to redefine the responsibilities of the Central Government and the states in implementing the plan. For instance, she had noted on page 17 of EBS/83/16 that the Central Government was planning several large power plants.

It was noticeable from Chart 1 on page 44a of SM/83/28 that money and price developments had moved hand-in-hand in the past, with money generally leading prices, Miss Le Lorier observed. The staff had noted that the relationship had proved to be crucial in the fight against inflation. In view of the slowdown both in activity and in prices and of the data shown in Table 2 of EBS/83/16, she wondered whether the monetary targets for March 1983 were still appropriate. Compared with March 1981--equals 100--by March 1983 broad money would be 131 and narrow money 121. While she could concede that March 1982 might be an abnormally low point, she wondered whether the rate of growth from March 1982 to March 1983 was not on the high side. The target for commercial credit had been selected in July 1982 bearing in mind the need to finance a buildup in foodgrain and sugar stocks to the extent of Rs 5 billion. That amount had not so far been used. What she had in mind was that the phrase "maintaining the present cautious credit policy" should be interpreted to mean considering the advisability of undershooting the monetary targets for March 1983, especially as the fall in agricultural income was likely to have a lag effect on the demand for credit in the coming months. She commended the authorities for having made determined efforts to make interest rates positive and to widen the range of financial assets offered to savers. On the other hand, she had noticed that some of the instruments were promoted by offering fiscal exemptions. Such arrangements might prove costly to the public finances over the medium term, and they had clearly already contributed to a shift in the tax structure from direct taxes to indirect taxes. She wondered whether any attempt had been made to calculate the "tax expenditures" for that purpose.

On the supply side, Miss Le Lorier remarked that she could support the recommendations both by the staff and by the World Bank for further project implementation and resource mobilization, particularly at the state level. She could also commend the authorities for having resisted the complaints of domestic producers about import liberalization. She would encourage the authorities to consider going beyond the measures announced in April 1982 both in the import field and in the industrial field. On the export side she had noted that it had been found necessary to introduce a new cash compensatory scheme covering a slightly higher share of export commodities than formerly, although at a slightly lower rate. The progressive introduction of a value added tax might make it possible to escape from the various cash compensatory schemes, although under such an arrangement it might be difficult to reconcile the tax rights of the Central Government and of the state governments.

On pricing policies, the information provided by the staff for sugar, as well as the recent increases in fertilizer subsidies, seemed to show that a review of pricing methods toward greater flexibility would be warranted, Miss Le Lorier stated. For external policies and balance of payments matters she would associate herself with the recommendations of the staff. It was quite remarkable that in volume terms export growth was expected to be fully in line with the initial assumptions, despite the slowdown in activity. That expectation was perhaps the most striking sign that structural adjustment was indeed under way.

Mr. Taylor commented that, although the views of his chair had not changed greatly in the recent past, he attached great importance to the review of the program. The five key elements that the Managing Director had stressed in summing up the Executive Board discussion in November 1981 (EBM/81/138 and EBM/81/39) still remained relevant. The Managing Director had in particular put the stress on the need to increase public sector resource mobilization, and to pursue flexible interest and exchange rate policies.

The authorities' initiatives had been frustrated in the past year by major weather problems and adverse market conditions, Mr. Taylor went on. The fall in the rate of growth of real GDP to below the rate of increase in the population was of course a disappointment, and it would make the attainment of structural adjustment more difficult. While the Indian authorities were accustomed to having to cope with such adversities, like other speakers he had been particularly impressed by the rapid adjustment that had been made in the monetary area in 1982. He was glad to see that inflationary pressures due to supply shortages had been successfully contained.

The budget position and the growth in credit to the Government from the banking system both needed constant scrutiny, Mr. Taylor considered. Revenues had suffered and expenditures had increased because of the drought in part of the country; it was therefore particularly welcome that the authorities had managed to observe credit ceilings in December 1982. The outcome seemed to have been associated with some shortfalls in important areas of public investment; the implication seemed to be that the authorities should examine with considerable urgency the scope for improving revenue performance. The poor position of the states' finances was of course a matter for concern. Like others, he welcomed the measures that had been taken to restrain the states' overdrafts; but he wondered whether there was not a need for a more thorough examination of the structure and efficiency of the states' finances.

One of the principal justifications put forward for the program had been that India should use the opportunity of being able to draw on the Fund to liberalize the import regime, Mr. Taylor recalled. The staff had said that, while access to imports had risen considerably, effective rates of protection for many industries remained high, and the basic framework of the import restrictions remained intact. He would have welcomed a more concerted attempt by the staff to quantify the situation. It might be rather ambitious to try to assess the general effective level of protection in the economy, but he did feel the need for a more complete assessment of the progress that had been made in connection with import liberalization, and of what remained to be done under the program.

He had thus been rather disturbed to read that provision had been made for the introduction of countervailing duties in cases of unfair competition, Mr. Taylor mentioned, even though the number of cases in which duties had been increased was very small. He urged the authorities to consider carefully whether they needed to make extensive use of such duties, and he would be interested to know which principal types of import had been subject to aggressive penetration tactics. He welcomed the steps that had been taken to liberalize controls on both direct and portfolio investments by nonresidents, but investment from abroad was still apparently subject to comprehensive controls. The rise in short-term interest rates in May 1982 had been both bold and constructive, but the extensive controls on investment from abroad could be an obstacle to the growth of industrial capacity and to the introduction of technical progress in the longer run. If it was true that certain investments were still only permitted on the basis that any future income could not be repatriated, the potential benefits for the Indian economy from a further elimination of controls could be quite large.

On the supply side, Mr. Taylor said that he welcomed the numerous internal price adjustments that the authorities had undertaken, and the readier acceptance of price flexibility. It had to be admitted that the benefits of the more liberal industrial policy had been slow to emerge; nevertheless he urged the authorities to maintain the impetus that they had developed toward the adoption of more liberal policies, and to do everything necessary to achieve a more appropriate level of competitiveness in the industrial sector. In the electrical power industry, financial constraints had led to a disruption of electricity supplies, and electricity was of course a fundamental prerequisite for better industrial performance. The authorities should surely accord a high priority to the provision of generating capacity, if necessary switching financial resources from less important fields.

He supported the proposed decisions and endorsed the thrust of the staff appraisal, Mr. Taylor concluded. While the program had many good features, it needed strengthening in a number of areas, and he hoped that the staff and the authorities would give them further attention in preparing the program for 1983/84.

Mr. Sangare stated that he supported the proposed decisions set out in EBS/83/16. The Indian authorities deserved to be commended for the way in which they had continued to tackle their economic problems within the program agreed with the Fund. It was encouraging to see that the performance criteria had been satisfied and that the authorities had been able to make both purchases scheduled so far in FY 1982/83. Economic activity in FY 1982/83 had certainly been affected by a number of adverse developments, particularly the lack of adequate rainfall and a major strike. As a result, the growth in real GDP was expected to be no more than 2 per cent, as opposed to the 5 per cent recorded in 1981/82 and well below the program target of 7 per cent. Nevertheless, with the help of prudent demand management policies, coupled with efforts to alleviate food shortages through imports and improvements in the distribution system, the authorities had been successful in keeping inflation down to about 8 per cent, as intended under the program.

The authorities had made significant progress in implementing their investment program in a number of key sectors, and they had been successful in adopting appropriate policy measures that should enhance the ability of the economy to sustain a high rate of growth and improve the country's balance of payments position in the longer term, Mr. Sangare observed. In the agricultural sector, for instance, the authorities had used the pricing policy to provide adequate incentives to farmers, who were also being supported by efforts to expand the areas under irrigation and the use of fertilizers and high-yielding varieties of grain. In industry, measures had been introduced to bring about a relaxation of regulations on private industry, to liberalize the price structure in key industries, such as steel, coal, and cement; and to increase efficiency in the public enterprises, including the railway system, which was now in a position to meet the needs of the economy.

Important developments had also taken place in the energy sector, Mr. Sangare remarked. Coal production was expected to rise from 125 million tons in 1981/82 to 133 million tons in 1982/83, while the accelerated oil production program appeared to be on track, with output for 1982/83 projected to meet the target of 21 million tons, or even slightly to exceed it. Power generation had also increased, although further improvement was needed to prevent shortages from creating a serious bottleneck, particularly in efforts to expand industrial production. As electric power was critical to the country's overall development program, he was glad that the authorities were taking steps to ensure the availability of resources for further investment by allowing increases in the costs of power generation to be passed on to consumers more readily than in the past, and by increasing the access of state electricity boards to borrowing from the Industrial Development Bank of India.

In the fiscal field, Mr. Sangare continued, there had been some deviations from the program targets for 1982/83, with an expected shortfall of about Rs 2 billion in revenue and an increase in expenditure above the original budget figure. The budget deficit was therefore expected to be 6.2 per cent of GDP, compared with the 5.3 per cent originally projected. Although the deficit could be serious, the measures aimed at increasing revenue and reducing expenditure, which had been put into place in recent months, indicated that the authorities remained aware that an improvement in the public finances was crucial to the country's adjustment efforts, and in particular to maintaining the momentum of the Government's investment program.

The authorities continued to apply a cautious monetary policy in view of the need to keep inflation under control, Mr. Sangare noted. However, the impact of the restrictive credit policies introduced in 1981 seemed to have been stronger than expected, and some industries had suffered from the lack of credit. In the circumstances, it could be understood that the authorities would decide to ease monetary conditions somewhat, particularly to meet the credit needs of some of the major industries, such as textiles and heavy engineering, while making it clear that the expansion of credit was to remain consistent with the objectives of the program. The authorities' flexible approach to interest rates had resulted in both lending and deposit rates being positive in real terms. The situation demonstrated the need to keep inflation under control.

It was notable that households contributed about 85 per cent of private savings, Mr. Sangare observed; he therefore wondered to what extent that phenomenon was due to the accessibility of financial institutions, and what lessons other developing countries could learn from the Indian experience.

In the external sector, Mr. Sangare noted, while the balance of payments deficit for FY 1982/83 was currently expected to be SDR 1.7 billion, slightly more than the estimate made in May 1982, it would still be some SDR 0.5 billion less than the revised figure for 1981/82. The export prospects for 1982/83 seemed favorable, with a 12 per cent growth projected for the year. Nevertheless, Indian manufacturers would have to overcome not only increased competition from producers in industrial countries but also problems associated with the rise of protectionism in many countries. Furthermore, India's export markets were concentrated in only a few countries; one country alone had accounted for more than half of the increase in India's exports over the past two years. The situation might contain the seeds of danger for India's balance of payments in the future, especially as many industrial countries were now seeking aggressively to penetrate India's market as a result of its import liberalization policy. While it was certainly desirable for importers to benefit from low prices for certain products, it was essential to guard against unfair pricing practices that would put local producers out of business and hence inhibit domestic industrialization in the long run. He welcomed the authorities' intention to keep exchange rate developments under continuous review.

Mr. Tvedt stated that like others he broadly agreed with the staff appraisal and strongly supported the proposed decisions. On the face of it, progress toward strengthening the balance of payments position and increasing public sector savings, the two key objectives of the program, had been slow. However, in view of the unexpectedly bad weather and the weaker terms of trade, the underlying adjustment had been quite satisfactory. It could not have taken place without the highly commendable political commitment by the authorities to the Fund program. Table 1 of EBS/83/16 showed that the terms of trade were expected to decline for 1982/83 below the position forecast in April 1982. While the new figure might be more realistic, he would be interested to know the staff's forecast for terms of trade developments in 1983/84. He also noted that the staff had lowered the estimate of the increase in trade from 7 per cent to the range of 5-7 per cent for 1982/83. In the circumstances, it would be valuable to know which export figure would be consistent with the estimated current account deficit of 2.2 per cent of GDP in 1982/83. Import policies for 1982/83 had included significant liberalization of trade, carrying further the steps in that direction taken in the late 1970s. Nevertheless, the basic framework of restrictions remained largely intact and there was, therefore, still scope for further action. While recognizing India's concern over increasing protection abroad, it was important that the Indian authorities should continue to pursue a policy of liberalization.

In the domestic economy, Mr. Tvedt stated, he agreed with the staff on the importance of additional resource mobilization at both central and state level if the medium-term savings target was to be achieved. He had therefore been pleased to learn about the recent steps taken by the authorties to increase revenue. Nevertheless, still further action seemed necessary in connection with pricing policies and subsidies. He had been interested by Annex III to SM/83/28, dealing with private saving, interest rates, and financial assets in India. The relatively high savings ratio was remarkable in view of the country's low per capita income. He wondered whether there was any easy explanation for the phenomenon. Moreover, given the apparent strong elasticity of growth of financial savings with respect to real interest rates, it would be interesting to learn whether the staff had any views about the possible impact of interest rates on private financial savings in 1982/83, the year in which real interest rates had become positive for the first time since 1978/79.

Mr. Finaish stated that he was in broad agreement with the staff assessment and that he supported the two proposed decisions. Despite some setbacks, the policy responses had been appropriate and the performance criteria under the program had been observed.

The Indian economy continued to operate in a highly unfavorable world environment, aggravated by serious adverse weather conditions in 1982, Mr. Finaish observed. One evident manifestation of the difficulties was the expected drop in the growth rate of gross domestic product in 1982/83 from the expected 5 per cent to the newly estimated 2 per cent. The impact of falling agricultural income on demand, as well as continued recessionary conditions and rising protectionism in major export markets, had contributed to less buoyant industrial activity in the second year of the program. The impact on public savings and resource mobilization was also significant, creating budget difficulties, and making it necessary to undertake a review of the Sixth Five-Year Plan. The additional imports of foodgrains, amounting to 0.4 per cent of GDP, had also affected the balance of payments performance. The authorities responded well to the mounting problems. The performance criteria had been observed and the authorities had achieved considerable success in containing inflationary pressures. Indeed, the inflation rate was expected to be somewhat lower for 1982/83 than the program had forecast. The overall budget deficit was also expected to be close to the program, despite a shortfall in resources. The slow progress in making balance of payments adjustment was more a reflection of temporarily adverse factors than any underlying weakness. Important progress had also been made in the area of structural reform.

Nevertheless, it would be interesting to hear how the staff had reached its assumptions regarding rainfall, Mr. Finaish observed. The projections for 1982/83 showed that an unrealized overoptimistic assumption regarding weather conditions could lead to a considerable departure from the program, thus changing the whole picture on which economic policy was based. As adverse weather conditions had been a recurring phenomenon, it was worth considering whether it was not excessively risky to base projections largely on a single assumption with respect to rainfall. The question was a general one but, in view of their sophistication, he had no doubt that the planners in India would take the matter into account.

The staff had referred to the sharp fall in workers' remittances from 1981/82 to 1982/83, Mr. Finaish recalled. It would be useful to know whether remittances were expected to remain at the high level of 1980/81. There were various indications, including those in a World Bank study on international migrant workers published in 1981, that seemed to caution against excessively optimistic expectations regarding the future prospects for remittances. He had however noted that the program figure for 1982/83 was relatively moderate.

Regarding the liberalization of imports, the staff had stated that the most conspicuous impact had been the increasing competition from foreign suppliers, as producers in the industrial countries were seeking aggressively to penetrate India's markets, Mr. Finaish recalled. In view of the increasingly protectionist trends outside India, it was worth asking whether further liberalization at the present time would not adversely affect the balance of payments and the adjustment effort. It would be much easier for India, and for that matter for less developed countries in general, to undertake trade liberalization and adjustment efforts if the barriers to their exports were lowered and liberalization were practised in their export markets as well. He was not suggesting that the Indian authorities should undertake less liberalization; he was only commenting on a factor that might make them less receptive to the advice they had received in that field. Finally, the staff had said that India's export performance had been cushioned by the existence of strong trading ties with Eastern Europe and the Middle East. As some of those countries maintained payments arrangements with India, he would welcome a comment on the extent to which such arrangements had contributed to the achievement of what the staff had called a high level of exports.

Mr. Teijeiro observed that he too was in broad agreement with the staff appraisal; despite adverse conditions for agriculture and some setbacks in the area of public finance, the Indian authorities had in general been successful in pursuing their program with the Fund. Inflation had remained under control, balance of payments developments had been broadly in line with program estimates, and progress in implementing the investment plan had been mainly good. On the other hand, in public finance insufficient adjustment of prices as well as higher subsidies had contributed to a savings shortfall. He was confident that a more vigorous policy at the state level would strengthen the public finances to the extent needed.

With respect to monetary policy, Mr. Teijeiro went on, the authorities had been remarkably cautious, and he encouraged them to keep a close watch on price developments and adjust their credit policies in such a way as to prevent any re-emergence of inflationary pressures. The recent adjustment of interest rates on long-term bank deposits was an important step in the right direction; it was likely to stimulate private savings and improve the allocation of financial resources.

On the structural reforms, Mr. Teijeiro observed, he wished to hear further comment from the staff. For instance, he wondered whether there was any study that could give a clear account of the net effect of all the distortions that had existed before trade liberalization began. Taking a broad view of the situation, many distortions might be mutually offsetting. For instance, both the tariff system and import restrictions were intended to protect manufacturers; but at the same time the excise tax system discriminated against manufacturers, as farmers were exempt from those taxes. Similarly, the tax system might have important effects at various stages of manufacturing, since if there were a great deal of tax evasion, there would clearly be implicit discrimination against large industry in favor of small industry. The net result might be that even with high tariff protection, many industrial sectors might not have such high effective rates of protection as the nominal figures would indicate, particularly if most of the activity was carried out by large firms. Many examples of the same kind could be adduced; in such a complex situation it was difficult to know even whether partial liberalization measures could be considered a positive move, since many parts of the economic system and many regulations would remain unchanged.

An overall evaluation of the combined effects of the import restrictions, the tariff system, the export subsidies, the pricing policy, and other regulations would be particularly valuable, Mr. Teijeiro stated. Such an evaluation would also shed light on other sorts of distortions including, for instance, the possible anti-export bias or particular distortions in the combinations of capital and labor in different sectors. The outcome should be very helpful not only for the Fund but also for the Indian authorities. First, it would enable the authorities to decide which distortions it was most important to correct. Second, an understanding of the interrelation between the various factors could lead to valuable ideas about the appropriate dynamics of the liberalization policies. The "second best" theory would lead to the conclusion that the removal of certain restrictions might not improve the situation if the remaining distortions were not also removed. Third, such an evaluation, made by an unbiased observer, could help to form a domestic consensus about which were the most important problems and the most appropriate solutions. Such a consensus was essential if the authorities were to be successful in carrying out their structural reform.

Mr. Jaafar remarked that the expected slowdown in India's overall performance for FY 1982/83 was disappointing after the remarkable recovery of the previous two years from the impact of a severe drought and the sharp rise in petroleum prices in FY 1979/80. The strategy of pursuing growth in the face of impending balance of payments weakness had paid off extremely well for India. Growth in 1980/81 and 1981/82 at 7.5 per cent and 5 per cent, respectively, seemed satisfactory and the programs designed to bring about medium-term adjustment in the external balances had remained on course. The authorities had been able to adhere to the performance criteria for the first period of the program. The outcome of the balance of payments had, however, been less satisfactory because, although export volume had increased, the terms of trade had turned downward.

The targets for the second year had been drawn up in an atmosphere of optimism that growth could be sustained and therefore that progress could be made in structural adjustment, Mr. Jaafar noted. However, the expected outcome was a slowing down of 2 per cent in the growth of GDP, reflecting once more the vagaries of weather, which adversely affected agricultural output. It was disheartening that agricultural production, which had been expected to exceed that of the previous year, had in fact declined by about 6.5 per cent, with a consequent decline in agricultural income by 2 per cent, instead of an increase by the same amount.

Industrial production had also been disappointing, as it was currently expected that the target would not be reached, Mr. Jaafar observed. Not only was external demand weak, on account of the global recession, but local conditions--particularly falling income--had more than offset the notable progress made by the authorities in alleviating supply bottlenecks and other constraints. The two main contributions by the authorities had been to adopt a tight monetary stance and to adhere to liberal import policies. While the tight rein on credit had certainly helped to curb inflation, in view of the apparent weakness of the economy he wondered whether such a policy should not be applied more flexibly. The result of the tight monetary stance appeared to have been more severe than anticipated. The sharp squeeze on credit, which had continued into 1982/83, had perhaps been accentuated by the effects of the fall in the velocity of income. The working of the liberal import policy, which had been continued into the second year of the program, served to highlight another policy dilemma. In the face of global recession, the liberal import policy had in the short run led to domestic industries being severely hit by increased competition from foreign suppliers, as had happened during FY 1982/83. While competition was welcome if it led to efficiency in the use of factors of production, it should be resisted if it became unfair. The authorities should be commended for adhering resolutely to their policy of import liberalization in the face of such difficulties.

It was satisfactory to note that the key sectors of industry had all performed better, particularly in respect of capacity utilization and production, Mr. Jaafar noted, except steel and railways; those sectors were both suffering from what the staff had called special factors. He would be glad if the staff could expand somewhat on what it meant by "special factors" affecting the steel expansion program.

Since the present circumstances had led to a setback in the income of most earners, it was inevitable that there should be a shortfall in savings, Mr. Jaafar considered. The target for the second year of the program was to achieve a significant increase in public sector savings in order to be able to finance public investment programs through noninflationary sources. It was significant that, in the face of a slowdown in activity, the ratio of public savings to GDP had risen by 0.5 per cent during FY 1982/83. Although the outcome had been Rs 10 billion short of the target, it nevertheless represented a 20 per cent gain over FY 1981/82. He agreed with the authorities that the savings outcome was a creditable performance in the circumstances. It was heartening to see that the staff considered that the investment part of the development plan would be feasible with the return of normal weather and some economic growth.

He was rather disturbed by the poor performance at the state level, Mr. Jaafar stated. Savings were well below the program projections, and the states had failed to raise savings to the level necessary to reach the targets in the Sixth Five-Year Plan. He therefore agreed with the staff that it was important for the states to understand that the public savings target for FY 1983/84 should be achieved. He urged the central authorities to continue resolutely with their efforts to close the prospective budget gap.

It was perhaps extraordinary that, despite the poor overall performance in 1982/83, the deficit on current account, which had been a source of concern, was not any worse than that of the previous year, particularly in view of the adoption of a more liberal import policy, Mr. Jaafar commented. Export performance had indeed been creditable in the face of sluggish world demand. Apart from export promotion measures, exporters were beginning to benefit from access to more imported inputs and the streamlining of procedures. The authorities should continue to try to improve efficiency, particularly in capital utilization, in order to ensure the competitiveness of Indian exports. He also agreed with the staff that the authorities should continue to monitor exchange rate policy very closely for the same purpose.

In view of the downward revision of the forecast for growth in FY 1982/83 from 5 per cent to 2 per cent, Mr. Jaafar observed, it was important to know whether the figure in Table 1 of EBS/83/16, showing that fiscal revenue and grants were expected to grow at the rate of 14.5 per cent--the same figure as had been projected with a GDP growth of 5 per cent--implied a doubling of revenue buoyancy. Second, in view of the changes in economic circumstances, the performance criteria for the forthcoming review should perhaps be adjusted accordingly.

In the present difficult circumstances, he commended the Indian authorities for the success of the strategies for growth and adjustment that they had adopted during the past two years, Mr. Jaafar stated. The vagaries of weather had been a constant exogenous factor for India; nevertheless, notable progress had been achieved with structural adjustment. He would therefore support both the proposed decisions.

Mr. Conrado stated that he was in broad agreement with the staff assessment of developments in the Indian economy and that he supported the proposed decisions. The Indian economy had performed well during the first year of the extended arrangement and all the criteria had been met. Real GDP had expanded by about 5 per cent, inflation had decelerated sharply, and foodgrain production had increased to high levels. Unfortunately, the economic environment during FY 1982/83 had been much less favorable, and economic performance for the present year would certainly fall short of projections in certain fields. Real GDP was likely to grow by no more than 2 per cent, and some of the burden would fall on the adjustment effort, particularly in public finance.

In the less than satisfactory circumstances, Mr. Conrado went on, the Indian economy had withstood rather well the unfavorable developments associated with world recession and the drought. It seemed likely that the increase in wholesale prices over the course of FY 1982/83 would be less than the program projection of 8 per cent; the overall balance of payments deficit during the first three quarters of the year had been broadly in line with the projection for the year as a whole; and the competitive position of exports, as measured by the real effective exchange rate, was now estimated to have improved by about 1 per cent during the first ten months of FY 1982/83 and by 6 per cent in FY 1981/82. All performance criteria up to December 1982 had been met, and the authorities should be commended for their flexible and pragmatic management of economic policies in difficult circumstances. The situation could have deteriorated markedly had not the authorities adopted the appropriate policies at the right time. He recalled in particular the possibility of inflation because of the tighter supply position caused by the drought. The timely announcement of cautionary grain imports had clearly helped to sustain confidence and contain the spurt in inflation. More generally, the restrictive financial policies adopted by the authorities had been crucial in bringing about such a successful outcome.

For the current year, Mr. Conrado considered, it was important for the authorities to overcome the temporarily adverse conditions and to achieve their program targets. The area of most concern was that of public finances, where there was really a need for additional resource mobilization. Indeed, he agreed with the staff that the importance of additional resource mobilization could hardly be overemphasized. Significant slippages in that respect could make it difficult to carry through the whole investment effort, with obvious consequences for the medium term. The authorities' policy responses seemed generally appropriate; the recently announced increases in consumer prices for petroleum products were most welcome.

One of the main objectives of the program, Mr. Conrado recalled, was to increase economic efficiency in India, particularly by means of more general import liberalization measures. The steps already taken were having the intended effect; further action was likely to be beneficial in the medium term but the current situation both at home and abroad clearly made the adoption of such measures difficult. The authorities should be commended for the courageous steps they had already taken, in the face of public complaints and increasingly protectionist tendencies in the major industrial countries. He had been interested in Mr. Dallara's remarks regarding the need for increased efforts to bring about import liberalization in connection with extended arrangements. While he could agree in general terms that there was a need for more import liberalization, it was important to maintain an appropriate balance between members using the Fund's resources and members that did not. Clearly, symmetry would call for the Fund to pay greater attention to the area of import liberalization and to the import restrictions imposed by all members, not only those that were using Fund resources. A case could even be made that the Fund should pay greater attention to those matters in the case of major countries, as they represented the largest market for exports.

Mr. Prowse stated that he agreed with the staff's analysis, and that he supported the two proposed decisions. India seemed to have made considerable progress, including bringing inflation under control. Regarding the allocation of resources for investment purposes, he had noted carefully what the staff had said on page 29 of EBS/83/16. As the mobilization of resources--and he saw no difference between resources and savings in that context--was the key to the whole program, it was important to relate other comments by the staff to those it had made on the question of resource mobilization. The staff had for instance said, on page 28 of EBS/83/16, that insufficient adjustment of the prices of goods and services provided by the public sector, together with higher fertilizer subsidies, had contributed to the savings shortfall. The staff had also said that power shortages continued to impede activity in some areas, and that they could become more severe if hydrogeneration failed as the result of the drought. The supply of power continued to represent the single most important and pervasive infrastructural constraint facing the economy, and every effort should be made to meet the capacity expansion targets in coming years. Nevertheless, investment allocations for power generation were falling well behind schedule. The financing of power generation projects would have to be looked at in more detail, but it was clear that the charges for services by the generating plant should be related to the capacity to generate internal financing.

India's balance of payments position was relatively strong, Mr. Prowse considered, and the current account deficit was modest by the standards of almost all other developing--and indeed some industrial--countries; the external debt ratio was also quite modest. One conclusion might be that not only should there be more active mobilization of domestic savings in both the public and the private sectors, there should also be greater efforts to obtain access to larger external resources. It ought to be possible to show that total per capita income and total output in India would both be higher if there had been greater access to foreign resources. He saw no medium-term risks that in acting thus the authorities would run into debt servicing problems.

Mr. Arias remarked that the present was the fourth occasion on which the Executive Board had discussed the affairs of India since 1981. He commended the authorities for their success in fulfilling all the performance criteria. He admired the way in which they had been able to implement an orderly and efficient set of economic policies despite unexpected domestic problems and the failure of the world economy to recover as had been hoped. The achievements by the Indian authorities were impressive. In the current fiscal year inflation had been less than projected and exports had been higher; the current account was in line with projections; there had been a substantial reduction of price controls and a liberalization of imports, bringing with them increased competition for domestic industry; most barriers to foreign capital in high technology industries had been abolished, and most industrial targets had been reached.

A strict monetary policy had played a key role in the program, Mr. Arias observed. Particularly commendable was the timely increase in interest rates. Fiscal policy had also been well conducted, although there had been some delay in increasing budget revenues. Although during most of the year the basket of currencies used by the Indian authorities had led to a slight real effective appreciation of the rupee, the situation had corrected itself more recently. The one important area in which there had been less progress than had been hoped for was the failure to increase the public savings rate. The causes for that disappointment had been the declining surpluses of public enterprises, both in the states and in central government control, and the failure to increase oil prices during most of the year.

Regarding the staff papers, Mr. Arias noted, first, that he had found no detailed information about the drought during the past year. Second, despite the material on pages 5 and 6 of EBS/83/16, the causes of the sluggishness in industry were not very well explained. Third, there seemed to be a conflict between the statement in SM/83/28 that the population growth rate was 2.1 per cent, and the figure of 2.3 per cent set out in EBS/83/16. Fourth, the passage on interest rates and financial savings in SM/83/28 was admirable. He hoped that the staff would be able to produce similar passages on other countries. On page 111 of SM/83/28 he noted that the staff had concluded that the most discernible coefficient of the financial savings regression equation was savings of the previous period--a very important finding for policy purposes. The staff had rightly emphasized the importance of real interest rates for savings, noting that a 1 point increase in real interest rates implied a 2.7 per cent increase in financial savings. He would also be interested to know how the staff had devised the lagged equation of expected inflation, also on page 111 of SM/83/28.

Despite their achievements, it would be wrong to minimize the difficulties facing the Indian authorities, Mr. Arias declared. During FY 1982/83, GDP had been lower than projected; exports had increased, mainly because of reliance on a number of bilateral payments agreements that had increased India's net claims by SDR 150 million; imports had been higher than projected; and the central government deficit had been higher than forecast because of the need to financially assist the state governments and to alleviate the effects of the drought. Much still remained to be done, but he was happy to see that the necessary measures to increase public revenues had already been taken. The program was a sound one, and the authorities were performing well. Naturally, they would have to adapt the program to changing circumstances both in India and in the world at large.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/30 (2/16/83) and EBM/83/31 (2/18/83).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 82/114 through 82/120 are approved. (EBD/83/38, 2/11/83)

Adopted February 17, 1983

3. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/45 (2/16/83) is approved.

APPROVED: July 21, 1983

JOSEPH W. LANG, JR.
Acting Secretary