04

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/32

3:00 p.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	
	Jaafar A.
	H. Suzuki, Temporary
R. K. Joyce	
A. Kafka	
	G. Grosche
G. Lovato	
R. N. Malhotra	
	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
	O. Kabbaj
F. Sangare	E. I. M. Mtei
	S. E. Conrado, Temporary
J. Tvedt	L. Vidvei
	Wang E.

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

African Department: J. B. Zulu, Director; L. M. Goreux, Deputy Director; O. B. Makalou, Deputy Director; C. V. Callender, R. O. Carstens, S. E. Cronquist, Z. Ebrahim-zadeh, S. M. Nsouli, D. J. Scheuer, N. E. Weerasinghe. Asian Department: Tun Thin, Director; P. R. Narvekar, Deputy Director; H. Neiss, 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: W. A. Beveridge, Deputy Director; D. K. Palmer, Deputy Director; H. Hino, S. Kanesa-Thasan, M. Nowak, E. J. Zervoudakis. Fiscal Affairs Department: P. S. Heller, M. Holmes. IMF Institute: M. K. Ghoshal, Participant. Legal Department: A. O. Liuksila, J. M. Ogoola, S. A. Silard. Middle Eastern Department: R. H. Floyd, M. Shadman. Secretary's Department: A. P. Bhagwat, J. A. Kay. Treasurer's Department: A. G. Chandavarkar, P. K. Woolley. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, J. R. N. Almeida, C. J. Batliwalla, L. Ionescu, M. A. Janjua, P. Kohnert, H.-S. Lee. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. Arias, T. A. Connors, M. Hull, J. M. Jones, P. Leeahtam, W. Moerke, J. A. K. Munthali, V. K. S. Nair, J. G. Pedersen, G. W. K. Pickering, E. Portas, J. Reddy, J. Schuijer, D. I. S. Shaw, J. C. Williams, Zhang X.

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

The Executive Directors continued from the previous meeting (EBM/83/31, 2/18/83) their consideration of the staff report for the 1983 Article IV consultation with India and the review of the extended arrangement for India (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).

The Director of the Asian Department commented that the staff had consistently assumed that the adjustment of the fundamental structural imbalances in the Indian economy would take a long time. The extended arrangement pointed both to the direction and to the magnitude of the needed policy changes in various areas, including import, pricing, industrial, and regulatory policies. In particular, the arrangement included provision for substantial increases during the program period in public investment in key sectors, such as energy and transportation, which were aimed at helping to strengthen the balance of payments in the short to medium term. The staff report described the progress that had been made in the effort to achieve structural adjustment. It was clear that significant progress had been achieved during the previous two years in all the most important areas, although the progress had not been uniform, and more rapid progress in certain areas would certainly have been welcome.

The authorities and the staff agreed that policy changes designed to liberalize the economy must be sustainable, the Director continued. No benefit would be gained from bold changes that subsequently had to be reversed, and in that respect the authorities had been quite successful; there had been no significant reversals of structural reforms. The authorities were in the best position to judge the appropriate timing of policy changes, and they had expressed their intention of introducing measures to liberalize further the economy when, and to the extent that, circumstances permitted. The authorities had stressed that the effect of changes in one policy area on developments in other policy areas had to be taken into account in making decisions concerning the process of liberalization. Even so, the staff felt that India would benefit from a more comprehensive and planned approach to policy changes in related structural areas.

Fortunately, the Director explained, the authorities had detected the shortfalls in revenues and savings soon after the adoption of the budget for the current year, and they had subsequently decided to scale down development projects and low-priority budgeted expenditures.

There seemed to be a feeling by some Executive Directors that the monetary targets for March 1983 were liberal, the Director remarked. Those targets took into account the very low level of both the narrow and broad money supply in March 1982 and the prospective large need for food credit. The levels for March 1983 were below those that had been projected in the first year of the program. In addition, it had been assumed that the improvement in inflation and, consequently, in real interest rates, would increase the demand for broad money, which was projected to grow at a rate of 15.5 per cent, while the growth of narrow money, which was more closely linked to transactions demand, was projected to rise by 12.5 per cent. The staff had carefully considered whether the credit and monetary targets were sufficiently restraining, and had agreed with the authorities that the program targets continued to be appropriate even though circumstances had changed. The main factor in the unexpectedly slow real growth in 1982/83 was the reduction in agricultural incomes which was expected to have its main impact on money demand in the coming year. Farmers' expenditure and savings in 1982/83 were influenced largely by the 1981/82 harvests; similarly, the 1982/83 harvests would provide income for 1983/84. Continued relatively low rates of inflation, at rates below the program projection, would have a positive effect on the public's demand for real cash balances in 1982/83.

It was useful to compare the experience in 1982/83 with that of 1979/80, the previous drought year, the Director noted. In that year, both monetary and budgetary policies had become excessively expansionary because of the need to support sectors of the economy that had faced serious problems. That situation had not recurred in 1982/83. The agreed financial program had proved to be an invaluable framework within which to contain the pressure for excessive money growth.

The Government used both quantitative restrictions and tariffs to protect domestic industries, the Director explained. The domestic prices of some imported and import-competing goods were higher than the import prices together with the customs duties paid because the volume of the imports was limited by quantitative restrictions; for those products, the actual level of protection was determined by the quantitative restrictions. The domestic prices of some other important goods approximately equaled the import price plus tariffs; in those cases, the tariffs determined the real level of protection. Despite the import liberalization of the previous several years, the majority of imports remained under the first category that he had described. The domestic prices of a large number of products were 50-150 per cent higher than the import price plus tariffs. The real level of protection could therefore be reduced more effectively by liberalizing the quantitative restrictions than by reducing tariffs.

The authorities had introduced a significant import liberalization in 1983, the Director went on. Recent increases in auxiliary duties had raised the general level of protection, but for a larger number of products quantitative restrictions, rather than the tariff measures, determined the level of protection. The staff felt that the adjustment in duties had had a negative overall impact, although the measures had had beneficial effects on revenues. One of the characteristics of the industrial structure in India was the wide variation in the level of effective protection; the level was high for a number of products but negative for some other important items. It was not clear to the staff whether adequate protection was provided for the products that should be promoted in the long-run best interests of the economy, or whether excess protection was being given to products whose long-run outlook was not promising. As the import policy had been liberalized, tariffs had become an increasingly important means of protection. The staff believed that steps should be taken to identify the products for which tariffs could be reduced without worsening the long-run outlook for the economy.

The State Electricity Boards (SEBs) were responsible for setting prices in the power sector, the Director remarked. Power tariffs had been increased on average by 18 per cent in 1981/82 and by more than 10 per cent in the first half of 1982/83, but studies indicated that those for some classes of consumers remained well below long-run marginal costs. Further tariff increases would therefore provide additional resources for the vitally important capacity expansion program in the power sector and would have a desirable allocative effect. In states participating in the World Bank-supported rural electrification scheme, the operating surpluses of SEBs were to contribute 20 per cent of their overall investment. In addition, the scheme limited the subsidies that the state budgets could provide to rural consumers. As a result, substantial tariff increases were expected to occur in a number of states. As for petroleum prices, pricing policy was kept under continuous review, and the prices of petroleum products had been raised in early February 1983. The latest adjustment was expected to raise Rs 8 billion in additional revenue over a full year and Rs 1 billion in the rest of the current financial year. Prior to that adjustment, the average price of petroleum products was estimated to have been marginally higher than the world market levels.

At the time of the writing of the staff report, the Director of the Asian Department explained, all the deposit interest rates had been positive in real terms, and the staff had projected a rate of inflation of 8 per cent. At present, the staff cautiously estimated that, in general, the deposit rates continued to be positive in real terms. Finally, soda ash, steel, and man-made fibers were examples of industrial products whose domestic producers had experienced increased competition from producers in the industrial countries seeking to penetrate India's market.

The staff representative from the Asian Department said that the moderate increase in disbursements of commercial loans shown in the balance of payments table in the staff report gave the wrong impression about the extent of the commercial borrowing by India in 1982. The staff expected that, on a commitment basis, commercial borrowing by India would be of the order of SDR 2 billion in 1982/83, or nearly double the level of 1981/82. The increase was substantial and was very close to the original program target. The low level of disbursements was not seen by the staff as a cause for concern. It had always envisaged that, during the program period, the authorities would attempt to build up a pipeline of borrowing that could be used in subsequent years. Until recently, India had had virtually no access to commercial credit markets, and it had been assumed that some time would be needed to construct the pipeline. Moreover, the loans were related directly to projects and it took time to arrange such loans, which would in any case be disbursed in stages over a number of years.

The staff expected private savings as a percentage of GDP to decline from 18.6 per cent in 1981/82 to 17.8 per cent in 1982/83, the staff representative explained. However, it was important to bear in mind that the latest firm data on private savings on a national incomes basis covered only 1980/81, and that the projection for 1982/83 was quite tentative, although it had been accepted by the authorities and took into account a number of factors, the most important being the effect of the decline in incomes in the present year. The marginal savings rate in India had been very high--of the order of 30-40 per cent--in recent years. Such high marginal rates tended to move downward as well as upward, and lower than expected growth would lead to a lower savings/GDP ratio. The lower incomes in agriculture in particular would have a substantial effect on savings in 1982/83, although savings rates in agriculture tended to be lower than the rates in other sectors.

There were a number of factors accounting for the relatively high rate of private savings in India, the staff representative considered. Progress had been made in interest rate policy during the program period. Deposit rates had been raised on three occasions during the program period, and inflation had declined substantially. The authorities should be given due credit for the significant improvement in interest rate policy on the deposit side, which acted as an encouragement to private savings.

Commenting on the relatively high rate of household savings in India, the staff representative said that it was important to recognize that there was a large number of farming households that were, in many respects, enterprises. The increasingly attractive investment climate in agriculture resulting from both the improvements in irrigation and other aspects of the infrastructure and the efforts to promote modern production techniques, had encouraged savings in the household sector. In the financial sector, the authorities had extended the network of financial institutions, particularly in rural areas, thereby providing adequate facilities for savings in rural areas. Moreover, considerable progress had been made in increasing the range of attractive financial instruments issued by both the Government and the financial institutions. Private savings in India were also supported by the high level of workers' remittances from abroad.

The concern expressed by some Executive Directors about the distortions in the patterns of prices and effective protection were well founded, the staff representative said. The distortions had been caused by a number of factors, including import restrictions, tariffs, tax rates, and pricing policy. A number of detailed studies of the problem had been made by official and academic circles in India and by the World Bank. The Fund staff, together with the World Bank staff, had been encouraging the authorities to continue the examination of the problem of price distortions in India. In India, as in many other countries, the tariff structure had evolved over a number of years and was based on decisions that were designed to affect particular industries while taking into account certain budgetary programs; tariff decisions were based only partially on their impact on the pattern of industrial protection. The effective rate of protection varied considerably from one industry to the next. The rate was particularly high in consumer goods industries, partly because of the scarcity of such goods as a result of the import restrictions on them. Man-made fibers and railway equipment also benefited from particularly high levels of effective protection. The tea, coffee, leather, textile, and chemical industries faced negative rates of effective protection. Some industries--such as intermediate goods--had been particularly affected by import liberalization in recent years and had experienced a relatively rapid decline in the rate of effective protection. The rate had also fallen in the fertilizer, cement, iron and steel, nonferrous metals, and cycle and motorcycle industries.

The tax system was an important factor contributing to the price distortions in the economy, the staff representative went on. The tax system in India relied heavily on central excise taxes and state sales taxes. Central excise taxes were levied on 136 items, including petroleum, metals and manufactures, textiles, chemicals, and transport equipment. Some were ad valorem and others specific; tax rates in some cases exceeded 50 per cent. Indirect taxes were levied on intermediate products, and in some cases the cascading effect was significant. The authorities understood the role played by indirect taxes in the distortions in the economy and had been examining possible changes, such as the substitution of a value-added tax. However, certain administrative and constitutional difficulties stood in the way of changes. The system of price controls also had the potential for causing distortions, but the staff was inclined to feel that the increased flexibility in pricing policy in recent years, especially in the prices for petroleum, steel, and other basic items, had markedly alleviated those distortions.

The unexpectedly large budget deficit in the current year had been caused in part by the shortfall in revenues and, even more important, by the increase in capital and current expenditure necessitated in part by the drought. The increase in the fertilizer subsidy had also contributed to the rise in the budget deficit. The authorities were taking steps to improve tax collection and administration to reduce the revenue shortfall. They were also introducing significant resource mobilization measures that were intended to have a significant effect in both the present year and the coming one. The measures implemented since November 1982 were expected to yield about Rs 2.6 billion--a significant contribution. Cuts in low-priority expenditure were also likely to be needed to reduce the budget deficit. In sum, the authorities were successfully handling the various budgetary problems, but the difficulties they would face in the final part of the present financial year should not be underestimated.

Any problem with the formulation of the government credit ceiling was more apparent than real, the staff representative said. The rise in credit above the ceiling followed by a sharp decline below the ceiling just prior to the end of the period in which the ceiling was applied was the normal seasonal pattern in India and reflected mainly the quarterly payment of taxes, in the final month of each quarter. The staff had recognized the pattern and had taken it into account in setting the ceilings for the end of each quarter.

A question had been raised, the staff representative recalled, about the way in which state overdrafts were accommodated by the central financial framework. The taking over by the Central Government of the state overdrafts constituted a mere transfer in the books of the Reserve Bank that did not affect the credit ceilings in any way. Ways and means advances to the states were meant to enable them to deal with temporary imbalances, and the increased level of the ways and means advances should be seen as a practical attempt to accommodate the temporary swings in the states' finances. The temporary imbalances should be distinguished from the real problem caused by fundamental weakness in their financial position; the increase in the ways and means advances was not meant to address that problem. The latest available data, which covered January 1983, showed that the aggregate of the states' ways and means advances had been kept within the ceiling established by the authorities. Financial problems continued in a few states--not all of them--and consultation between the states and the Central Government had taken place. Financial discipline had been increased in the states facing financial constraints; there was considerable evidence that those states were being forced to make difficult decisions concerning expenditure. The arrangement between the Central Government and the states with respect to the ways and means advances provided seemed useful but in no way reduced the need for more fundamental improvements in the state finances which, in turn, would require an increase in their resource mobilization.

Some Executive Directors felt that some of the staff's statements on the railway system were contradictory, the staff representative recalled. On the one hand, the staff had apparently suggested that the railway's performance as measured by the carriage of freight had not been fully satisfactory. On the other hand, the staff had concluded that the rail system met the present needs of the economy. The difficulty seemed to have arisen because of the measure of railway freight movement that the staff had originally chosen to use in formulating the program. The measure was not fully representative, as there had been a reduction in the average lead because of shorter hauls. The Fund and World Bank staff had also examined broader measures of performance, for instance, tons of originating traffic, which measured in gross terms the tonnage moved by the railways without regard to the length of the haul; the performance according to that measure had improved substantially. Another useful measure--net ton kilometers per railway wagon day--also showed a substantial improvement. The railways were performing well, and the authorities were to be commended on the important improvement in the performance in the previous two years.

The staff did not have direct data to support the estimate for workers' remittances in the current year, the staff representative explained, but there were indirect indications that developments were broadly in line with the projections in the program. There was scope for improvement in the collection of data on workers' remittances.

The authorities' policy on inward remittances by workers abroad had become more positive and active during the previous year, the staff representative noted. The interest rate on deposits in India by nonresidents had recently been raised by an additional 2 percentage points above the rates applied to residents' deposits, thereby significantly increasing the attractiveness of investments in India. The Government had also increased investment opportunities for nonresident Indians. The likely course of remittances, as reflected in the program projections, was not particularly bright. The authorities were therefore reviewing their policies, with a view to taking further steps to encourage remittances. Maintaining a stable financial environment in India would certainly make an important contribution to encouraging remittances.

The staff intended to discuss the likely evolution of the terms of trade in 1983/84 when it met with the authorities to formulate the details for the 1983/84 program, the staff representative remarked. For the moment, the staff did not expect the terms of trade in the coming year to have any substantial negative effect on the economy. Indeed, a slight improvement in the terms of trade was likely to occur. The present export target for 1982/83 was unchanged in value terms from the original target. In other words, the downward revision of the figure for export volume had been offset by the somewhat higher prices than had been originally expected.

The latest available figure on the population growth rate was 2.1 per cent, the staff representative from the Asian Department said. Finally, the 3.9 per cent effective appreciation of the exchange rate mentioned by the staff was the actual figure through the first ten months of 1982; it was not a target for the year as a whole.

A Deputy Director of the Exchange and Trade Relations Department said that the staff would wish to consider Mr. Finaish's request for a medium-term scenario. His preliminary reaction was that the staff was unlikely to be able to develop a scenario based on anything better than the authorities' own assumptions about weather conditions.

The extended arrangement for India was scheduled to run from November 1981 through November 1984, the Deputy Director explained. The next staff mission to India planned to discuss the appropriate level of Fund financing in support of the program for the Indian financial year ending March 31, 1984. Management had advised the Indian authorities of the need for a fourth and final set of discussions on the appropriate level of financing and the performance criteria for the last seven months of the third year of the extended arrangement. There was no question of the staff attempting to stretch out the period of the arrangement.

Commenting on the appropriate size of Fund financing in the present case of India, the Deputy Director remarked that Mr. Dallara apparently agreed with the staff that, in the absence of an early approach to the Fund for support of the country's adjustment effort, India's balance of payments position would certainly have worsened considerably. It was true that the proposed program did not provide for a substantial reduction in the level of the current account deficit. However, as a percentage of

GDP, the deficit was expected to be relatively low, about 1.8 per cent. Although the decline would not be large in absolute terms, India's external sector was not large, and the adjustments that were being made were clearly sizable in the circumstances of India.

The balance of payments problems facing India were serious, the Deputy Director stated. They had been caused to some extent by financial mismanagement, but the main cause was the sizable deterioration in the terms of trade on the import side, particularly with respect to petroleum. Accordingly, the authorities were attempting to make certain important adjustments in the economy. Nevertheless, the staff had maintained that the payments situation in India did not constitute a crisis.

Management and staff had consistently stated their support for the authorities' basic strategy in the area of commercial borrowing, the Deputy Director commented. The authorities were receiving balance of payments financing from the Fund and had stepped up their investment program with the support of commercial loans. The authorities expected the bulk of the borrowing under the 1982/83 ceiling to be committed; in comparison, one year previously there had been considerable uncertainty about the extent to which available funds would actually be committed. Mr. Narasimham had assured the Executive Board that the basic strategy was to implement a heavy program of foreign borrowing over several years, and all the available evidence suggested that the authorities had in fact been doing so. The staff had assumed that the associated development projects would not show up as expenditures in the balance of payments for several years; that expectation was consistent with the medium-term balance of payments effort that the authorities had undertaken. The objective of the adjustment supported by the extended arrangement was to place India in a position to carry on without Fund assistance in the period after the expiration of the arrangement. In sum, the commercial borrowing constituted an important element of India's overall borrowing strategy and was expected to have a positive effect on the balance of payments in the medium run.

In the case of India's arrangement, as in the case of any multiyear arrangement, the Deputy Director of the Exchange and Trade Relations Department remarked, the staff would take a fresh look at the balance of payments need before negotiating the financial program for the next 12-month period of the arrangement, to be certain that a need still existed. In the coming period, the Indian economy was likely to benefit from the decline in the price of oil imports, but the recession and protectionist tendencies in the world economy would make it difficult for the authorities to maintain the desired export volume. The balance of payments need for each 12 months would be assessed on the basis of its own merits.

Mr. Malhotra noted that there seemed to be a consensus that the program had been moving on track, and that the authorities had reacted effectively to the changing circumstances. Several speakers had noted how the major setback due to the very severe drought had been handled. The total precipitation and the pattern of precipitation in 1982 had been almost as unfavorable as in 1979, one of the worst drought years on record. The 1982 monsoon had arrived late, thereby delaying sowing, and precipitation had been erratic, with long dry spells occurring. The monsoon had also withdrawn prematurely, leaving inadequate moisture in the soil for the winter sowings. On the basis of information provided by Indian meteorologists, the authorities had realized early--around mid-July 1982--that the weather conditions constituted an important problem, and they had planned several measures to deal with the situation.

The Agriculture Ministry, Mr. Malhotra continued, in consultation with State Governments, had worked out a strategy to limit the damage caused by the drought by supplying inputs, especially seeds, and through resowing, where necessary. Action had also been taken to safeguard, and to increase the output of, the winter crop. The final assessment of meteorologists was that the 1982 drought had been only about 10 per cent less severe than the 1979 drought. However, the estimated loss of production in 1982--some 8 million tons--had been much less than the 22 million tons lost in 1979/80. The less damaging effect of the latest drought was due in considerable measure to the fact that a substantial area had been brought under irrigation since 1978/79 and had been used effectively.

Commenting on the steps that had been taken to suppress inflationary expectations, which had spurted in June and July 1982, Mr. Malhotra said that he agreed with the staff that the restrictive monetary policy stance had helped, but a whole series of other measures adopted over the previous two years had also helped. Price policies, particularly in the energy area, had helped to soak up a large volume of liquidity. The importance of the measures to build up stocks of foodgrains with the public distribution agencies should not be underestimated. For that purpose, remunerative prices had been fixed to encourage the voluntary sale of the marketable surplus of foodgrains to the public distribution system, which played a crucial role in promoting price stability as well as agricultural production. As a result, despite the shortfall in production, the procurement of rice in 1982 had been as large as it had been in 1981, partly because a large portion of the procurement had taken place in surplus areas with assured irrigation. Furthermore, as the staff had noted, about 4 million tons of wheat imports had been contracted. Those measures, together with the management of other important commodities, such as sugar and edible oils, had considerably moderated the inflationary expectations. As for sugar in particular, production in 1982 had reached a record level, but exports had been limited by weak demand and low international prices that had been well below production costs. In any event, sugar exports were regulated under the provisions of the International Sugar Agreement. Sugar stocks had been used effectively to bring down the price of sugar by raising releases into the market.

The production of oil seeds in 1981/82 had increased by 20 per cent, Mr. Malhotra remarked. Therefore, stocks of domestic and imported edible oils had been comfortable at the end of that year. Still, it had been decided that for 1982/83 the previous level of imports should be maintained.

The success in controlling inflation had been much greater than the authorities had dared to hope, Mr. Malhotra said. Similarly, Executive Directors clearly appreciated that the exchange rate policy had been effective. Mr. Laske, however, had mentioned that there had been a few months' delay in fully correcting the appreciation of the rupee that might have taken place in real effective terms in July 1982. In that connection, it was important to note that price data became available with a time lag. Furthermore, there was a basket of currencies against which the exchange rate of the rupee was fixed from time to time. That mechanism, which had been in place for several years, had served India well. It was not always possible to correct minor imbalances from one month to the next, but he agreed that it was important to maintain the competitiveness of Indian exports. Indeed, the supplementary information circulated by the staff showed that the competitiveness of the rupee since the start of the program had improved by about 6 per cent.

Speakers had endorsed India's interest rate policy of the previous two years, Mr. Malhotra commented, and they appreciated that real interest rates were positive. In fact, at the present rate of inflation the rates could be open to the charge of being excessively positive. However, the authorities intended to maintain the present interest rates on deposits because they attached great importance to encouraging financial savings.

Trade liberalization had helped to improve the availability of industrial raw materials, components, and capital goods, Mr. Malhotra remarked. India had in fact been moving in that direction since 1978/79, even before the authorities had thought of approaching the Fund for an arrangement. However, considerable progress had been made during the program period. The staff papers provided a useful analysis of how the objectives of the liberalization policy were being achieved. They mentioned the increases in imports of capital goods, industrial raw materials, components, and other requirements of the economy, but there had been serious problems, several industries--including some competitive ones--having "felt the heat." The Indian authorities had taken a pragmatic approach. They had maintained the broad stance of import liberalization not because the Fund wished them to do so, but because they believed that such a policy, subject of course to certain qualifications, was generally in the best interests of the Indian economy. The authorities had tried to resolve complaints by looking at specific cases, and they had taken appropriate corrective steps in a few areas, as the staff had noted.

There also seemed to be broad agreement that monetary policy was appropriate and that the balance of payments was on track, Mr. Malhotra went on. Taken together, the policies that he had described amounted to a very comprehensive framework. A judgment that the policies were in tha right direction was in itself significant. However, the authorities were not complacent about the program. In a large and diverse country like India, where powers were divided between the center and the states, developing a consensus in support of a program was by no means an easy task. India had a multiparty system, and the party in power at the center was not necessarily also in power in all the states. Despite the success they had achieved thus far, the Indian authorities were aware of the difficulties confronting the economy and of the need to overcome them.

The statement by Mr. Dallara questioning the appropriateness of the application of the enlarged access policy to the Indian program, Mr. Malhotra said, was similar to the statements that had been made when the program had first been discussed. After a wide-ranging discussion, the program had been approved by the Executive Board. The staff had already answered the questions that had been raised in that connection, but he wished to add two points. First, the staff had originally estimated that the terms of trade loss over the program period would amount to some SDR 9 billion. On page 74 of SM/83/28, it was said that "in total, the deterioration of the terms of trade amounted to more than 30 per cent in the period 1979/80-1981/82, and its total direct impact on the 1981/82 trade account is estimated at about SDR 4.5 billion." For the year 1982/83, the staff had assumed that the terms of trade had neither deteriorated nor improved. Hence, after adjusting the estimate for the volume of imports and exports, the impact on the 1982/83 trade account due to the accumulated terms of trade deterioration would also be large; for the two years taken together, the figure would reach SDR 9 billion.

Second, Mr. Malhotra continued, the arguments that he himself might have put forward in favor of the program had been correctly anticipated by Mr. Dallara. In particular, Mr. Dallara had noted that, if the Fund's support had not been given, India's payments position would have been much worse than it actually was. Mr. Dallara felt that India should have gone to the commercial market, and the staff had provided information on the country's recourse to the market. It was clear how reserves would have moved in the absence of the Fund-supported program. They had declined from the equivalent of eight months' imports at the end of 1978 to only about four months' imports at present; and, as imports increased, the proportion of reserves to imports would be reduced. A major objective of the program was to prevent such a deterioration in reserves.

It was important to note, Mr. Malhotra stated, that the amount of the Fund's assistance under the proposal was equivalent to 291 per cent of quota, well below the ceiling for support under the enlarged access policy.

In his statement, Mr. Malhotra recalled, Mr. Laske, noting the slight improvement in the overall balance of payments in 1982/83 and the fact that India had kept its commercial borrowing below the established limits, had suggested that the balance of payments need for 1983/84 should be looked at with "exceptional care." In that connection, it was useful to note that, under the program, the drawdown of reserves during the two years 1981/82 and 1982/83 was SDR 1 billion. The reserve drawdown in the two years ended December 1982 had actually been SDR 1.65 billion. The current account deficits for those two years had deteriorated only marginally compared with the staff projections. The actual use of commercial borrowing during the period had been greater than had been expected by SDR 351 million. Similarly, the overall balance of payments for the two-year period had also shown only marginal deterioration. Moreover, the staff had concluded that developments in the balance of payments were broadly on track. Given those facts, he had been somewhat surprised by the statement to the effect that the staff had to look at India's balance of payments need with exceptional care. The staff would of course continue to pay the usual close attention to the need aspect of the country's external position, but he hoped that it would not result in India being treated in an exceptional manner.

It had been suggested by Mr. Dallara, Mr. Malhotra recalled, that Fund financial support under a stand-by arrangement should only be used when there was an acute need for it. His authorities felt that the need already existed to use the resources to ensure the success of the program and to maintain reserves. Mr. Dallara had also suggested that annual Fund support should be treated as a ceiling and not as a target. It was of course up to the Executive Board to consider whether a new approach to handling extended arrangements should be evolved. Until then, the present arrangement and all others should be handled within the bounds of established policy. Furthermore, the period of the extended arrangement should be looked at as a whole. It was true that the performance criteria and disbursements were agreed upon each year, but the need to maintain reserves at an appropriate level was at the heart of India's program.

After noting that the performance criteria had been met, Mr. Laske had asked whether the criteria had not been excessively liberal, Mr. Malhotra said. His response to the question was based on his authorities' actual experience. As had been clearly explained in the staff reports, there had been a severe squeeze on bank credit in the first half of 1982. The authorities had had to live with the agreed ceilings on commercial credit and had monitored the ceilings closely. Indeed, they had established internal ceilings that were somewhat lower than those agreed with the Fund. In retrospect, it was clear that the ceilings had contributed to the severity of the squeeze, which partially explained the slack that had developed in some important industries. The various ceilings, including the one on bank credit to the Government, had been very difficult to live with. That outstanding bank credit to the Government had somewhat exceeded the ceilings on two occasions in the present financial year merely underscored the toughness of the ceilings and the difficulty the authorities had had in living with them. It was important to avoid a Catch-22 situation in which the staff was blamed for being excessively liberal if ceilings were met, and for being excessively tough if disbursements under an arrangement were suspended. It was the responsibility of the Executive Board to guide the staff; at the same time, it was important to give the staff room to make their own judgments in consultation with the authorities. It was much too difficult for the Executive Board to give directions to the staff on such technical matters.

He agreed that monetary policy should be cautious, and that the growth of monetary aggregates should be kept under control, Mr. Malhotra commented. At the same time, it was essential that monetary policy should meet the needs of the economy and be implemented flexibly. Problems had arisen in the past when the authorities had had to respond quickly to new developments. Such corrections were difficult to implement, as the signal of change had to be sent to thousands of bank branches in a large country like India. Flexibility was needed to ensure the viability of a reasonable monetary policy and he remarked that the growth in the monetary aggregates in the previous year had not been on the high side.

Although the increase in the wholesale price index had been very low, Mr. Malhotra remarked, the rate of inflation based on the consumer price index in 1982 had been 7.9 per cent. The possible reasons for the difference between the rates of price increase based on the wholesale and consumer price indices had been explained by his chair on previous occasions. In considering the growth of the money supply in 1982, including the 15.5 per cent rise in M-3, Executive Directors should bear in mind the movement in the consumer price index and the deflationary impact of the substantial loss of official reserves.

Commenting further on the rate of growth of M-3, Mr. Malhotra said that the interest rate policy had played a significant role in increasing bank deposits. The aggregate increase in the deposits of the banking system in the first half of 1982 had been sluggish, but the rate for the whole year had exceeded the rate for the year 1981. A substantial portion of the deposits were term deposits for three to five years. The increase in M-3 in response to policies aimed at promoting financial savings was therefore certainly not a cause for concern.

A question had been raised, Mr. Malhotra recalled, about the use of the additional limit of Rs 5 billion, which was in the nature of a contingency provision. At the time of the consultation discussions, the authorities had considered whether the staff should not be asked to increase the ceiling on commercial credit. At that time, bank credit to the commercial sector had not been growing rapidly, partly because of the slack in industry, and therefore no change in the ceiling had actually been requested. Subsequently, however, commercial credit had picked up, and the Reserve Bank and the commercial banks had to provide finance for the large sugar stock and for the increased foodgrain stock with the public distribution system. Nevertheless, the authorities had informed the Fund that, for the time being, they had decided not to use the cushion that had been provided. While the possibility of a problem arising in that area could not be ruled out, the authorities wished to live within the ceilings.

Some Executive Directors had expressed concern about public savings, the budget, and the availability of investment financing, Mr. Malhotra remarked, but public savings had increased at a good rate, moving from 3.7 per cent of GDP in 1980/81 to 4.3 per cent in 1981/82. Under the original program, public savings were to have increased to the equivalent of 4.8 per cent of GDP in 1982/83. During the discussions on the program for 1982/83, the substantial increase in public savings in 1981/82 had encouraged the authorities to do even better in 1982/83. As a result, the original target for 1982/83 of 4.8 per cent of GDP had been raised to 5 per cent. The drought and the slack in the industrial sector would inevitably have an adverse impact on public savings, and, in the circumstances, the projected level of savings was remarkable.

It was true that there had been some budgetary shortfalls, Mr. Malhotra continued, but the authorities had reacted to them in a positive way. The new measures adopted since end-1982 would add about Rs 2.6 billion to resources in the current fiscal year and Rs 12.5 billion in 1983/84. Other postbudgetary measures had also been taken, especially with respect to charges of the railways and the Post and Telegraph Department. There were obvious limits to taxation in a period that was characterized by severe drought and slack in several industries, but the authorities had taken substantial steps to increase resource mobilization. They had also made adjustments on the expenditure side. The staff had noted that expenditure on drought-related programs was expected to increase. In India, drought relief was provided essentially through an employment-creation program rather than by doles. Districts maintained lists of works that could be taken up in drought periods. The lists were occasionally updated and were being increasingly dovetailed into the Development Plan, wherever possible. However, some of the areas that had been severely hit by the drought lacked irrigation facilities and had limited public works; therefore, extra expenditures on drought-related programs had had to be incurred. Nevertheless, the authorities were trying to live with the limits on bank credit to the Government that had been agreed with the Fund. There were no unnecessary expenditures in the budget. Some expenditures were of course accorded a higher priority than others.

The blame for many of the problems facing the Indian economy ought not to be heaped on the state governments, Mr. Malhotra remarked. The additional resource mobilization by the states for the year 1982/83 had been close to what had been envisaged. In addition, the states were contributing 48.5 per cent to the financing of the present Development Plan. Hence, while there was scope for improvement in state finances, Executive Directors should not be left with the impression that the states were making anything other than a major effort. In the past, the recourse by several states to the Reserve Bank tap for overdrafts had been a major source of concern for the Government, and the decision taken by the Government in consultation with the states to deal with the problem was a significant development. The new scheme had held up well thus far. The Reserve Bank's ways and means limits for the states had been doubled because the state budgets, including state expenditures, had considerably increased; thus the move of doubling the limits was a necessary correction of the situation that had been developing for a number of years.

It had been suggested by Mr. Laske, Mr. Malhotra recalled, that tardiness in persuading the states to raise finances could create problems. There was no tardiness as far as dialogue between the states and the Central Government was concerned. In fact the Planning Commission discussed with the states the size and financing of their plans every year. In addition, financing issues were discussed in the National Development Council, which consisted of the Prime Minister, her associates, and all the chief ministers of the states. The development of a broad national consensus on the development strategy of the country had been one of the great achievements since the inception of planning in India. The consensus had held for over 30 years because the division of powers under the Indian Constitution had been respected by both the Central Government and the states. The state governments generally had acted with great responsibility in tackling the tasks of development. At the same time, however, it was important to appreciate that the state governments were closer to local groups than the Central Government and were particularly sensitive to public reactions.

The Constitution recognized that, while the states had considerable responsibilities for agriculture, education, security, health, and several other areas, the resource base was not proportionately large, Mr. Malhotra said. To correct the imbalance, the Constitution provided for the appointment of a Finance Commission every five years to examine the state finances in detail and to recommend the devolution of resources from the Central Government to the states. The latest Finance Commission was scheduled to make its report in a few months. The previous Finance Commissions had helped to improve the flow of resources to the states. In the short run, the Central Government and the states had to find solutions to budgetary shortfalls.

Two of the states' responsibilities--irrigation and power--had been highlighted during the discussion, Mr. Malhotra noted. The actual increase in the irrigated area in the first three years of the Plan was broadly in line with the program targets; the shortfall was marginal. That achievement was the result of a shift in emphasis from large works, which took several years to complete, to smaller works that could be completed quickly, and to minor irrigation in the private sector, which attracted additional private savings. Although more could be done, irrigation was not a cause for major concern.

Shortfalls in the creation of power generation capacity were likely to occur, Mr. Malhotra went on. However, the matter should be seen in perspective. Mr. Laske seemed to feel that the Indian Development Plan was much too ambitious and left no cushion for the kinds of adverse economic developments experienced in 1982. However, while excessive ambition might not be desirable, some ambition was a crucial factor in successful planning. Still, in retrospect, the authorities had been very ambitious in their plans for power generation. Before the start of the present Five-Year Plan, the power generation capacity had been of the order of 31,000-32,000 megawatts, which had been developed over several decades. The present Plan was aimed at increasing the capacity by as much as 19,000 megawatts in five years. It was therefore not surprising that some shortfalls in capacity creation were likely to occur. On the other hand, the authorities had tried to ameliorate the situation. Three power projects, with a total capacity of 3,000 megawatts, which had not been envisaged in the current Plan, were being undertaken with the help of external finance. It was quite possible that those projects might not not come on stream by the end of the Plan period and might spill over to the next, but they should help meet the shortfall with some delay. Meanwhile, there had been a heartening improvement in the efficiency of thermal plants. The plant load factor had risen by about 2 per cent in 1981/82 and was likely to rise by another 2 per cent in 1982/83.

The broader question of a possible shift of responsibility for the power sector from the states to the Central Government was a very difficult one, Mr. Malhotra went on. The states could not be asked to transfer their responsibilities to the Central Government. However, the authorities were establishing a large generating capacity in the central sector. Many of the central power stations would ultimately have capacities of about 2,000 megawatts each. Some of the new externally supported plants that he had mentioned were in the central sector.

Coal production had been consistent with the projections under the current Plan, Mr. Malhotra noted, and the staff report had adequately described the satisfactory developments--including the significant gains in efficiency--in the rail system. Net ton kilometers per rail wagon a day had increased from 986 in 1980/81 to 1,126 in April/October 1982. That remarkable improvement had been due to some extent to a reduction in the number of wagons on the rails. Wagon turnaround time, another important indicator of efficiency, had declined from 15.2 days in 1980/81 to 13 days in April/October 1982. Extra money had been channeled to the rail sector, and a large program for establishing computer-based management systems to improve further the movement of goods by the rail system was being implemented with the assistance of the World Bank.

Capacity creation in the fertilizer sector was in line with the targets under the Plan, Mr. Malhotra said, and the capacity added in the cement sector had been remarkable, about 7 million tons in just one year. All the investment areas that he had mentioned were crucial to the adjustment of the external account. Oil production would also play a crucial role and, in that connection, the recent developments had clearly constituted a success story. The Plan had originally provided for a much lower level of investment in oil than had actually occurred. However, once the authorities had discovered that the potential reserves in the Bombay high oilfield were larger than had been assumed, an accelerated production program had been prepared, thereby increasing the budget for the oil sector by about 100 per cent. Domestic oil production was in line with the revised targets.

In considering the resource shortages for the power sector, Mr. Malhotra said, Executive Directors should take into account the substantial shift of resources to the oil sector, which had had a direct and immediate effect on the balance of payments. Although most of the industrial programs were broadly on track, a shortfall in power capacity creation was expected. The authorities were making every effort to find supplementary resources for the power sector and to improve the sector's efficiency. An improvement in efficiency could have a significant impact.

Despite the adverse external environment, India's exports had grown at a satisfactory pace, Mr. Malhotra remarked. There was some feeling among Executive Directors that the export subsidies in the form of cash compensatory support were large. The cash compensatory support was a refund of unrequited, indirect taxes on exported goods that could not be returned directly to exporters. The cash compensatory support was reviewed in detail every three years, and there were a large number of goods for which cash compensatory support was not provided even though exporters paid unrefunded indirect taxes. Given the present budgetary position, the authorities could not afford to be generous with their cash support. He understood that the cash compensatory support did not constitute an export subsidy.

On the feasibility of introducing a value-added tax, Mr. Malhotra said that while he personally was a great admirer of that tax, it was not feasible in India. For some time the Central Government had discussed with the states the limited suggestion for substituting a central excise tax for the sales tax on some commodities. Under the Constitution, the states were empowered to levy the sales tax, a major source of their revenue, and they did not wish to give up that power. The Central Government was prepared to pay the states the revenue that they might lose, together with increments, but the states had not been persuaded. As a practical matter, therefore, the value-added tax could not be introduced.

A number of Executive Directors had welcomed the import liberalization that had already taken place, Mr. Malhotra noted, and some of them felt that the authorities should take further steps to reduce protection of industry and to allow more competition than hitherto. On the other hand, several Executive Directors apparently felt that, in the present circumstances, further progress in liberalization might be difficult and should be approached with caution. The staff representative had noted that the tariff structure had developed essentially in response to the need to raise resources, and it was true that, except in a few cases, customs duties had been raised for revenue reasons and not for protection. It was also true, as the staff had pointed out, that a large number of industries had negative protection. In sum, several industries in India had negative protection, and a few had positive protection for special reasons.

A study by a nongovernment organization (the ICICI) in 1975 had concluded that effective protection for industry in India was not high, Mr. Malhotra stated. Import liberalization in India had to be approached with caution. The country had substantially liberalized its system, but the effort had to be sustainable if it was to remain broadly acceptable. It was also important to note that, although India was more industrialized than some other developing countries, manufacturing accounted for only about 15 per cent of GDP in India. There was a tendency to look at India's total industrial production and not at the contribution of manufactures to GDP. India had still a long way to go before the contribution of its manufacturing sector reached the present levels in several middle-income industrial countries. It was important to remember that the authorities' steps to liberalize imports were being taken at a very difficult time characterized by an unfavorable trading environment and protectionism.

The question had been raised, Mr. Malhotra recalled, of what the Fund could do to counter protectionism in larger economies that did not use the institution's resources. The Fund could merely exhort them to avoid protectionism or even to roll it back. However, protectionism was growing in the stronger economies. Many of India's exports had run into difficulty because of the protectionism abroad. In addition, India had suffered terms of trade losses. Because of the import liberalization, several Indian industries, many of which were relatively new, were feeling the heat of foreign competition, and there was therefore a clear need to approach further liberalization in a cautious way. On the other hand, the intentions that had been expressed in the letter of intent would be fully honored. Taking any further steps would be difficult, given the present international environment, the state of industry in India, and a number of other factors, including political ones. Some time ago it had been decided that the products of 14 industries--large, capital-intensive industries, including power, cement, and fertilizers, which accounted for a substantial part of total investment in India--should be the subject of international tenders that could be floated by users. Problems had arisen, however, as several cases akin to dumping had occurred; quotations had been received that were completely out of line with production costs. In one case, for instance, a large capital item had been quoted at $68 million in a neighboring country and at $38 million by a company operating in India. A committee has been established to detect such practices. However, the Government had not altered its liberalization policy despite the considerable pressure from domestic industries. Much had been done to promote competition in the important productive areas.

There was some feeling that the Fund should take a comprehensive look at India's industrial policy, Mr. Malhotra remarked. The staff reports described in detail the numerous steps that had been taken with a view to making industrial policy more flexible, production oriented, and supportive of exports and competitiveness. Industrial policy was under constant review, and there was no need for the comprehensive examination that had been suggested during the present discussion. The investment climate in India was very good, as was reflected by the large increases in new capital raised and in long-term credit disbursed to new and modernizing industries, which had occurred mainly because Indian industry was profitable. Price regulation in India was limited to a few basic inputs. There was a feeling in Indian industrial circles that there was a fresh breeze blowing through the country, that they had much more elbow room at present than in the past, and that government policies were highly supportive of both the public and private sectors. In addition, there had been a major change in attitude toward the importation of technology. In 1982, some 600 cases of technical collaboration had been sanctioned; and the figure for each of the two previous years had been about 450. The authorities' policies were helping to make Indian industry more modern and competitive than hitherto.

The authorities had introduced a number of incentives to promote the flow of remittances into India, Mr. Malhotra said. There was a large concentration of Indian workers in the Gulf area, where a number of problems had arisen. The surpluses of the Gulf countries had been declining and, given the uncertainties about developments in the coming period, it was difficult to be very optimistic about the outlook for remittances, although they were unlikely to decline.

It had long been an article of faith with the Indian authorities, Mr. Malhotra explained, that once foreign investment in India was admitted, remittances of profits, technical fees, or repatriation of capital should not be interfered with. The Reserve Bank of India monitored the flows, but the authorities had doggedly stuck to the policy of noninterference. In his comments on the matter, Mr. Taylor might have been referring to certain investment incentives that were given to nonresidents of Indian origin. If they wished to establish an industry without repatriating profits, they were permitted 100 per cent of the equity in certain industries; if they wished to repatriate profits, the equity could be as much as 75 per cent, which was also a high level.

The increase in the fertilizer subsidy was due mainly to the success in establishing new fertilizer capacity, Mr. Malhotra explained. Fertilizer was a capital-intensive industry, and the cost of new projects was extremely high. If fertilizer factories were to supply fertilizer at a certain price level, they must receive a proper return, provided they functioned efficiently in terms of capacity utilization and other performance norms based on input/output ratios. The fertilizer subsidy was not given to each and every fertilizer plant. Many old plants, which had written off their capital and did not carry a high interest burden, actually contributed to the pool that financed the subsidy in order to help ensure that new investment in the sector took place.

Fertilizer use had a special place in India's agricultural strategy, Mr. Malhotra went on. During the previous two years, fertilizer prices had been increased by about 70 per cent, and fertilizer prices in India were higher than those prevailing in other countries in the region. Recent experience had given the authorities reason to approach fertilizer price policy with caution. After the 70 per cent price increases, the annual growth of fertilizer use, which had been running at about 17-19 per cent, had fallen to an average of about 7 per cent; and the rate of decline earlier on had been even steeper. The decline in fertilizer use had some effect on agricultural output. In the wake of the fertilizer price increases, the price for the procurement of foodgrains by the public agencies had had to be raised, thereby affecting the consumer prices of foodgrains issued by the public distribution system. Many agronomists and economists felt that the massive increase in fertilizer prices had adversely affected the growth of fertilizer use. India was investing heavily in irrigation, and the utilization of irrigation could be optimized only if the use of fertilizers grew. The Government did not particularly wish to provide subsidies, but the subsidy situation was complex and the authorities intended to keep it under review. The considered view in

India was that a further increase in fertilizer prices would be counterproductive. Given the size of the country, fertilizer consumption was not high. The use of fertilizers was highly price elastic, and the authorities felt that it would not be wise to increase fertilizer prices at the present stage.

There had been no deliberate attempt by the Indian authorities to divert additional exports to a particular country or area, Mr. Malhotra explained. The authorities were seeking markets all over the world. Most of the exports to Eastern Europe were made by the private sector and were based entirely on the commercial judgment of the contracting parties.

The authorities were keeping the bilateral trading arrangements under review, Mr. Malhotra went on. As a result of past reviews, bilateral arrangements with some countries--for instance, Yugoslavia and Hungary--had been given up by mutual agreement. Similar arrangements with some developing countries had also been terminated. However, the authorities continued to attach importance to existing arrangements, which had been highly beneficial, particularly when Indian exports had encountered difficulties in several other markets.

The large increase in Indian exports to the Soviet Union had been noted by some speakers, Mr. Malhotra remarked. The reason for the increase was an indication of the usefulness of the remaining bilateral trading arrangements. The Soviet Union supplied a considerable amount of crude oil and oil products to India; 60-70 per cent of India's imports from the Soviet Union consisted of those commodities. When oil prices had risen by about 100 per cent in 1979, the balanced trade concept had required that the Soviet Union increase its imports from India, as it had in fact done. The temporary payments imbalance between India and the Soviet Union had arisen because the Soviet Union had been providing part of the oil from one of the Middle Eastern countries that had encountered some delays in supplying oil for export and, in the meanwhile, India had not wished its exports to the Soviet Union to be delayed. Another factor to take into account in considering bilateral trade arrangements was that, under such arrangements, a debit was charged, or a credit was given, immediately upon shipment of a good or service. Under multilateral systems, actual receipts typically materialized with a lag of two or three months but the lag in payments did not surface as an imbalance or credit. Under bilateral payments arrangements, temporary accommodation was essential to take care of imbalances in trade that evened out over time; over the 1970s, more often than not it had been India that had made use of that accommodation under its bilateral arrangements.

Mr. Dallara stated that he fully accepted the principle that members should deal with their balance of payments problems at an early stage in their development. However, he would not wish to go further and suggest that the acceptance of that principle meant that in all such cases the Fund should approve a stand-by or extended arrangement and, as in the case of India, provide a considerable volume of Fund resources. There were a variety of ways--such as technical assistance and Article IV consultations--in which the Fund could support members.

Mr. Taylor said that it had been his understanding that the repatriation of profits and dividends on certain kinds of inward direct investment in India was subject to limitations. The matter was an important one to his authorities, but it could be taken up bilaterally.

The Deputy Director of the Exchange and Trade Relations Department gave a further explanation of the concept of balance of payments need and the appropriate amount of Fund assistance. If a member had a three-year arrangement with the Fund for, say, SDR 3 billion, and the initial balance of payments projection suggested a need for SDR 1 billion of assistance in each of the three years of the arrangement, the Executive Board would formally commit SDR 1 billion in resources for the first year. Management and staff would review the situation in the country concerned in preparing its recommendation for the second year of the arrangement; a mission would visit the country and negotiate a program for the second year, and a specific proposal for more or less than SDR 1 billion, depending on recent developments and prospects, would be made. The same kind of review would be conducted in preparing a recommendation for the third year of the arrangement and, if management and staff found that there was no longer a balance of payments need, a program and proposal for the use of Fund resources under the arrangement would not be brought to the Executive Board. The maximum amount of Fund assistance under the arrangement would be SDR 3 billion. The amount that was actually drawn would depend on balance of payments developments in the country and might well be less than SDR 3 billion.

Mr. Malhotra remarked that he fully agreed with the Deputy Director of the Exchange and Trade Relations Department.

The Chairman said that India would of course be treated with the same care with which the Fund treated all members. He then made the following summing up:

> Executive Directors expressed satisfaction with the continuation in 1982/83 of the generally successful implementation of the adjustment program but noted that progress had been adversely affected by exogenous factors. In particular, economic growth and the balance of payments were affected by a serious drought and continued recessionary conditions in the world economy. As a result, savings, including those in the public sector, were expected to be lower than programmed in 1982/83, and there would be some shortfall from the program targets for public finances. Nevertheless, the performance criteria were all observed and important progress was made in several other areas, including the containment of inflationary pressures, which had been remarkable, and the implementation of the investment program. There had also been progress toward more open trading policies.

Directors agreed that restrained and skillful financial policies over the past year had played an important role in maintaining the program on track and in keeping inflation low in the face of drought. Restrictive commercial credit policies initiated in 1981 had resulted in slower than programmed monetary growth during the first half of 1982. Although credit policies have since been relaxed somewhat, policies remain cautious, a stance that Directors endorsed as being appropriate in view of the inflationary potential in the present situation. They recognized that there was concern about the slowdown in activity in some sectors but considered that caution would continue to be needed in the period ahead. Directors welcomed the recent increase in interest rates on bank deposits as a further encouragement to private savings. They noted that real interest rates on deposits and lending were positive.

Directors emphasized the importance of minimizing the impact of adverse factors on public finances. They welcomed the efforts the authorities were making to bridge the prospective budgetary gap in 1982/83 and reiterated that they attached importance to maintaining recourse to the banking system within the program projections for 1982/83. Even if the authorities' efforts in this direction are successful, public savings at both the Central Government and state levels are likely to fall considerably short of the program targets. The financial performance of some states was a source of concern. Because of insufficient resources, some curtailment of public investment would be necessary, a development that Directors noted with concern. They observed that part of the savings shortfall reflected delays in adjusting some prices and increased subsidies and urged that corrective steps in these areas be taken.

Directors welcomed recent steps to raise substantial additional public resources and stressed that sustained efforts were needed in the period ahead. Although progress in the key sector investment programs of oil, coal, fertilizer, cement, and railways was satisfactory, resource constraints were becoming increasingly apparent, especially in electric power and irrigation. As for irrigation, resource constraints had been mitigated by a shift of emphasis from large works to minor works so that additional creation of capacity was broadly in line with Plan targets. As regards power, it was noted that, in order to overcome the likely shortfall in capacity, external finance was being arranged to set up three large projects not previously envisaged in the Development Plan. Increased resource mobilization by the Central Government, and especially the states, will be imperative to prevent a disruptive shortfall in investment in areas crucial to external adjustment.

Directors noted with satisfaction that the import liberalization steps introduced in 1982/83 were being implemented effectively and that their impact on the economy was broadly as expected. They commended the authorities for their resolution in this area in the face of difficulties encountered by some domestic industries, which were intensified by the impact of the international recession and protectionism abroad. Increased competition should yield a welcome improvement in the efficiency of the Indian economy.

A number of Directors observed that despite the recent progress, India's basic framework of restrictions remains largely intact and they saw need for further significant import liberalization. These Directors urged the authorities to achieve the agreed objectives of the extended arrangement during the remaining period of the program and to match that by an active tariff policy. Several Directors, however, thought that further progress in this area may be difficult in view of the unfavorable external trading environment, protectionism abroad, and the need to adjust the balance of payments. Directors noted that considerable progress has been made in reducing controls and regulations on private industry and in liberalizing pricing policy, but Directors urged the authorities to continue to press ahead in this area in order to improve economic efficiency.

Directors noted with satisfaction that, despite the adverse circumstances of the current year, balance of payments developments were broadly in line with the program projections. Export performance, while falling somewhat short of the target, was satisfactory in the context of weaker than expected world demand. A large part of export growth took place under bilateral payments arrangements, and some Directors encouraged the authorities to rely less on such arrangements and on special export assistance.

While welcoming underlying progress toward balance of payments adjustment, Directors emphasized that continued expansion of exports would be needed to ensure that the balance of payments and external debt positions remain manageable in the second half of the 1980s. While noting that India's export competitiveness had improved over the program period, several Directors drew attention to the importance of the role of exchange rate policy in ensuring the competitiveness of exports.

Some Directors noted with concern the slow pace of the use of commercial borrowing and encouraged the authorities to increase such borrowing in line with the levels envisaged in the extended arrangement. It was also noted that the level of new commitments of commercial loans is expected to rise substantially in 1982/83.

Overall, Directors commended the Indian authorities on the economic performance in 1982/83, despite shortfalls from program targets in some areas. For the future, they stressed the need for strong efforts in certain areas, especially in the budgets of the Central Government and the states, in the mobilization of savings, in the liberalization of imports, and in reducing the scope of internal controls in order to achieve the overall objectives of the adjustment program. All adjustment policies would be reviewed by the Board when it considers the 1983/84 program under the extended arrangement.

The Executive Board then took the following decisions:

Decision Concluding the 1983 Article XIV Consultation

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

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

Decision No. 7327-(83/32), adopted
February 18, 1983

Review of Extended Arrangement

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

Decision No. 7328-(83/32), adopted
February 18, 1983

2. BRAZIL - EXCHANGE SYSTEM

Mr. Kafka made the following statement:

> I would like to inform the Executive Board that, in view of the unsatisfactory development of world markets, and in order to accelerate the program for which we are asking Fund support and to make certain that it can be carried out as originally conceived, the Brazilian authorities have today devalued the cruzeiro by 23 per cent, which involves a 30 per cent increase in the dollar price of the cruzeiro. Everything else remains essentially unchanged, although some recalculations will have to be made, and the staff is working on them. I would like to stress that throughout the period prior to this decision the Managing Director was kept fully informed.

The Chairman remarked that he had been in close contact with the Brazilian authorities during the previous several days. The adjustment of the exchange rate did not alter the thrust of Brazil's program. 1/

The Executive Board took note of Mr. Kafka's statement.

APPROVED: July 22, 1983

JOSEPH W. LANG, JR.
Acting Secretary

1/ A description of the devaluation and an analysis of its impact on Brazil's program were circulated in EBS/83/33, Supplement 1 (2/24/83).