NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/108

10:00 a.m., July 22, 1983

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
	A. Le Lorier
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
	Jaafar A.
R. K. Joyce	
A. Kafka	
G. Laske	
G. Lovato	C. P. Caranicas
R. N. Malhotra	
Y. A. Nimatallah	
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	
F. Sangare	
	J. L. Feito
J. Tvedt	A. Lindø
	C. T. Taylor
	Wang E.

J. W. Lang, Jr., Acting Secretary
L. Collier, Assistant

Also Present

African Department: A. B. Diao, U. R. Gunjal. Asian Department: Tun Thin, Director; U. Baumgartner, D. Burton, S. M. Schadler, B. J. Smith, G. Szapary. Central Banking Department: D. R. Khatkhate. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; S. J. Anjaria, H. Hino. Fiscal Affairs Department: P. S. Heller. IMF Institute: R. Borkar, Participant. Legal Department: S. A. Silard. Treasurer's Department: A. G. Chandavarkar. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, J. R. N. Almeida, C. J. Batliwalla, S. El-Khouri, H.-S. Lee, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, H. Arias, M. Camara, T. A. Connors, M. K. Diallo, M. Eran, I. Fridriksson, N. U. Haque, M. Hull, A. Juusela, H. Kobayashi, P. Leeahtam, W. Moerke, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, E. Portas, T. Ramtoolah, J. Reddy, J. Schuijer, Shao Z., D. I. S. Shaw, Wang X.

1. INDIA - EXTENDED ARRANGEMENT - PROGRAM FOR 1983/84

The Executive Directors considered the staff paper on India's program for 1983/84 under its extended arrangement (EBS/83/130, 6/24/83; Sup. 1, 6/24/83; and Sup. 2, 7/20/83).

Mr. Malhotra made the following statement:

India entered into a three-year extended arrangement with the Fund in November 1981 in support of a medium-term program to promote balance of payments adjustment. The performance of the economy in the first year of the program (1981/82) was encouraging and was in close conformity with the program projections. In the second year (1982/83), however, progress was constrained by a widespread drought of severe intensity and the impact of international recession. Even so, with appropriate demand management and supply policies, progress toward adjustment was maintained. The 1982/83 program remained broadly on track, and all performance criteria were met.

The objective of the program in the third year is to overcome the setback experienced in 1982/83 and restore the momentum of development in line with the objectives of the original medium-term balance of payments adjustment program. Particular importance is attached to fostering economic growth through promotion of domestic savings and investment while maintaining price stability. Toward this end, further steps will be taken to strengthen the country's infrastructure and production base, encourage enterprise, and make further progress toward external adjustment. Overall financial policies will continue to be cautious.

Directors now have before them the results of the latest consultation under the extended arrangement, together with the letter of intent and the statement of specific policies for 1983/84 that are designed to carry forward the process of adjustment.

The program for 1982/83 was based on the assumption that the economy in that year would grow at a rate of 5 percent. This did not materialize, as the severe drought affected foodgrain production. However, the decline in production from 133 million tons in 1981/82 to 125 million tons in 1982/83 was substantially lower than that experienced in the drought year of 1979. The fact that damage to food production was effectively contained demonstrates the growing resilience of the agricultural sector, which has been achieved through increases in the area under irrigation and the spread of agricultural services and inputs. There was also a marked slowdown in industrial growth in 1982/83 on account of the interplay of complex factors, which included slackening of demand due to lower farm incomes, greater competition induced by the liberalized import policy, the impact of world recession on export industries, inventory drawdown of manufactured goods in response to tight credit conditions, and the prolonged textile strike. As a result, the growth of output did not exceed 2 percent. Gross domestic savings and capital formation as percentages of GDP showed marginal declines.

The decline in agricultural production would normally have resulted in strong inflationary pressures, but the authorities effectively held these in check by undertaking foodgrain procurement and distribution, by securing precautionary imports of foodgrains, and by ensuring adequate supplies of other essential consumer commodities such as sugar and edible oils. The restrained stance of monetary policy played an important role in dampening inflationary expectations. The rate of inflation in 1982/83, as measured by the wholesale price index, was 6.2 percent on a point-to-point basis and 2.5 percent on the basis of monthly averages. This was a dramatic improvement over the price developments in the previous drought year.

The growth-oriented adjustment strategy had laid special emphasis on improving the performance of the infrastructure, especially in the related sectors of power, coal, and railways. In 1981/82 and 1982/83 basic infrastructure services registered marked improvements. Production of coal rose substantially. The efficiency and performance of the railways improved. The availability of electrical power increased following the commissioning of new capacity and owing to a steady rise in the plant load factor. This was despite some decline in hydroelectric power generation on account of inadequate rainfall in the catchment areas of hydel reservoirs. Production in crude oil doubled in two years. There were also major gains in the production of fertilizer and cement.

The slowdown in GDP growth had an adverse impact on revenues, and additional expenditures had to be incurred in providing relief in areas hit by flood and drought. The Government adopted effective measures during the fiscal year to keep the budget on an even keel. The authorities undertook sizable additional revenue measures and, while seeking to protect the development component, exercised tighter control over expenditures of relatively lower priority. Pricing policies helped to improve the financial performance and profitability of the public sector and contributed to resource mobilization for the development plan. In the event, the budget performance was satisfactory. Net credit to the Government in 1982/83 was restricted to 3 percent of GDP as against the program ceiling of 3.3 percent of GDP.

Monetary policy in the first two years of the adjustment program has aimed at containing the growth of monetary aggregates within prudent limits with a view to reducing inflationary pressures. In 1982/83, narrow money grew by 14.6 percent and total liquidity by 15.8 percent. As the staff report points out, these growth rates were heavily influenced by the tight liquidity situation at the end of 1981/82. The average increase in money supply in 1982/83 of 11 percent reflects more accurately the cautious stance of monetary policy. Interest rates remained positive in real terms and helped the promotion of financial savings.

Although the balance of payments continued to remain under considerable pressure, the overall deficit in 1982/83 was SDR 1.3 billion, SDR 0.4 billion less than projected in the program for that year. The current account deficit, however, remained unchanged in relation to GDP at 2.1 percent. The deficit could have shown some improvement if the drought had not led to substantial foodgrain imports and if the growth in exports in the second half of 1982/83 had not been adversely affected by the poor world trading environment. To promote external adjustment, government policies have placed considerable emphasis on increasing productivity and efficiency in the economy through greater access to imports under a progressively liberal import policy. There has been a marked growth in the absorption of imports other than oil, fertilizer, cement, steel, and aluminum, whose domestic production has increased substantially in the past two years. Total commitments of official commercial loans rose from SDR 0.9 billion in 1981/82 to SDR 2.1 billion in 1982/83. Actual use of such loans in 1981/82 and 1982/83 has been higher than envisaged in the original program.

In summary, despite adverse developments, the 1982/83 program remained on track. Government policies succeeded in largely reducing inflation, improving public savings, and protecting planned investments, especially in areas crucial to growth and adjustment objectives. The economy remained firmly on the adjustment course. "The economy," in the words of the staff report, "is now poised for recovery."

Program for FY 1983/84

The third-year program continues and advances the main elements of the adjustment effort, which aims at achieving a further gradual improvement in the balance of payments through strengthening export performance and import substitution. The authorities recognize that to promote external adjustment, continued substantial investments in basic industry and infrastructure would be called for to avoid emergence of bottlenecks and constraints on growth and exports. The program continues the emphasis on policies for improving economic efficiency through greater flexibility in pricing and reduction in regulatory constraints. Access by industry, especially by export-oriented industries, to imported inputs, spares, capital equipment, and technology has been enhanced by the liberal import policy for 1983/84. The new policies that are being introduced and the strengthening of policies already in place are expected, given normal weather, to contribute to a further improvement in economic performance. Growth in real GDP is projected to reach 6-6.5 percent, with agricultural output rising by about 5 percent and manufacturing output increasing by 7 percent. Gross domestic savings are expected to rise from 22.6 percent of GDP in 1982/83 to 24.3 percent in 1983/84 with a corresponding increase in gross capital formation from 24.7 percent to 26.4 percent of GDP.

The program continues to place emphasis on higher domestic resource mobilization, especially in the public sector. Public savings, as a proportion of GDP, increased sharply from 3.7 percent in the preprogram year 1980/81 to 4.8 percent in 1982/83. For 1983/84, the ratio is planned to rise further to 5.4 percent, which is above the target of 5.2 percent in the original program. Additional resource mobilization effected in the central government budget for 1983/84 is estimated at Rs 12.3 billion, including Rs 4.4 billion to be generated through railway and postal tariffs. With this last tariff increase, the railways have carried out three major rate increases in less than two years. Despite the softening of international oil prices, an increase was effected in domestic petroleum prices in February 1983 that would yield Rs 8 billion in 1983/84, of which Rs 5.2 billion will accrue to the budget. In total, resource mobilization measures undertaken by the Central Government since November 1982 and including those contained in the 1983/84 budget are projected to yield Rs 24 billion in 1983/84, equivalent to 1.3 percent of GDP, a substantial effort. The states have also taken steps to mobilize additional resources. The share of state plans to be financed from state resources will increase from 58 percent in 1982/83 to 64 percent. Additional resource mobilization by the states and their enterprises is expected to be Rs 8.3 billion in 1983/84. The scheme introduced last year for regulating recourse of the States to credit from the Reserve Bank of India has been working well.

The additional resource mobilization efforts have enabled the Government to step up plan outlays by 21.5 percent in 1983/84. The bulk of the investment will be directed to expanding productive capacity in areas critical to external adjustment. Significant additional expenditures in 1983/84 are planned in such key sectors as oil, electric power, coal, and irrigation. A substantial provision has also been made for railways. Government would endeavor to make supplementary budget provision for the railways and some other sectors in the light of further budget developments.

The petroleum sector has, through rapid and sharp production increases, played a major role in the adjustment effort. As a result, reliance on imported oil is expected to drop significantly by the end of 1983/84. The emphasis on the petroleum sector required a major step-up in outlays far above the provisions made originally in the Five Year Plan. This has entailed some diversion of resources from other sectors and partly explains the less than planned capacity creation in electrical power generating capacity. Price policy regarding petroleum products is aimed at restrianing undue growth of domestic consumption and raising resources, primarily for developing the oil sector. Several increases in power tariffs and coal prices have contributed to improving the financial performance of enterprises responsible for these sectors.

As regards agriculture, policies in 1983/84 are designed to stimulate a strong recovery in agricultural production through supportive price policies and increased inputs. Accordingly, the procurement price for rice paddy has been raised by 8.2 percent, for coarse grains by 5.1 percent, for pulses ranging from 4.2 percent to 14 percent, and for oilseeds from 4.5 percent to 6.8 percent. As regards inputs, the main focus, as in the past, will be on increasing irrigated area. Following an increase of 2.4 million hectares in irrigated area in 1982/83, a further expansion of 2.5 million hectares is planned for 1983/84. A 12.5 percent increase in fertilizer consumption is planned. As explained in Supplement 2 of EBS/83/130, following a slowdown in fertilizer offtake and accumulation of stocks, my authorities were compelled to reduce fertilizer prices by 7.5 percent. Between February and June 1983, stocks of fertilizer rose from 1,640,000 tons to 2,008,000 tons. In this connection, fertilizer prices have increased by more than 60 percent in the past two years. Since then, despite substantial additions to irrigated area, the growth rate in fertilizer use has declined significantly. The authorities expect that this step will contribute to additional agricultural production.

As regards economic activity in the private sector, industrial policy has been designed to further encourage investment and productivity and to allow potential economies of scale to be exploited more fully. Government intends to continue and strengthen the access of domestic industry to foreign technology. The industrial investment climate has remained buoyant despite mild recessionary conditions last year. Resources raised in the capital market have grown from Rs 2.8 billion in 1980/81 to Rs 7.9 billion in 1982/83. The number of foreign technical collaboration agreements approved has risen from 389 in 1981 to 590 in 1982. Further steps have been taken to ease industrial regulations. For instance, some clearance procedures for large houses in respect of eight nationally important industries will not now be necessary. The investment limit below which an industrial license is not required has been substantially increased.

In formulating the monetary targets for the year, the Government has kept in mind the important objectives of maintaining price stability while providing adequate support for a recovery in growth. Broad money is expected to increase by 15 percent and narrow money by 12 percent. Both these aggregates are consistent with the expected real growth in output of 6-6.5 percent and an increase of 7 percent in the price level. In keeping with these broad monetary aggregates, total domestic credit expansion is to be limited to 17.8 percent. The Government remains alive to the danger of price pressures as a result of lagged effects of last year's drought and increase in administered prices. In line with this cautious approach, the Reserve Bank of India recently announced a two-stage increase in the cash/reserve ratio to improve its flexibility in policy options.

The program aims at a further improvement in the balance of payments in 1983/84 and beyond. The current account deficit in 1983/84 is projected at SDR 3.4 billion, SDR 0.4 billion less than that projected in May 1982. The estimated overall deficit of SDR 1.5 billion is marginally lower than that projected a year ago. Despite the difficult international situation and increasing protectionism, my authorities have again taken measures to effect further significant liberalization of the import policy in 1983/84. My authorities are firmly committed to achieving higher growth in exports. Policies are in place for encouraging exports and export-oriented industries. The competitiveness of Indian exports, which has increased in recent years, is being maintained. These policies will remain under review, but success here will depend greatly on the strength of world recovery and the openness of the international trading system.

During 1983/84, the Government intends to limit the official contracting and guaranteeing of nonconcessional loans to no more than SDR 1.5 billion. External borrowing by the private sector will continue to be permitted on the basis of the creditworthiness of the companies and the viability of their projects. The Government will continue to avoid substantial recourse to short-term borrowing. These prudent policies are intended to prevent an excessive debt servicing burden while tapping the Government's access to international capital markets.

To sum up, the policies implemented so far under the extended arrangement have brought about substantial underlying structural adjustment in the Indian economy. Despite the difficult external environment and the setback caused by last year's drought, the Indian authorities have acted with courage and determination in raising domestic resources for growth of the economy, controlling inflation, liberalizing imports, and evolving a policy framework conducive to external adjustment. I look forward to the continued support of the Board for the extended arrangement.

Mr. Nimatallah commented that India's performance under the extended arrangement had been largely satisfactory. Output growth had exceeded the target in 1981/82, but unfortunately had fallen considerably below the target in 1982/83 because of factors beyond the control of the authorities. Inflation had been contained below the target; the improvement in the balance of payments had been more rapid than expected; and all the performance criteria under the arrangement had been observed. He commended the authorities on those achievements. The program for 1983/84 was strong, and he supported it as it would reinforce the authorities' successful adjustment efforts.

The financial program for 1983/84 aimed at increases in narrow money and broad money of 12 percent and 15 percent, respectively, Mr. Nimatallah noted. Those rates were somewhat lower than those of the previous year, and were consistent with the economic growth and inflation targets of the program. Within the total programmed increase in credit, the commercial sector's share was the same as in the 1982/83 program--60 percent--which should be fully adequate to support the economy's recovery during the year. The financial program as outlined in Table 5 of the staff paper was appropriate, and he could support it.

On fiscal policy, Mr. Nimatallah continued, the authorities had taken a number of revenue-raising measures that were expected to strengthen the revenue performance in 1983/84. However, budget expenditures, including the supplementary expenditures, were expected to increase rapidly, due mainly to a sharp rise in current expenditures. As a result, the ratio of the central government budget deficit to GDP was expected to be slightly higher in 1983/84. Furthermore, the bank financing of the central government budget deficit and the combined deficit of the Central and State Governments as a ratio to GDP were also expected to increase somewhat in 1983/84.

According to the World Bank staff, the weakness of the state finances had led to a shortfall in investments in irrigation and electric power, Mr. Nimatallah said. Furthermore, the investment allocations for the coal and railway sectors in the 1983/84 budget appeared inadequate to meet minimum investment needs.

All those developments pointed to the need for strengthening further the finances of the public sector, Mr. Nimatallah commented. Action to restrain sharp increases in current expenditures by the Central Government and to improve the finances of the state public enterprises would contribute to overall financial stability, while enabling the authorities to achieve their goals under the public sector investment program.

In the external sector, the authorities were to be commended for maintaining the policy of import liberalization, Mr. Nimatallah remarked. That policy was very courageous when viewed against the difficult international environment in which it was being pursued. The authorities' pursuit of a flexible exchange rate policy was also laudable. However, the full benefits of such import and exchange rate policies could only be realized if there was a recovery in the world economy, and if India's access to foreign markets was not impeded by protectionist barriers.

Regarding purchases under the extended arrangement, Mr. Nimatallah concluded, the staff was proposing that the Fund financing for 1983/84 should be SDR 1.2 billion--compared with SDR 1.5 billion suggested earlier--because the balance of payments deficit was expected to be lower than envisaged. He accepted the staff proposal, assuming that it was agreeable to the Indian authorities and that the amount could be raised to SDR 1.5 billion if unforeseen balance of payments developments warranted it.

Mr. Sangare observed that the Indian authorities had implemented the second year of their adjustment program under unfavorable economic conditions, with real growth reduced to 2 percent in 1982/83, compared with the program target of 5 percent and actual growth in 1981/82 of 5.2 percent. That disturbing outturn mainly reflected large reductions in the growth of manufacturing output, as well as a decline in agricultural output resulting from drought conditions throughout the year.

Notwithstanding those unfavorable conditions, Mr. Sangare continued, the authorities had been able to implement their financial program successfully; all quantitative performance criteria set for the second year of the program had been met. With strong demand management policies in place, inflationary pressures had subsided: the GDP deflator had fallen to 3.5 percent in 1982/83 from 8.7 percent in 1981/82, and consumer prices had decelerated. Meanwhile, the central government budget deficit had been contained at 6.3 percent of GDP. Although that figure was higher than the target of 5.6 percent in the 1982/83 program, recourse to domestic bank borrowing to finance the budget deficit had been limited to the equivalent of only 2.4 percent of GDP, which was lower than the target set in the program and represented a further reduction from the level of 1981/82.

The external sector also showed further improvement in 1982/83, Mr. Sangare commented, with the overall deficit in the balance of payments narrowing from SDR 2.175 billion in 1981/82 to SDR 1.280 billion in 1982/83.

Prospects for 1983/84 were encouraging, Mr. Sangare remarked, as output growth was expected to rebound strongly, with the resumption of growth in agricultural production reflecting, in part, the return of good weather conditions. The manufacturing sector was also expected to show significant improvement, and should benefit from the recovery in agricultural incomes as well as from the less adverse external environment. In light of the favorable economic outturn forecast for 1983/84 and the continued implementation by the authorities of the sound policies outlined in the program, which he endorsed, he was confident that the financial targets would be achieved.

The Indian authorities had taken exemplary and courageous action in opening up their domestic market to imported manufactures at a time when it was felt that protectionism had intensified in many industrial countries, Mr. Sangare stated. They believed that exposing their domestic industries to foreign competition would encourage efficiency. However, the authorities had proceeded cautiously in order to safeguard the progress that had been achieved; aggressive foreign exporters could undermine fledgling Indian industries that might be facing new growth problems rather than outright inefficiency. He underscored the commendable efforts of the Indian authorities to liberalize imports and encouraged those industrial countries that were raising additional trade barriers to emulate the Indian example.

With regard to public sector investment, Mr. Sangare said that he was concerned about the lack of progress made in implementing the program, which was expected to fall short of the original target contained in the Sixth Plan. In particular, the shortfalls in anticipated outlays that had impeded progress in irrigation were worrisome if efforts to minimize vulnerability to adverse weather conditions and to achieve the desired growth in agriculture were to be successful. He was encouraged to note that additional capital expenditure was envisaged in the 1983/84 budget to accelerate implementation of projects in the priority sectors. He welcomed the current mid-term review of the Plan, and he encouraged the authorities to speed up completion of the exercise, which, when concluded, should provide information that would be helpful in making the necessary adjustments. In conclusion, he supported the proposed decision regarding the third year of the adjustment program.

Mr. Prowse stated that he supported the proposed decision. In 1982/83 the performance criteria had been met and the program had remained broadly on track, despite a severe drought and difficult export markets. The rate of growth of industrial investment was encouraging: resources had increased to Rs 7.9 billion compared with Rs 2.8 billion in 1980/81. As for 1983/84, there were several areas of concern, although he found the overall program appropriate. In particular, it was encouraging that a real growth objective of 6-6.5 percent for GDP could be set, and that there was continuing emphasis in the program on mobilizing domestic savings, from 22.6 percent of GDP in 1982/83 to 24.3 percent in 1983/84. He commended the focus on economic activity in the private sector and he hoped that the Plan would envisage increased access for foreign technology and associated foreign entrepreneurial capital.

One area of concern was budget savings in the Central Government, Mr. Prowse said. Savings remained below the 1981/82 level, reflecting a worrisome increase in the subsidy bill over the past two years. Another area of concern was the continuing weakness in state government finances, notably the state electric authorities' losses due to inadequate pricing policies. The adverse position of state government finances had led to too few resources being applied to irrigation and electric power. It was also evident that investment in the coal and railway sectors was insufficient to maintain services. The prospects for improving investment in those basic areas hinged on the adoption of more realistic pricing policies in the public sector.

With regard to the external sector, Mr. Prowse remarked that, while he commended the authorities for having taken import liberalization measures, more should be done. About four fifths of domestic industry continued to enjoy protection. Although the licensing system no longer appeared to be an effective constraint on imports falling within the less restrictive licensing categories, there continued to be restraint in more restrictive categories, which was a large part of the trade. Despite the liberalization that had taken place, and the world trade recession, the overall balance of payments position had improved. Commercial capital inflows had increased from SDR 0.9 billion in 1980/81 to SDR 2.1 billion in 1982/83, but the projected figure for 1983/84 was only SDR 1.7 billion. As his chair had suggested in the past, more use could be made of commercial capital markets by the Indian economy. The staff had noted that the authorities' borrowing program would facilitate an increase in disbursements following the extended arrangement. Although the debt service ratio was forecast to rise, it would remain modest. Because of the need for economic growth in the Indian economy, some increase in the commercial borrowing program warranted consideration.

The fundamental objective of the program was a strengthening of the balance of payments position over the medium term, Mr. Prowse said. Looking at the substantive policies that had been put in place, some criticism was justified in connection with investment, infrastructure and basic industry, government finance, and pricing. While a viable external position was being achieved, the underlying goals were not as close to being reached as hoped.

The present program had been the largest approved by the Fund, Mr. Prowse concluded, and it was interesting to record the fundamental objectives in terms of the Fund's concept of balance of payments need. The program had broken new ground, and he looked forward to further discussion.

Mr. Joyce commented that the program for India was an important one, not only because of its size, but also because of its nature and timing. It had been supported by all Directors, but perhaps with some hesitation and questions. If the program had failed or had fallen significantly short of expectations, it would have been a serious setback for India and for the Fund itself. The success of the program to date had not been unqualified: some objectives had not been met and some high hopes had not been fulfilled.

The overall deficit of the Government in 1982/83 had been higher than programmed and higher than the authorities had anticipated, Mr. Joyce noted. Although the trade balance had improved and the current account deficit was lower than forecast, it had been achieved through a large reduction in import expenditures, not all of which was attributable to lower oil prices, and therefore not likely to be sustainable in an upswing. Growth in the Indian economy in 1982/83 had been much lower than anticipated, partly due to severe droughts in tea farming areas and partly due to reduced world demand for India's manufactured products, to some extent because of the reduced competitiveness of domestic producers. Those developments in turn had had an adverse impact on public finances.

India had met all of the performance criteria under the program, Mr. Joyce recalled. More important, the authorities continued to maintain the broad thrust of the adjustment strategy, despite adverse developments. He congratulated the Indian authorities for their satisfactory progress to date. He welcomed the Central Government's firmness in the pursuit of demand management policies; its continued flexible approach to monetary and exchange rate policy; its adherence to monetary targets; and the measures taken, including increases in real interest rates, to stimulate private savings. Although levels of protection in India remained high and there had been some slippages within the past year, progress continued to be made in liberalizing trade restrictions. All those measures could not but help to strengthen competitive forces and improve the medium-term prospects for the Indian economy.

The program for the present year would continue to emphasize growth and savings in both the private and public sectors, Mr. Joyce noted. The basis of the 1983/84 program was a reasonably optimistic growth scenario for both agriculture and industry. If realized, it should result in further and more lasting improvement in the balance of payments and some amelioration in public finances, which in turn would permit sizable growth in public investments and relieve financing pressures in the private sector. The authorities had also indicated that they intended to make additional structural changes with respect to prices, subsidies, and trade restrictions.

While he supported the proposed program, Mr. Joyce said, there were still two areas of concern. First, with regard to pricing policy, although the authorities had made a number of price adjustments, particularly with respect to petroleum and railway freight, changes in coal prices were still being studied. Fertilizer prices had been appropriately cut to reduce inventories and to encourage consumption, but continued maintenance of producer prices at unrealistic levels would lead to even higher government subsidies in that sector. Electricity tariffs, which were determined by the states, were still too low in many jurisdictions and were contributing to budget deficits at the state level, which was one of the weak spots in the public sector.

Second, Mr. Joyce continued, with regard to investment, the staff report noted that progress had been made in expanding capacity in most key sectors; there was a large provision for additional public and private inventories in the coming years. Once again, the softness was at the state level, which was crucial given the states' responsibility in important areas. The World Bank had noted that in 1983/84 investment shortfalls were forecast to spread to other areas not directly affected by state resource restraints, and it had also called attention to weaknesses in the investment program in coal, irrigation, electric power, and railways. Those sectors were vital to the continued success of India's development program. He therefore welcomed the existing budget provisions for investment expenditures, the intervention of the authorities to provide additional assistance to the states, and their undertaking to make supplementary funds available for investment if budget developments permitted. Ultimately, however, the solution lay in achieving appropriate pricing policies, ensuring that more opportunities were provided to the private sector, and persuading the states to change their priorities and to strengthen their finances.

He welcomed the Indian authorities' view that they might not have to draw down the full amount of Fund resources originally envisaged for the coming year, Mr. Joyce remarked. That development would assist the Fund in meeting the needs of other members. It was also sensible, given India's ability to tap private markets and the relative charges it would incur with the Fund compared with what it would have to pay in those markets. He wondered whether the Indian authorities, having gone so far, might not be able to go a step further. If a country with a long-term arrangement with the Fund suddenly found itself with an appreciable improvement in its balance of payments and reserve position, over and above what was envisaged in the program, what was the position, from a legal point of view, with respect to its continued eligibility to draw under the program? Was that a matter of choice for the country concerned, or were there mandatory provisions? Specifically, how did the requirements of Article V, Section 3(b)(ii) of the Articles of Agreement apply in such a case? Those considerations were not necessarily germane to the Indian case, but what were the circumstances in which the so-called deferred amount of SDR 300 million might be added to the currently scheduled drawings?

Mr. Polak commented that he agreed with the staff appraisal. In the circumstances of a world recession and severe drought, India had achieved a positive rate of economic growth of 2 percent and had prevented adverse effects on its balance of payments in the face of inflationary pressures. India's capacity for intelligent demand management had always been high, through both budgetary and monetary measures. On the monetary side, however, he emphasized the dangers of further expansion. The past year's financial expansion, coupled with the relatively low rate of economic growth, had not yet fully expressed itself in prices.

He found the export projections optimistic, Mr. Polak commented; the world economy might be slow to respond to the recovery in the United States, and consequently India's exports might be relatively slow to react to the world recovery. Chart 5 of the staff paper indicated that actual and projected growth of world trade was well below that of India's exports; it was not clear why India's exports were expected to increase more rapidly than world trade.

Investment and import liberalization were two main areas of concern that deserved particular attention in the context of the extended arrangement, Mr. Polak stated. That arrangement was unusual in that it focused on efficiency and productivity rather than simply on the containment of demand. On the investment side, the limiting factor remained the provision of resources through state finances. The resulting inability to make the necessary investment expenditures with regard to electricity, irrigation, coal, and railroads had resulted in underfunding of the investment programs. The lack of central government financial resources could be attributed to a number of factors, including higher investment in other areas, such as oil, and the pricing policy. The Government was undertaking a study of the pricing policies with regard to coal, fertilizer, and railroad tariffs, and he urged the authorities to reach satisfactory conclusions without undue delay.

The Indian authorities had been consistent and determined in pursuing an import liberalization course, Mr. Polak observed; they had resisted demands for continued or new protection and had achieved a net increase in liberalization. However, it was difficult to appraise the amount of liberalization from the staff's description of the impenetrable web of restrictions. From one viewpoint, there were many reductions in the severity of restrictions for enterprises that met some arbitrary administrative criterion. The most favored exporters received general open license access for imports of secondhand machinery, returning travelers were allowed to bring in some consumption goods, and so on. The licensing system no longer appeared to be an effective constraint on imports falling within the least restrictive licensing category. But he wondered whether India would be able to approach an open trading environment through the process it was following at present. He was not urging India to adopt a nineteenth century free-trading regime, but it was true that the enhancement of efficiency through effective import liberalization was a crucial element in the program between the Fund and India. Was that aim in the process of being achieved?

As a specific alternative remedy, Mr. Polak continued, he suggested that the Indian authorities should consider a decisive step to shift their reliance on restrictions to tariffs. There were obvious fiscal benefits, but more importantly a tariff system had a quantitative measure. Such a system could be reduced in a quantitative program, or renounced, so that domestic producers could be aware of changes in competitive conditions. A drastic step such as the one he had suggested, rather than small steps easing restrictions, could bring about true import liberalization.

He strongly endorsed the proposal whereby, barring unforeseen balance of payments developments, India's drawing would be SDR 1.2 billion rather than SDR 1.5 billion, Mr. Polak commented. Given the improved situation in the Indian balance of payments, it seemed only appropriate that other needy members of the Fund should share in the Fund's resources made available by the reduction of the amount of purchase. It was a welcome development that the Indian program, in spite of difficulties, had been successful enough to make the reduction possible.

Mr. Schneider expressed his support for the 1983/84 program proposed by India under its extended arrangement, as well as the proposed decision. He was pleased to note that in spite of the unfavorable world economic environment and a severe drought in 1982/83, the Indian authorities had made satisfactory progress in the implementation of the program. The authorities had aimed at the medium-term objectives of restraining inflation to acceptable levels and substantially improving the balance of payments situation through the restoration of economic activity, in order to provide a basis for the pursuit of longer-term targets. He noted the efficient implementation of demand policies and the adequate increase in supplies of essential commodities, which had contributed to the reduction of the inflation rate to 6.5 percent and the shrinking of the current account deficit to 2.1 percent of GDP.

The most critical element in obtaining a good overall performance under the program was the public finances, Mr. Schneider commented. An unfortunate shortfall in tax reserves, mainly due to the sluggishness of economic activity and unplanned increases in budget expenditures, had caused the budget deficit to increase from 5.8 per cent of GDP in 1981/82 to 6.3 percent, missing the target. At the same time, public and gross domestic savings had fallen short of the target. It was evident that an improvement in the public sector and a high rate of growth in both public and private savings were needed to generate the domestic savings required to offset foreign borrowing and contribute to the financing requirements of India's sizable investment projects. The authorities needed to pay special attention to increasing the contribution of state public enterprises to investment resources. He therefore welcomed the intention of the authorities to increase capacity utilization and to strengthen the management and enhance the efficiency of the public enterprises.

With regard to structural policies, Mr. Schneider continued, he welcomed the results of the positive real interest rate policies; the efforts to strengthen the capital market, especially the introduction of a secondary market for nonconvertible debentures; and the revision of the credit authorization scheme.

In the area of pricing policy, there seemed to be a divergence of views between the Fund and World Bank staff, Mr. Schneider noted, especially with respect to the fertilizer pricing policy. For example, in the section on World Bank staff views related to the program, he had not found a comment on the adequacy of the pricing policy for fertilizers; the only reference was an expression of concern by the Bank regarding the rising fertilizer subsidy. The fertilizer pricing policy had been formulated in the program in terms of four aims: first, to avoid undue fiscal burdens; second, to broadly reflect fertilizer's economic cost; third, to encourage the wider use of fertilizer; and fourth, to carefully time the price adjustment necessary to those ends. The achievement of those aims in the short term seemed to be a very difficult task for the authorities and he would appreciate further comment by the staff, especially in view of the recent announcement by the Indian authorities of a reduction in fertilizer prices of 7.5 percent and its meaning in terms of the fertilizer subsidy.

Balance of payments projections for 1985/86, which were generally more favorable than those for earlier periods, anticipated that the current account deficit would remain at about SDR 3.3 billion, Mr. Schneider remarked. Apart from the question of financing the structural deficit, it was clear that greater emphasis must be given to increasing export earnings through a more flexible exchange rate policy and careful monitoring of the trend of public finances.

He was in agreement with the broad thrust of the program, Mr. Schneider concluded, and hoped that the Indian authorities would achieve the goals they had set within its framework.

Mr. Taylor welcomed the opportunity to review progress under the major Fund arrangement with India at its midway stage. He was pleased to note that all the performance criteria had been observed, and that most of the variables regarded as objectives of the program were moving in the right direction, if not always at the desired pace.

Regarding domestic financial policies, Mr. Taylor remarked that monetary policy had been well managed on the whole and that the authorities' monetary stance was realistic at present. However, it was important for them to remain aware of the possibility of inflationary pressure building up as a result of the lagged effect of the fall in agricultural output the previous year. Like other speakers, his main worry about the economy at present continued to be the fiscal position of the Central Government and more especially of the states. It was crucial to maintain the pace of releasing scarce resources tied up in public expenditures to provide investment in the priority capital projects, especially those in the transport, power, and irrigation sectors. A reduction in subsidies over the medium term could make a vital contribution. Although prices of fertilizer in India were among the highest in Southeast Asia and the authorities wished to promote high yields in part through its greater use, it was worth bearing in mind that even a small unit of subsidy could quickly threaten to absorb substantial public expenditure resources if associated with a large increase in fertilizer use. The best way to achieve greater agricultural output and fertilizer use was to ensure that producer prices were fully remunerative. He welcomed the Government's detailed study of all aspects of fertilizer pricing, and he hoped that the authorities would promptly implement the findings that arose from it.

More generally, Mr. Taylor continued, he could endorse the view that the budget position would need careful monitoring if the ceiling on net credit to the Government was not to be breached.

The balance of payments position was quite encouraging, which was the result of a degree of liberalization, import substitution, and structural adjustment, Mr. Taylor remarked. But no relaxation in the authorities' efforts to achieve external viability could be afforded, especially under an extended arrangement where the objective was to carry forward a comprehensive effort to strengthen the balance of payments into the medium term. Naturally, it would be important to keep external debt at prudent levels and to maintain a flexible exchange rate policy. If for some reason the expected pickup in exports was delayed, he hoped that the authorities would take appropriate adjustment measures promptly.

Given the present climate of world capital markets and the projected increase in India's debt service through most of the 1980s, the best strategy was to pursue a prudent containment of the current account deficit during the early part of the 1980s in case events led to an unexpected turn for the worse.

In February, several Executive Directors had noted the comment made by the staff that the basic framework of import restrictions remained largely intact, Mr. Taylor recalled. He acknowledged the difficulties of liberalizing the import regime in the current international climate, but it was disappointing that the staff still had to say that there remained more to be done to develop a truly open trading environment at the present stage of the extended arrangement. He agreed with Mr. Polak that a radical shift to a tariff-based system--rather than the "impenetrable web of restrictions"-- would be worth considering.

On the other hand, Mr. Taylor went on, export promotion policy seemed to be achieving a degree of success, and he welcomed the measures taken to liberalize the import system. The measures were significant and he believed they would benefit consumers and producers alike in the medium term. It was also reassuring to learn that the impact of selective measures taken to increase import restrictions was small. It was difficult to appraise such measures and he could agree with Mr. Polak that a more transparent system of containing imports would yield a clear indication of the thrust of protection and its likely movement in future.

He joined other speakers in welcoming the authorities' proposal to limit their purchase to SDR 1.2 billion rather than the SDR 1.5 billion originally agreed, Mr. Taylor remarked. The decision was reasonable in view of the improved external position and India's immediate balance of payments prospects. It would be sensible, however, to maintain a degree of flexibility and to return to the question if necessary, in light of the external situation, at the time of the mid-term review. The staff and the authorities had assessed the economy's needs well and had devised an effective program for the third year of the arrangement. He supported the proposed decision.

Mr. Laske welcomed India's further progress in its adjustment under the extended arrangement. The major aim of the three-year program was the mobilization of more savings from both the private and the public sectors for the financing of the substantial investment program upon which the authorities had embarked. To date that objective had been achieved to a satisfactory degree, although as a percentage of GDP the previous year's savings had lagged behind the program's target. The strong mobilization efforts in the public budgets and the provision of adequate incentives to private savers were instrumental in that achievement. The containment of inflation was commendable, especially in the consumer area. But in contrast, wholesale prices had risen considerably more in 1982/83 than in the previous year. Footnotes to the data in the staff report explained that differing measurements had been applied for consumer and for wholesale prices, and he asked the staff to comment on the increases in consumer and wholesale prices when determined on the same statistical basis.

Progress in certain areas of the adjustment process had been less than hoped for, Mr. Laske commented. Those slippages were partially due to unfavorable exogenous conditions to which the Indian economy had been exposed the previous year, but to some extent, they also had to be ascribed to policy shortcomings. However, he welcomed the favorable development in the balance of payments; in the past program year a smaller overall deficit had been recorded than originally expected, although the SDR 1 billion improvement was primarily due to movements in the capital account. About half of the improvement stemmed from the sizable reduction in the negative errors and omissions item, and another 40 percent of the improvement was due to a bridging loan that would have to be repaid later in 1983. Those factors should be kept in mind when the balance of payments improvement was evaluated.

Developments in the current account had been on track when measured in percentages of GDP, Mr. Laske remarked. The weakened performance of exports, however, had to some extent been rightly ascribed to the effects of the recession in the industrial countries. Some major markets in the developing world had also shown signs of weakness. That experience seemed to indicate structural shortcomings in the export area. The staff report had indicated that India's export experience was similar to that of other developing economies. Nevertheless, he wished to draw attention to Turkey's export performance, which showed volume increases and market gains under equally difficult circumstances. Particular efforts should be made in the area of marketing in order to enlarge India's market shares.

The deficit of the Central Government in 1982/83 was larger than envisaged, both under the budget and under the program, even when the expenditure-cutting measures adopted the previous year were taken into account, Mr. Laske remarked. The less favorable outcome indicated the need for additional measures to secure the achievement of the outcome projected for the third-year program. In that context, he wondered whether the ceilings for net credit to the Government should not have been set somewhat lower in order to emphasize the necessity of continued fiscal restraint.

As in previous reviews of the arrangement for India, Mr. Laske continued, fiscal performance of the states and their nonfinancial enterprises continued to be a source of concern. It was disconcerting that up-to-date information on the state budgets was not available at the time of the staff's discussion with the authorities, and he wondered whether more adequate information had been obtained since that time. The state enterprises' continued experience of losses was worrisome. The Central Government should attempt to impress more vigorously on the states' administrations the urgency of progress in that area.

Improved performance in coal production, electricity generation, and irrigation was vital for the success of the adjustment in the real economy, Mr. Laske stated. He agreed with Mr. Joyce that the authorities' efforts in those areas should be intensified as results had fallen short of the objectives for the previous year. Although production results might have been adequate for current demand, bottlenecks could emerge when the economy returned to a more vigorous growth path, as was envisaged for the following program year.

Import liberalization had obviously played a useful role in enlarging the supply of resources to the Indian economy, Mr. Laske noted. The previous year, the authorities had proceeded further with the relaxation of import restrictions. Although the steps taken and those envisaged for the next program year reduced the protection of Indian industry from foreign competition, the overall level of protection was still very high. Four fifths of Indian imports continued to be under some form of effective restriction. He strongly urged the Indian authorities to be bolder in dismantling the restrictive system, primarily in the interest of an efficient resource allocation in their own economy. He could associate himself with Mr. Polak's proposal for a basic reorientation of the foreign trade system through a move away from restrictions and toward a more market-oriented method of tariffs. Furthermore, the restrictions on foreign direct investment could also be relaxed further to give India the benefit of foreign business and technological expertise as well as providing autonomous capital inflows for the financing of the balance of payments.

He was pleased that the improved balance of payments outlook had allowed India to scale down drawings for the third year from original projections, Mr. Laske concluded. However, the expected overall deficit would be financed to a large extent with Fund resources. In previous discussions he had put forward the view that India might well be in a position to make more intensive use of private borrowing possibilities. The country's standing in the credit markets was good, enabling India to make more use of those sources, and he strongly endorsed the views that had been put forward by Mr. Prowse, Mr. Joyce, and Mr. Polak in that regard. Finally, he supported the proposed draft decision.

Mr. Hirao stated that he also was in broad agreement with the staff appraisal and could support the proposed decision. In 1982/83, despite the difficult circumstances that they had faced, the Indian authorities had been able to avoid major adverse affects on prices and external balances. To date, all performance criteria had been observed. The aim of the program for 1983/84 was to consolidate the progress on the inflation front and in the balance of payments position, while supporting the transition to economic recovery.

It was important that demand management policies remained cautious in order to contain lagged inflationary pressures resulting from the previous year's supply shortfall, Mr. Hirao remarked. In that sense, the proposed stance of monetary and financial policies seemed to be in the right direction. The projected increases of money and credit for 1983/84, which were somewhat less than those in the past year's program, would contribute to containing inflation. The ceiling on net credit absorbed by budget financing would allow increased credit to the commercial sector.

In the area of public finance, Mr. Hirao noted that a major element of the program was to strengthen India's medium-term external position through public investment in areas essential for balance of payments adjustment. To provide resources for those investments and to contribute to adjustment, domestic savings, especially public savings, would need to be substantially increased. He welcomed the large increase in the surpluses of central public enterprises, which reflected the strength of the Government's resource mobilization effort. On the other hand, further progress could be made in increasing central government budget savings and state savings. As to central government budget savings, the authorities should curb the increase in current expenditures, in particular the subsidy bills. State finances were another problem area; further efforts should be made by the states to reduce widespread losses of some state public enterprises and to mobilize resources for investment.

Regarding the investment program, Mr. Hirao continued, substantial progress had been made in expanding capacity in most key sectors of the economy in 1982/83. However, there were sectors, such as irrigation and electric power, where investment funding had fallen short of the original program, mainly owing to state resource constraints. It was hoped that additional resources, to be made available through domestic mobilization efforts, would be allocated to those sectors.

On the external front, there had been marked progress in replacing imports by increased domestic production, Mr. Hirao remarked. The oil import bill had fallen sharply in 1982/83, and imports of other bulk items, including fertilizer, iron, and steel, had also declined. As a result, the overall balance of payments position had improved in 1982/83, despite the shortfall in export growth caused by the drought and reduced world demand. Export performance was expected to improve gradually in response to the recovery of world demand. The authorities would need to monitor exchange rate policy closely in order to avoid possible adverse shifts in the competitive position of Indian exports. He noted that the stabilization of the external position and a persistent strengthening of the balance of payments over the medium term were projected.

Regarding external borrowing, it was appropriate that the Government maintained a prudent stance to prevent an extensive debt servicing burden, while utilizing more fully its access to international capital markets, Mr. Hirao commented. The debt servicing burden would remain manageable, although it was projected to rise.

He welcomed the new import liberalization measures for 1983/84, Mr. Hirao stated, which would increase access to previously restricted items and thus contribute to competitiveness of domestic industry; nevertheless, he believed that more could be done. In conclusion, he commended the proposed change in the phasing of purchases in 1982/83 under the extended arrangement.

Mr. Salehkhou said that the performance of the Indian economy during the second year of the adjustment program had remained, with minor variations, on track. Except for the effects of a severe drought and of the world recession, which had affected India's export markets, the economic performance had been outstanding.

In monetary policy, the overall stance had remained cautious, Mr. Salehkhou commented. The ceilings on total domestic credit and on net credit to the Government had been observed, commercial credit growth had been closely controlled, and the increase in broad money had been in line with the program targets.

With regard to public finances, expenditure outlays had surpassed earlier estimates, mainly because of flood relief and drought measures, Mr. Salehkhou remarked. Budget revenues, however, had risen faster than programmed estimates, and the total budget deficit for 1982/83 would be only slightly higher than estimated earlier. Bank financing would be lower, thus averting undue pressure on financial resources and eventually on prices. Within the budget framework, public and private savings rose strongly compared with the previous year, underscoring the strong resource mobilization efforts and concerted central government and state enterprise measures aimed at cost efficiency.

Exports had increased slightly, Mr. Salehkhou continued, despite the adverse external environment marked by continued recession in India's export markets and weakness of commodity prices. The overall balance of payments deficit had fallen sharply as a result of a lower import bill and higher net nonmonetary capital inflows, together with aid and commercial loan disbursements.

Slightly changed positions had been recorded in the agricultural sector and in some areas of industry, Mr. Salehkhou observed. The drought had affected the autumn food harvest in a large part of the country. The slowdown in the industrial sector had been due to external causes. Nevertheless, the authorities had taken appropriate measures to isolate such developments and to prevent any upward pressures on prices; as a result, inflation had been successfully contained.

He was pleased that the program for 1983/84 had the twin objectives of continuing the medium-term strategy of stabilization and growth while confronting the delayed effects of the adverse external developments of 1982/83, Mr. Salehkhou commented. Within that framework, monetary and fiscal programs were designed to strengthen the basic aims of continued investment, structural reforms, and a consolidation of growth-promoting industries. At the same time, the program underlined the crucial role that savings would play in the overall development strategy. It was also noteworthy that the World Bank concurred with the thrust of the authorities' industrial and investment programs.

While he had no difficulty with the main performance criteria for the third year of the program, Mr. Salehkhou said, the credit and financial provisions might be overly restrictive to support the economy's recovery. The projected money and credit increases in 1983/84 were less than those allowed for in the program the previous year, while real GDP was expected to grow threefold. In view of India's success in containing inflation, some slight easing of the credit targets might strengthen the recovery drive. In addition, despite wide-ranging success and improvements, especially with regard to expenditure controls, the overall budget deficit forecast for 1983/84 was higher than the previous year. The authorities were, however, conscious of the need to monitor the overall budget structure, especially the supplementary expenditures and other contingencies. In conclusion, he supported the decision and commended the authorities for their admirable efforts.

Mr. Kafka observed that future economists would conclude that India was one of the best examples of the favorable results achieved by an early approach to the Fund's arrangements. Investment growth had been significant, financed by increased domestic savings despite the setback caused by the severe drought. It was noteworthy that most of the increase in savings had been in the public sector despite interest rate liberalization as recommended several times by the Executive Board.

At the Executive Board meetings on February 18, 1983 (EBM/83/31 and EBM/83/32) several Directors had urged India to expand its commercial borrowing without departing from its cautious and prudent policies, Mr. Kafka recalled. It was difficult to define a prudent policy, but he noted that commercial loans as a share of total debt would increase from 8.5 percent in 1981 to almost 14 percent in 1985. He wondered whether further growth at a similar rate should be pursued. The current levels seemed comfortable, and he agreed with India's authorities that an exaggerated dependence on commercial markets might eventually produce debt service problems.

The staff seemed justifiably pleased with India's performance, Mr. Kafka commented, but he detected some World Bank staff worries, particularly with regard to industrial policies for railways, power, and irrigation. The shortfall in savings by the state governments could adversely affect investment efforts in irrigation, which should be avoided.

The report by the staff lacked an analysis of bilateral payments arrangements and there was no detailed information about commercial borrowing and administered prices, particularly petroleum prices, Mr. Kafka stated. In passing, he noted that he could go along with the new temporary fertilizer subsidy.

The authorities had been able to keep the program on track, despite the difficulties noted, although some corrections, particularly in the investment structure, might be necessary, Mr. Kafka concluded. External factors and poor weather had lowered the past year's output growth, but he was confident that current development efforts would be rewarded by a rising standard of living in the years ahead. It was noteworthy that India had been able to propose a rescheduling of drawings, and he agreed to the proposed decision.

Mr. Lovato said that he also endorsed the proposed decision concerning the 1983/84 program submitted by India under its extended arrangement. Macroeconomic outcomes had been mixed in the past year: output growth had fallen considerably short of program targets but the inflation and external balance records were good. The process of domestic resource mobilization, which would continue to be the backbone of the present program, seemed to be making headway. Gross domestic savings had suffered a slight setback in 1982/83 but were presumed to attain the original programmed target in the current year. Similarly, gross capital formation as a ratio to GDP was forecast to reach its program target. On that front, public savings intended for development plan financing had performed well and should rise further to 5.4 percent of GDP, as envisaged in the program. Public enterprises, in particular, seemed to be on a sounder footing at present. He noted the beneficial effects of the increase in domestic petroleum prices described on page 18 of the staff report, and he would appreciate further comments on the pricing policy that the authorities intended to pursue in that area. Had the staff detected some impact of higher oil prices on energy consumption?

With regard to the power-generating sector, Mr. Lovato noted that capacity had been significantly expanded and that it might be less of a constraint to the growth potential of other industries than had been thought some time previously. On the other hand, average tariffs remained well below costs and he would appreciate further elaboration by the staff on that issue.

Private savings had also responded well to the policies adopted under the program, Mr. Lovato commented. The increase in deposit rates, the tax incentive schemes, and the wider menu of financial instruments available to domestic savings should have helped to promote a higher propensity to save. Yet, he missed precise figures on the matter in the present report. Private savings had marginally decreased in 1981/82, the first year of the program, and had possibly remained unchanged in the following year due to the depressing impact of lower than expected income growth and other factors. He asked the staff for clarification of the issue, and to also shed some light on how savings were broken down between financial and physical assets.

Better export performance and import substitution were essential medium-term ingredients of the extended arrangement, which aimed at securing a sustained balance of payments position, Mr. Lovato remarked. Some setbacks had been suffered by the Indian economy in 1982/83, and the program framed for the current third year of the arrangement was designed to overcome the lagged effects of such adverse outcomes. A particularly disturbing factor was the export shortfall. When the Executive Board had held its latest review of the extended arrangement in February 1983, he had expressed serious doubts regarding the export growth target for 1982/83 of 7 percent in volume terms. Indian exports had expanded by that amount in the preceding year and were unlikely to grow at the same pace in a shrinking world market. Actual growth had been almost nil. During the current year, the slow recovery in world trade under way should give some stimulus to Indian export sales, yet the forecasts for volume growth had appropriately been revised downward from 8 percent to 5 percent. He agreed with the authorities' view that the uncertain world trade outlook and the growing instances of protectionism might seriously undercut Indian export potentials. He was pleased to note that supply constraints in tradable-goods industries were less a cause for concern than previously. The staff had offered some arguments with regard to agriculture and textiles, but he wondered what the supply situation was for other manufactured exports.

Export growth in future years was essential for the improvement of the external payments position, Mr. Lovato remarked, as underscored in Table 11 of the staff report. Exports were expected to grow by 5 percent during the current year, and 8 percent and 9 percent in the two following years. Domestic policies would have to be in place that would assure the attainment of such high growth rates, given the favorable world trade scenario. He noted that India had implemented appropriate measures in several areas: the exchange rate was carefully managed and competitiveness was maintained; export incentives were being improved; greater efficiency in the production of exportables was being sought. He encouraged the authorities to continue to take suitable actions along those lines.

Miss Le Lorier stated that the program before the Board deserved strong support. The results achieved over the first two years of the arrangement fully demonstrated that Fund conditionality need not be costly in terms of economic growth; on the contrary, it had enhanced the potential for growth despite an adverse international environment. The successful containment of inflationary pressures, notwithstanding a widespread drought, had been crucial in that respect. As a measure of their success, the authorities expected to limit their drawings on the Fund to SDR 1.2 billion; they should be warmly commended for achieving that result. For its part, the Fund must stand ready to increase the amount to SDR 1.5 billion if unforeseen adverse balance of payments developments were to occur that could not be checked by additional corrective measures.

In the fiscal area, Miss Le Lorier noted, provisions had been made in the federal budget for contingencies. That seemed to be a traditional procedure in India, but it might be helpful for Directors to be given some idea of their relative share in total expenditures. She wondered whether it might not be more appropriate to monitor fiscal developments excluding the provision for contingencies. Perhaps the staff might attempt to provide such a presentation for the next mid-term review. On another point, she would be interested in having some estimate of the tax expenditures that had been actively used to promote savings and investments. She shared the recommendations made by the staff to at least contain the subsidy bill and to enforce greater discipline in state finances. In the program year, however, equal importance should be devoted in the public sector to structural aspects and, more particularly, to the early completion of the mid-term review of the Sixth Plan in order to minimize the impact of shortfalls in key sectors. She welcomed the allowance made in the program for additional funds for investment in irrigation, power, and railways. As a corollary, the mobilization of additional resources through flexible pricing policies should be actively pursued.

In the monetary area, she had no difficulty with the ceilings proposed by the staff, Miss Le Lorier remarked. The Reserve Bank had shown its determination to pursue a cautious stance, which seemed necessary and appropriate because monetary growth might well be significantly higher than during the past year, although end-year ceilings were consistent with previous increases.

On the external side, Miss Le Lorier continued, substantial efforts had been made to further liberalize imports. However, she agreed with other Directors on the need to resist imposing restrictions on specific products and to continue to pursue actively the opening up of the economy.

India's program was a convincing example of the mutual reinforcement brought about by an appropriate mix of demand management and supply policies, Miss Le Lorier remarked. Demand management was a necessary condition for successful adjustment, but it was not sufficient. The results achieved by India should dispel any doubt about the merits of the extended Fund facility. In conclusion, given the cautious demand policy implemented by the Indian authorities, it was tempting to place more emphasis at present on structural measures, which did not imply the pursuit of expansionary fiscal policies. She fully supported the recommendations made jointly by the World Bank and the Fund.

Mr. Feito stated his broad agreement with the staff appraisal and his strong support for the proposed decision. After an extremely good economic performance in 1981/82, a more difficult external and domestic environment during the second year of the extended arrangement had caused some deviations from the projected path of the economy. A severe drought had had a negative impact on agricultural output, while weak external demand had affected the growth of industrial production. Thus, real GDP was estimated to have grown by 3 percentage points short of target. Notwithstanding those unfavorable developments, it was encouraging to note that the Indian economy had continued to adapt well to the less favorable economic environment; both the rate of inflation and the overall balance of payments deficit were considerably below the figures originally projected in the program. The authorities should be commended for the prompt and successful implementation of economic policies in the face of more difficult than expected economic circumstances.

The program for 1983/84 correctly aimed at supporting recovery in real economic growth and containing inflationary pressures within the framework of the medium-term balance of payments goals, Mr. Feito said. The projected growth rate for real GDP, although higher than initially projected, seemed feasible given the policies to be implemented to encourage the growth of industrial production and the recovery of the agricultural sector. The aim of expanding the area under irrigation and the recently introduced supply-oriented measures to foster cultivation and productivity in the agricultural sector were particularly important. Cautious monetary and credit policies were needed to attain the program objectives. The projected growth of money and credit would make room for the expected economic recovery without unduly fueling nominal demand and inflationary pressures. That relatively prudent stance of monetary policy would be accompanied by structural measures to enhance the efficiency of the financial system, thereby encouraging private savings. The flexible interest rate policy combined with measures to diversify and increase the attractiveness of financial assets were especially welcome and would contribute to increasing the already high ratio of private to total domestic savings and further reducing the need for foreign savings.

In the area of public finance, Mr. Feito continued, substantial progress had been made toward achieving financially sound budgets, particularly by raising public savings. The program for 1983/84 contemplated significant expenditure and revenue measures to continue that progress. However, the growing share of subsidies in the budget had to be curtailed.

With regard to public investment, the authorities should be commended for the significant progress already achieved in key sectors of the economy, such as petroleum, electric power, coal, fertilizers, and steel, Mr. Feito commented. Further progress in those sectors was contemplated in the investment program for the period ahead. In order to take advantage of the increased growth potential brought about by those investments, the rigidities arising from some categories of subsidies and public pricing policies should be gradually eliminated. The 17 percent increase in the price of domestic oil was an important step; however, further adjustments were needed in the prices of coal and fertilizer. The authorities were fully aware of the importance of those pricing policies on resource allocations and domestic absorption, and it was encouraging that they were reviewing current practice in those two areas.

He commended the Indian authorities for the courageous steps taken to liberalize imports in the face of adverse international and domestic circumstances, Mr. Feito remarked. The continuation of import liberalization in 1983/84 through the adoption of far-reaching measures would further enhance overall access to imports, thereby improving economic efficiency.

In sum, Mr. Feito concluded, the program for the third year of the extended arrangement correctly combined adjustment with growth. It included an appropriate mix of prudent demand policies and more fundamental supply-oriented measures consistent with the objectives, and thus deserved full support.

Mr. Wang noted that the Indian economy had made encouraging progress during the first two years of its three-year adjustment program. Despite the impact of international recession and a severe setback caused by a drought in 1982/83, performance criteria set for the first two years had been observed. The economy remained firmly on an adjustment course, and the progress so far achieved had provided a solid basis for the successful implementation of the third-year program. He supported the proposed decision, but he believed that Fund financing for the third year under the extended arrangement should be increased to SDR 1.5 billion, as envisaged, if warranted by unforeseen balance of payments developments.

Mr. Tshishimbi commented that in the face of mounting financial imbalances, India had decided to request an extended arrangement early with the view of spreading out the adjustment effort over the medium term. The staff appraisal's optimistic tone affirmed the perception that the economy remained firmly on the adjustment path agreed two years previously. The performance during the first two years of the extended arrangement had been uneven. The first year, success had been remarkable, with all major targets attained and often exceeded. The second year, the economy had faced difficult circumstances: a severe drought had affected agricultural output and incomes, while a combination of the protracted world recession, restrictive credit policy, and labor unrest had cut industrial growth. Despite those developments, the authorities had contained slippages and kept the program on track, so that all performance criteria to date had been observed. Those developments had however had an adverse impact on the fiscal sector: tax revenue had fallen short of the program target, although overall budget revenue, excluding grants, was estimated to exceed the target. As expenditure had also exceeded the target, the overall budget deficit was estimated to have increased by about 0.5 percentage point.

He commended the authorities for the efforts to mobilize domestic resources, Mr. Tshishimbi said. Central public savings had increased from 2.8 percent of GDP in 1981/82 to 3.2 percent of GDP in 1982/83. The external accounts had improved, the current account deficit had stabilized at the level of the program's target, and the overall deficit had been reduced to SDR 1.3 billion, lower than the program target.

The measures envisaged by the authorities for 1983/84 should consolidate the gains achieved during the first two years of the extended arrangement, Mr. Tshishimbi remarked. Those measures were designed to counteract the effects of the adverse developments in 1982/83 and to keep the overall program on track for a successful medium-term adjustment. In the agricultural sector, production would recover, on the assumption that better weather would prevail. The effort to promote modern methods in agriculture and to exploit the full potential of that sector was welcomed. With the recovery taking place in the international economy, the industrial sector should also resume growth.

He welcomed the cautious fiscal and monetary policies, Mr. Tshishimbi commented. The projected increases in money and credit would be adequate to accommodate industrial recovery in 1983/84 and would not aggravate inflationary pressures, and resource mobilization efforts would be strengthened. The 1983/84 budget contained a number of tax incentives designed to promote private savings, including tax deductions for savings through life insurance contributions and improvements in tax arrangements for nonresident Indians investing in India. At the state government level, where public savings reported in the past had not been as substantial as at the central level, it was encouraging that some of the states had taken specific measures to mobilize savings. He shared the staff's view that the subsidy bill, which had been a drag on budgetary savings in the past, should be contained.

In the external sector, Mr. Tshishimbi continued, he commended the authorities for introducing new import liberalization measures as an important part of the 1983/84 program. Although the authorities should take more significant measures to expose industries to wider external competition, the difficulty of that step under present circumstances should be recognized. The cautious approach that the authorities had adopted seemed appropriate. They should carry out a flexible exchange rate policy that would enable the Indian economy to derive the potential benefit from a resumption in growth in world trade and its trade with developing countries, particularly on the African continent, where India had recently increased its presence. In conclusion, he hoped that the Indian authorities would continue their adjustment effort toward a sustainable balance of payments position in the medium term.

Mr. Jaafar said that he warmly supported the proposed decision on the 1983/84 program under the extended arrangement for India. He welcomed the intention of the Indian authorities to continue the adjustment program with the objectives of strengthening and consolidating the achievements of the past two years. He endorsed the staff appraisal; nevertheless, he was concerned by India's overriding dependence for economic development on the weather. Drought during the past year had significantly affected the economic performance in 1982/83. Performance in the coming year would also be constrained by the weather. Reports of lower investment in irrigation and other infrastructure were therefore worrisome. Improvement in the performance in that key sector was essential to achieve the aim of the program: a sustainable balance of payments position over the medium term. He hoped that with the present mix of policies and other measures taken by the authorities to contain inflation and promote adjustment, particularly the substantial liberalization of imports the past year, that objective could be achieved.

The balance of payments position illustrated in Table 10 was sustainable, Mr. Jaafar stated. The major factor was world economic recovery, as well as the elimination of protectionist tendencies in world trade. To a large extent, India's performance would also depend on agricultural exports, which were extremely dependent on the weather. The substantial progress in import liberalization was welcome and in the medium term could encourage the efficiency and competitiveness of the manufacturing sector, thereby promoting export growth of manufacturing output. He urged the authorities to emphasize the judicious application of trade liberalization policies. In conclusion, he commended the Indian authorities for their resolve and determination to continue adjustment efforts.

Mr. Erb commented that there were many positive features of India's policies during the past two years; in particular, he commended the Indian authorities on their continued prudent financial management during 1982/83, an appropriate response to adverse weather conditions and weak external demand. Financial policies should remain restrained in 1983/84, as recovery took hold, in order to contain pressures on domestic price levels. However, as noted by other Directors, there had been disappointments in several areas, particularly investment, mainly due to weakness in the state finances. World Bank expertise and views on macroeconomic issues presented in the report were useful.

If the desired level of investment in irrigation, railroads, and power generation were to be achieved, Mr. Erb continued, further efforts would have to be made to increase savings. Appropriate pricing of public sector goods would greatly assist in the effort to mobilize resources. He noted that domestic petroleum prices had been raised, but that fertilizer prices had been lowered. Although the staff report mentioned other increases in administered prices--for example, coal and electricity--many prices still appeared to be too low. Given the original objectives of the program in the pricing area, he was disappointed that more progress had not been made in instituting flexible pricing procedures that would ensure that goods were priced to reflect costs, including a rate of return on capital reflecting the opportunity cost of that capital.

The staff assessment of import policy for 1983/84 was complicated owing to the difficulty of the topic, but was helpful and interesting, Mr. Erb commented. The authorities had made progress in import liberalization, but clearly much remained to be done in the coming year. The authorities should keep in mind that the economy would be protected in an economically efficient manner by a simultaneous reduction in trade restrictions and an adjustment in the exchange rate.

The balance of payments position was stronger than projected, Mr. Erb remarked. Under the circumstances, it would be appropriate for the authorities and the Fund to scale down the level of Fund resources in the planned financing of the balance of payments deficit. As suggested by other Directors, it would be appropriate for the authorities to make an additional effort to obtain medium-term financing from other sources and thus preserve their potential use of Fund resources. In that way, they would be treated as stand-by resources, which could be used if unexpected developments led to a deterioration in India's current account or capital account in the near future.

Table 10 of the staff report indicated that the overall balance of payments was projected to remain in deficit in 1984/85 and 1985/86 by significant amounts, Mr. Erb said. He wondered how the deficit would be financed. Would India's balance of payments position be in a sustainable position by the end of the program without a further deterioration in its reserves? Would additional current account adjustments be necessary, or would India take a more aggressive approach to foreign borrowing? Would it open its economy to greater foreign direct investment, as suggested by other Directors? He believed that India was passing up growth opportunities by not permitting greater direct investment. Although that was India's decision, the economic implication of the choice was the need either to make additional cuts in the current account deficit or to engage in additional official borrowing. Given India's future debt servicing requirements, he did not encourage greater overall levels of foreign borrowing.

In sum, although he could support the third-year program, he continued to have the major reservations that he had mentioned in his initial statement, Mr. Erb said. He questioned the application of enlarged access and whether Fund resources as opposed to other financial resources were appropriate to finance some of the objectives pursued under the program. Where objectives deserved a commitment of Fund resources--for example, India's desire to significantly reduce import restrictions and export subsidies--he questioned whether the steps taken had matched the original objective. He looked forward to reviews of the issue during the coming year.

Mr. Tvedt said that it was satisfying to note once again the success of the policies carried out by the Indian authorities in the past two years. Despite some adversities, stemming mainly from the world recession and other circumstances beyond the control of the authorities, the program had remained largely on track, and many of its major objectives had been realized. He welcomed in particular the enhanced public sector savings and the improvement of the balance of payments. Furthermore, the trade liberalization and interest rate policies would continue to improve the efficiency of the economy and would increase domestic financial savings.

Nevertheless, Mr. Tvedt continued, there was room for significant improvement in some areas, such as the finances of the states. He welcomed the involvement of the World Bank in rationalizing the operations of the state electricity boards. Although India's economic situation had greatly improved, the importance of following careful and pragmatic policies in the future must be emphasized. External indebtedness and the debt service burden were relatively low, but debt service was forecast to rise in the next few years. The authorities should be careful in their borrowing policies and ensure the most profitable use of borrowed funds.

Export policies appeared to be appropriate, Mr. Tvedt commented, and should contribute strongly to the attainment and maintenance of a viable balance of payments situation. An appropriate exchange rate was the cornerstone of a realistic pricing policy, and the record firmly indicated the authorities' commitment to maintaining adequate competitiveness. In conclusion, he stated that the Indian program demonstrated the advantages of tackling emerging economic problems at an early stage and the success that appropriate and decisive policies could bring; he therefore warmly supported the proposed decision.

Mr. Abiad said that he agreed with the staff's analysis and assessment of the performance of the Indian economy in 1982/83 and the program for the third year of the extended arrangement; he fully supported the proposed decision. During the second year of the extended arrangement, the performance of the economy had been marked by the adverse impact of exogenous factors on real economic growth and public finances and was less favorable than in the first year. The authorities had reacted to the past year's developments by adopting measures aimed at containing the fiscal slippage, caused partly by the drought, and stepping up resource mobilization efforts while attempting to maintain the outlays on productive investments envisaged in the Sixth Plan. Reflecting that flexible and commendable response, combined with a cautious monetary policy and the implementation of structural supply-oriented policies, inflation had slowed down considerably, and pressures on external accounts had eased.

During the past two years, Mr. Abiad recalled, the authorities had broadly implemented the corrective measures envisaged under the arrangement, although some of those measures had involved generally sensitive areas. On the supply side, a number of cost-price distortions had been considerably reduced through the pursuit of more realistic pricing policies. Other measures introduced had aimed at rationalizing development expenditures, improving the performance of public sector enterprises, promoting external competitiveness, and increasing import liberalization. On the demand side, policy actions had been broadly consistent with the fiscal objectives of the programs under the arrangement. The departure of the overall budget deficit from the program target in 1982/83, partly reflecting the impact of the drought, was about equal to the overperformance in the previous year. The ceilings on total domestic credit had been observed.

With regard to the program targets, Mr. Abiad continued, it was remarkable that, except for output growth, changes in the GDP deflator and wholesale prices were well below the targets for each of the two years of the program. The current account deficit had also remained very close to the program targets despite the delayed impact of the world trade recession on export earnings and greater import liberalization. The implementation of the yearly programs under the arrangement had so far been generally successful, judging from the observance of the performance criteria.

The task facing the authorities in the third year of the arrangement seemed tougher than in the previous two years, Mr. Abiad commented. The authorities were fully aware of the need for continued adjustment efforts in several areas, particularly in conjunction with budget performance, public sector savings, and certain parts of the industrial sector, especially in the states. In addition, they also had to overcome the difficulties that had emerged in 1982/83 if further economic progress in strengthening the balance of payments position over the medium term was to be achieved. The policies outlined in the program for the third year of the arrangement seemed appropriate and consistent with the extended arrangement's fundamental objective.

With regard to the 1983/84 program, Mr. Abiad noted that a major target was the achievement of a real economic growth rate of 6-6.5 percent.

That expectation was based, inter alia, on the interdependent assumptions of a rapid increase in India's export volume growth and a substantial acceleration of world trade volume growth. While economic recovery had been under way for a number of months, mainly in certain industrial countries, it was still unclear whether its scope and strength would be sufficient to pull up other countries. On the other hand, the World Bank staff had highlighted the difficulties associated with the resource constraint on the funding of development projects in the states and investments in other critical sectors that could have an important bearing on external adjustment. The question therefore arose whether the target of a 6-6.5 percent real growth rate might not prove to be somewhat on the high side.

An important element of the third-year program was the introduction of new import liberalization measures, which followed those already adopted in the past two years, Mr. Abiad remarked. In that regard, it was encouraging to note the staff's more realistic view that "the significance of the measures is enhanced when viewed against the difficult international and domestic circumstances in which they have been taken." Indeed, in spite of the various constraints facing the country, including the current account position and the uncertainty surrounding export demand and the persistence of protectionist pressures in several large trading partners, the authorities had clearly signaled their intention to ensure continuity of their liberalization efforts. The pace at which such efforts were being carried out should be considered in the light not only of the possible counterproductive repercussions of too rapid an import liberalization but also of reciprocity on the part of India's trading partners.

Mr. Delgadillo stated that the proposed program for India merited the continued support of the Fund. To date, all performance criteria had been met, reflecting the appropriateness of policy measures already implemented in the various areas of the economy. As a consequence, there had been progress toward the achievement of the medium-term goals of the adjustment program. The policy program for 1983/84 contained further measures to pursue the medium-term objectives as well as to overcome the possible delayed effects that could emerge from the adverse developments observed in 1982/83, particularly in agricultural and industrial production.

On the fiscal side, Mr. Delgadillo observed that the overall deficit of the Central Government in the agreed program would rise by almost Rs 10 billion over the 1982/83 budget, accounting for 6.5 percent of GDP, a figure higher than in the previous year. The widening in the overall deficit, despite the projected increase of more than 14 percent on the revenue side, had to be viewed with caution, particularly since it would represent an increase in bank financing of the Government when compared with the previous period.

With regard to public sector pricing policies, Mr. Delgadillo continued, the intention of the authorities was to increase flexibility to allow prices to better reflect opportunity costs. Through a flexible pricing policy, it would be more feasible to mobilize resources for investment, to contain subsidies, and to promote an efficient allocation of resources. He commended the authorities for the pricing measures already adopted, but further adjustment should be implemented, particularly in the coal and fertilizer industries.

On the external front, the recent major liberalization of imports was welcome, Mr. Delgadillo remarked. While there remained more to be done to develop an open trade environment, the determination of the authorities provided an important signal of continuity in those efforts. In conclusion, the main objective pursued under the program supported by the extended arrangement could be achieved if the Indian authorities continued to implement the needed structural adjustments, and he commended the progress already made by the authorities.

The Director of the Asian Department, taking up some of the questions asked by Directors, commented on the Indian authorities' decision to reduce fertilizer prices. Those prices were high in India in relation both to those in other countries in Asia and to those in international markets. In addition, prices in international markets had fallen considerably during the past 18 months, and the authorities believed that farmers should receive some of the benefit of that reduction. There was also considerable evidence in India that pointed to the immediate responsiveness of farmers to fertilizer price changes. The staff had mentioned on page 12 of the staff report that fertilizer consumption had been projected by the Indian authorities to increase by up to 12 percent in 1983/84. However, the staff had been informed that the actual increase in fertilizer sales in the first four months of 1983/84 remained unchanged from the 6 percent growth in 1982/83. The authorities believed that to achieve the growth of fertilizer consumption planned, a decrease in price would be necessary.

There was another factor to which the staff attached considerable importance, the Director continued; the amount of fertilizer subsidy had risen from Rs 3.9 billion in 1981/82 to about Rs 6.5 billion in 1982/83, and with the new price reduction it would be about Rs 9.5 billion in 1983/84. The staff believed that action to contain subsidies was needed, but the issues surrounding the fertilizer subsidy were numerous and complex. For example, much of the recent increase in the fertilizer subsidy reflected the success of the investment program, undertaken with World Bank support, in bringing on stream new fertilizer factories. As a result, the average cost of production allowed to producers and charged against the subsidy had risen, because costs included a 12 percent return on investment, which was high for the new plants. The Fund and Bank staff had endorsed the authorities' efforts to undertake a detailed plant-by-plant study, referred to in paragraph 12 of the Statement of Policies, to unravel those issues. The authorities had confirmed that the study was proceeding, but that results were not yet available. The staff continued to believe that the study should be completed quickly and, in particluar, be followed by an appropriate policy response.

The monetary projections in the financial program had been based on a projected inflation rate of 7 percent and a strong recovery in the real growth rate to 6-6.5 percent, the Director said. A lower inflation rate could be achieved at the cost of a considerable loss in output. The monetary projections--particularly those for narrow money--implied an increase in velocity, which might appear at first sight to suggest that the financial program was too tight. But the projected increase in velocity in 1983/84 had to be considered in conjunction with the decline of velocity in 1982/83, when severe drought had reduced the growth in real GDP well below the rate on which the program was based. The shift in velocity between the two years was largely accounted for by the lagged effect of the decline in agricultural production on the demand for money. That effect was the result of the lag with which changes in agricultural production affected marketed output in India. Taking the two years together, velocity would remain about the same, which did not suggest that the program was too tight.

With regard to the many comments on import liberalization, the Director of the Asian Department concluded, the staff was in full agreement that the basic structure of import restrictions remained unchanged and that it was highly desirable and important to effect fundamental changes in the import system. The authorities had taken the gradual approach, and although a lot needed to be done, significant progress had been made.

The staff representative from the Asian Department, replying to other questions raised by Executive Directors, explained that the momentum of commercial borrowing described in the borrowing program was borne out by facts. The figures referred to in the staff report--SDR 900 million in 1982/83, SDR 2.1 billion in 1982/83, and SDR 1.7 billion in 1983/84--related to commitments of commercial loans. In particular, the bulge that had occurred in 1982/83 had included some SDR 600 million for a single thermal power plant. Excluding that bulky item, there was a strong upward trend in commercial borrowing. However, the staff had in mind especially the momentum gained on the disbursements side. As shown in the balance of payments, it was clear that disbursements were running at a somewhat faster pace than originally foreseen by the staff. The original program had projected that disbursements of commercial borrowings during the four financial years during which the program fell would total SDR 1.8 billion; current estimates indicated that commercial loans over those four years would total about SDR 2.5 billion. It was noteworthy that there had been a consistent and strong upward movement in disbursements from year to year.

The debt service ratio had risen further and faster than originally projected, the staff representative noted, and the staff currently projected that the debt service ratio would reach a peak of some 22 percent in the late 1980s before receding. While that level was not alarming by current international standards, it caused the Indian authorities to take a cautious approach, especially because the outlook was somewhat more difficult than envisaged when the program had been initiated. The difficulty was not due to a departure from the commercial borrowing program, but arose from two other factors: first, the terms of Indian borrowing had become harder than expected, principally because India's access to funds from IDA had been sharply cut; second, the growth in exports in nominal terms had been less than originally projected because of greater success both in India and abroad in controlling inflation.

With regard to balance of payments deficits beyond the program period, the staff representative said that the forecast amounts were small, especially relative to the size of the flows on both sides of the balance of payments. There was considerable uncertainty at present, and projections had been made cautiously in order not to overstate the extent to which adjustment was taking place. Nevertheless, the existence of projected deficits for 1985/86 suggested that further borrowing might be necessary beyond that provided for in the program. Of course, India's reserves would also be available to meet some of that gap because it was small. The existence of the gap did, however, emphasize the importance of policies to correct the balance of payments and to prepare for the rise in debt servicing that would occur in the second part of the 1980s. In that respect, export policies were of critical importance.

In 1982/83, the wholesale price index had risen 2.5 percent on an annual average basis, the staff representative said. But because of the pattern of price changes, the year-on-year change was 6.5 percent; the comparable figures for the consumer price index were 7.8 percent and 10 percent. In both cases, the end-year point-to-point increases were larger than the average for the year; the consumer price index, because of its different coverage, showed a more rapid increase than wholesale prices.

With regard to pricing policy, in particular oil pricing, the staff representative explained that before the increases introduced recently by the authorities, prices, on average, for oil products in India had been at par with world import prices. However, the weakness in world prices and the increase introduced by the authorities had had the effect of raising domestic petroleum prices in India above world prices on average. For social reasons there were some elements of cross-subsidization in India: some prices were well above international levels, while others were subsidized. Beyond its role in resource mobilization, pricing policy for oil products in India had had a second objective, that of reducing dependence on imported energy. The original program projections had envisaged considerable savings because of a reduction in oil consumption stemming from higher prices introduced at the beginning of the program period. At the time, that had seemed a bold objective because the elasticity of energy consumption in India was high, about 1.8 per cent, reflecting the underdeveloped nature of the economy, the low levels of commercial energy use, and the progressive shift from traditional forms of energy to commercial forms.

In fact, the staff representative continued, the original estimates had proved to be conservative. The savings in energy consumption--in particular, the responsiveness of oil consumption to price increases--had been much larger than expected, and consumption was currently growing substantially more slowly than envisaged. That had proved the important contribution of oil pricing policy and was one of the factors that had given the authorities courage to take the recent measures. The staff believed that oil pricing policies had been exemplary and hoped that the success in that area would be carried over into other areas where there was still a need for pricing adjustments. In the important area of coal, the authorities were completing a study that was a precursor to further action. Although progress was continuing, much more needed to be done on electricity pricing. There were also other areas, such as fertilizer and aluminum, where more action was called for.

Private savings had dipped rather sharply in 1982/83, the staff representative from the Asian Department said. As a percentage of GDP, they had fallen from 18.9 percent in 1981/82 to 17.8 percent in 1982/83. The rebound to 18.9 percent forecast for 1983/84 could be attributed to a reversal of the setback in the previous year. With a resumption of strong growth following the recovery from the drought, the share of savings would be expected to increase as consumption was related to a more stable level of income. Savings had taken the brunt of the shortfall in incomes in 1982/83, especially in rural areas. The shifts that had taken place in private savings had fallen particularly on savings in physical assets; financial savings had in fact shown much more stability. The shortfalls in agricultural incomes had reduced savings by farmers who were the principal savers in the form of physical assets. Evidence of the stability of financial savings was shown by the continued strong increase recorded in 1982/83 for time deposits, which were the principal avenue for financial savings. Other facilities for financial savings included capital markets, where activity had risen sharply in the past year.

The Associate Director of the Exchange and Trade Relations Department, replying to questions about the amount and phasing of the drawing, said that the approach in India was similar to that in any other multiyear arrangement. The original extended arrangement, which was still in force, established a maximum amount that would potentially be available to India. On the occasion of the first Executive Board meeting to discuss the arrangement, the Directors had taken a decision that established the schedule of purchases for what was than a truncated period of about six months, established the performance criteria, and so forth. In July 1982, the program for 1982/83 had been proposed. The performance criteria had been established and the balance of payments need assessed by the staff; the Board had concurred with the staff's assessment and had taken a decision regarding the scheduling of purchases of SDR 1.8 billion over a 12-month period. Following that decision, the Indian authorities had had the assurance that, provided performance criteria were met, they would be able to draw on schedule.

At present, a proposal was being made to the Executive Board for 1983/84, the Associate Director continued. The same process had been followed as for the program for 1982/83: performance criteria had been established and the balance of payments need had been assessed by the staff. The paper had mentioned on page 8 that at the time of presentation of the program for 1982/83, the staff had tentatively estimated that purchases against the 1983/84 program could be as much as SDR 1.5 billion. The recent staff mission had made a fresh balance of payments assessment, and therefore the actual proposal, which was before the Board for consideration, was for a somewhat lower amount.

A related question, the Associate Director continued, was under what circumstances would the staff come back to the Board to propose an increase above SDR 1.2 billion for the current year. It was not a question of returning to the Board if basic economic policies were to deteriorate and thereby weaken the balance of payments. Obviously, the circumstances would be those in which clearly unexpected developments beyond the control of the authorities had arisen. Bad weather or a sudden deterioration in the terms of trade would present a new situation to be looked at from the standpoint of balance of payments need.

Mr. Malhotra thanked his colleagues for their warm support for the proposed decision and for their interest in the Indian program. Their comments were constructive and would be helpful to his authorities. He noted that there was broad agreement that the framework of policies being pursued by India was appropriate; that exchange rate, interest rate, and fiscal policies were being implemented consistently over time; and that the program was broadly on track.

The major areas of concern mentioned by Executive Directors were the investment program and the shortfalls in some sectors, Mr. Malhotra recalled. Referring to Table 8 of the staff report, he pointed out that in the energy sector as a whole, plan outlays in real terms in the four years 1980/81-1983/84 would be 81 percent of the plan target, indicating that in the five-year plan period, outlays on the energy sector would exceed the target. Outlays in the final year of the Plan tended to be larger than the average of the first four years because expenditures built up as the works progressed from year to year. Within the energy sector, plan outlays on the petroleum sector were 139 percent of planned outlays. That sector was likely to contribute significantly to adjustment, because the major strain on the balance of payments had originated in the petroleum sector. Outlays on coal in the first four years were about 91 percent of the plan target, again implying that the plan target would be exceeded. He believed that progress in those sectors was very satisfactory.

Similarly, plan expenditure on the railways, in real terms, would be 86 percent of the target in the first four years of the Plan, Mr. Malhotra continued. Another important investment area was fertilizer, where, although outlays appeared to be inadequate, his authorities had indicated that the physical target was likely to be achieved. Production in 1983/84 was expected to be 5.3 metric tons, whereas the 1984/85 target was 5.9 metric tons. With regard to steel, taking into account the overall shortage of resources and slackness of demand, the authorities concentrated more on higher production from existing plant capacity than on meeting the full financing of new capacities.

The power program showed a considerable shortfall, Mr. Malhotra remarked. He recalled that Mr. Laske had in the past commented that the Indian Plan was too ambitious and did not leave much of a cushion. While it might not be true of the Plan as a whole, the power sector had the most ambitious program as capacity had been planned to increase from 33,000 megawatts to about 51,000 megawatts, more than a 50 percent increase in five years. That ambitious target was not likely to be reached; however, capacity creation over the five years would be substantial, to about 47,000 megawatts. Shortage of power was an important constraint, and the authorities had involved foreign financing to overcome the likely shortfall in the plan target. State finances had not measured up to ideal levels, although a large effort had been made by the states to mobilize additional resources. In that connection, the Central Government had also taken steps to build power capacity in the central sector. Apart from shortage of finance, some power plants had encountered technical difficulties and could not start commercial production, which could create an exaggerated impression of shortfalls in addition to capacity as such plants could be commissioned with a few months' time lag. Financial constraints affecting the power sector were partly explained by the much larger outlays from the petroleum sector than originally planned, because of the importance of the latter sector to external adjustment. In particular, for the offshore areas, outlays had increased greatly following the realization that the Bombay high oil fields and some of the gas fields in that area had greater potential than previously estimated.

The revised target for coal production in 1983/84 was 142 million tons, Mr. Malhotra observed. Production in 1982/83 had totaled about 131 million tons, 2 million tons lower than the target. More coal could have been produced from the large capacity that had been built up. However, because of lags in commissioning, some power projects--power plants and railways were the major users of coal--the expected demand for coal had not fully materialized. Further, because of the industrial slack, demand for coal from the railways was also not as large as previously expected. The shortfall in coal production in 1982/83 reflected those factors and might have helped keep pithead stocks under control. However, physical progress in capacity expansion and in increasing mechanization in the coal sector was satisfactory.

With regard to views of the World Bank staff that budgetary provisions for coal, railways, and irrigation did not show sufficient increases over revised estimates for the previous year, he wished to reiterate that, overall, expenditure for those sectors during the first four years of the Plan appeared to be slightly above the planned levels, Mr. Malhotra noted. His authorities hoped to provide additional resources for some of those sectors but it should be recognized that they had to balance investments and expenditures so that the price environment remained stable. It would be possible to increase outlays if recourse to bank financing were increased, but that was not the course that his authorities wished to take.

Progress in the power sector had not been entirely satisfactory, and there had been some shortfalls in the irrigation sector, Mr. Malhotra continued. However, his authorities believed that overall progress in achieving underlying adjustment in the real sector was of a high order.

With regard to the budget, Mr. Malhotra said that overall public savings were forecast to increase to 5.4 percent of GDP, 0.2 percent higher than envisaged in the original arrangement with the Fund. His authorities firmly believed that the forecast would be realized despite the projected increase in fertilizer subsidy. He thought that the level of subsidy should not be viewed in isolation. The important thing was the achievement of the public savings rate. As to fertilizer subsidies, he pointed out that prices of fertilizer had been increased by more than 60 percent in 1980 and 1981. It was also worth noting that large capital-intensive fertilizer capacity was coming on stream, based on gas from offshore oil and gas fields.

The Executive Directors agreed to resume 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/83/107 (7/20/83) and EBM/83/108 (7/22/83).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/28 through 83/31 are approved. (EBD/83/189, 7/15/83)

Adopted July 21, 1983

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/191 (7/19/83) is approved.

4. STAFF TRAVEL

Travel by the Managing Director and Deputy Managing Director as set forth in EBAP/83/192 (7/20/83) is approved.

APPROVED: January 26, 1984

LEO VAN HOUTVEN
Secretary