FOR AGENDA

SM/01/156

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May 30, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **India—Staff Report for the 2001 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2001 Article IV consultation with India, which is tentatively scheduled for discussion on Wednesday, June 20, 2001. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of India indicating that they do not consent to the Fund's publication of this paper.

Questions may be referred to Mr. Towe (ext. 38489) and Ms. Reynolds (ext. 38795).

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Thursday, June 7, 2001; and to the Asian Development Bank, following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

INDIA

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the 2001 Consultation with India

Approved by Anoop Singh and Mark Allen

May 29, 2001

Executive Summary

- **Article IV consultation discussions were held during March 14–27, 2001, following the release of the 2001/02 budget**. The staff team consisted of M. Blejer (Head), C. Towe, T. Baig (EP), P. Reynolds, and R. Salgado (all APD); and D. He (MAE). Mr. Gordon, the Fund's Senior Resident Representative in Delhi, assisted the mission. Mr. Kelkar, the Executive Director for India, and his Advisor, Mr. Jadhav, also participated.

- **The macroeconomic environment has weakened since the last consultation**. While the effect of high world oil prices on inflation and the balance of payments has been relatively modest, higher energy prices and poor monsoons caused real GDP growth to ease to just under 6 percent in 2000/01, the third successive year that growth has slowed. The more difficult external situation could prevent growth from recovering in the coming year.

- **The fiscal situation remains a concern**. Although the public sector deficit fell to an estimated 10½ percent of GDP in 2000/01, the overall fiscal situation could worsen in the coming year, especially given the recent growth slowdown and continued fiscal strains at the state level.

- **However, progress has been made in implementing structural measures, and the authorities have put forward a long-awaited agenda for "second-generation reform."** The measures envisaged—many of which were endorsed in the 2001/02 budget—would help address the significant structural problems facing the economy. However, implementation remains a critical challenge, including in the reform and deregulation of the power sector, industrial and labor markets, and the agricultural sector, as well as continued trade liberalization.

- **With the slowdown in activity and the easing of downward pressures on the exchange rate, the Reserve Bank of India cut official interest rates in early 2001**. This move appears to have been broadly appropriate, and while there may be further room for ease, it will be important to maintain the credibility of the RBI's commitment to price stability, especially in view of the large fiscal deficit.

- **The mission also reviewed progress in the area of financial sector reform, guided by the recent FSSA report**. Key issues include the need for progress in the areas of bank privatization, NPLs and asset recovery, weak banks, and prompt corrective action.

- **India subscribes to the SDDS**, but is still working to address outstanding observance issues, and macroeconomic data suffer from significant shortcomings. The authorities have not agreed to publish the staff report.

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I. Introduction

1. **Following a balance of payments crisis in 1991, India's macroeconomic performance was favorable.** With the introduction of structural reforms and other policy adjustments, the economy recovered strongly and growth reached an average of nearly 6½ percent during the second half of the 1990s—despite the Asia crisis, international sanctions that followed the testing of nuclear devices in 1998, various natural disasters, and an oil shock. Moreover, while India is estimated to be home to roughly one third of the world's poor, recent data have shown a substantial improvement in many social indicators, providing encouraging evidence of the beneficial effects of growth and reform during the 1990s (Table 1 and Chart 1).

2. **Nonetheless, by the end of the decade, the widening fiscal deficit and a large unfinished structural policy agenda raised questions about the economy's ability to sustain high growth and poverty reduction.** At the conclusion of the 2000 Article IV consultation, Directors called for a well-defined timetable for medium-term deficit reduction. They supported the authorities' goal of balancing the revenue deficits of the state and central governments backed by fiscal responsibility legislation, tax and expenditure reforms, and increased fiscal discipline at the state level. Directors also stressed the importance of reforms to facilitate economic restructuring and employment generation, including measures to improve the legal framework for debt recovery, reduce preferences for small-scale industry, increase labor market flexibility, and liberalize the external trade and agricultural sectors.

3. **Progress has been made toward addressing these policy issues during the past year, but significant challenges remain.** Encouragingly, a comprehensive framework for structural reform and fiscal responsibility legislation has been proposed, and a number of bold policy initiatives were announced in the 2001/02 budget. However, the fiscal situation remains serious and the macroeconomic environment has grown more difficult—growth has decelerated in recent years and net external demand may wane in the face of the global slowdown. Against this background, the key to improving India's longer-term growth prospects and for sustaining employment and income gains for the poorest segment of the population will be the determined implementation of the government's reform agenda (Box 1).

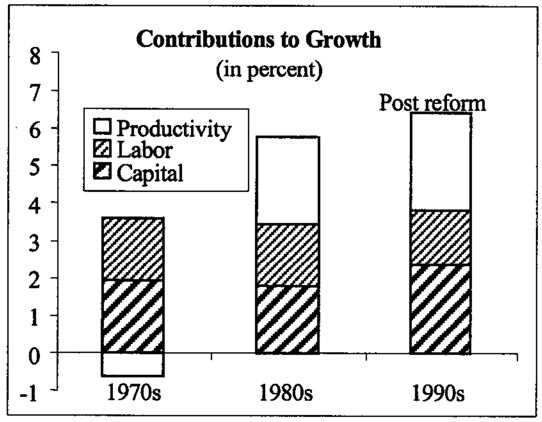
II. Recent Developments

4. **The economy has exhibited a decelerating trend in recent years.** Overall GDP growth (at factor cost) had reached just over 6½ percent in 1998/99 (the fiscal year begins April 1), with a rebound in agricultural production and substantial fiscal stimulus. However, growth slowed to under 6½ percent in 1999/00 and eased further to 5¾ percent (four-quarter basis) in the third quarter of 2000/01 (Table 2 and Chart 2). Supply factors include ongoing drought conditions in some states, higher energy prices, and infrastructure constraints, including with regard to power and transportation. On the demand side, the waning effects of large civil service salary hikes in previous years and weaknesses in agricultural incomes have adversely affected consumer demand. Business investment and confidence also have been

Box 1. India: Growth, Structural Reform, and Fiscal Consolidation

The Indian authorities have set an ambitious growth target for the medium term, with various official statements proposing that India's GDP growth rate should be raised to 8 percent or more.

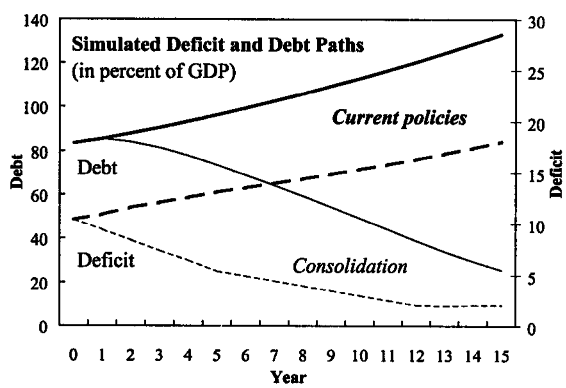
Achieving this objective would involve a significant increase in the economy's trend rate of growth, in turn requiring either higher investment or faster productivity growth. GDP growth has accelerated in the latter half of the 1990s, following the balance of payments crisis in the early part of the decade and the adoption of structural reforms. Average growth since 1992/93 has been around 6½ percent, nearly 1 percentage point faster than in the 1980s, reflecting both more rapid productivity growth and a higher investment rate. Given the relatively high private saving rate in India, a further acceleration in growth would need to rest on improvements in national saving, stronger private sector investment, and structural measures that would boost factor productivity.

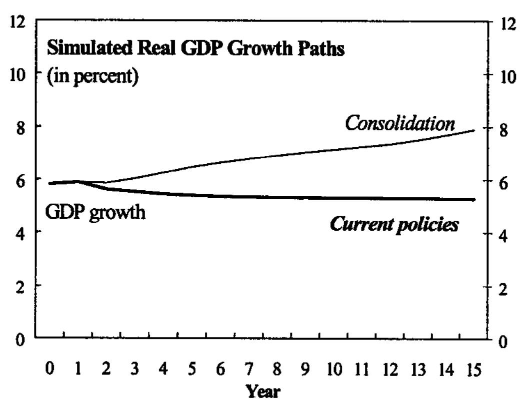


Fiscal consolidation coupled with structural reform will be critical for assuring fiscal sustainability and achieving the authorities' growth objectives.

- High public sector deficits have been sustained in recent years by a favorable interest rate-growth rate differential, but several studies have illustrated that the continuation of current policies would likely lead to public sector insolvency over the medium to long run. Moreover, simulations of a simple growth model of the Indian economy suggest that the maintenance of a constant primary deficit relative to GDP would cause growth to stagnate and eventually result in explosive debt dynamics. In the short run, this would leave the economy open to crisis in the event of external or domestic shocks, including an erosion of investor confidence that increased interest rates.[1]

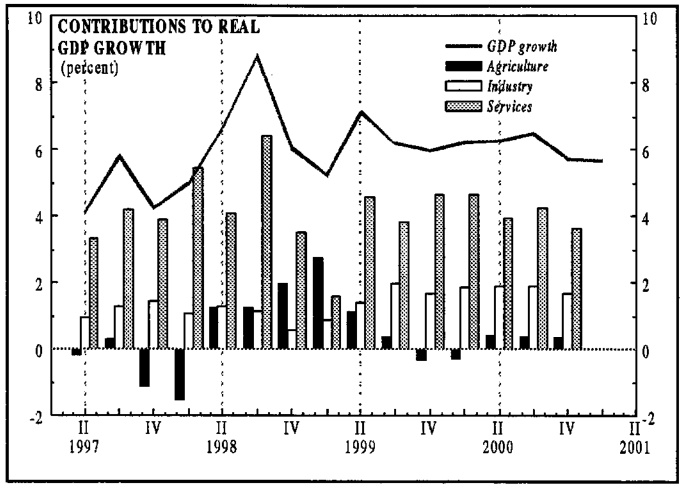
- However, if consolidation were to proceed as targeted in the draft fiscal responsibility legislation—so that the central government deficit would be reduced by about ½ percent of GDP per year over the next five years—and if this were accompanied by similar adjustment at the state government level, the outlook would be much brighter. Simulations of this program, if accompanied by increases in government capital outlays, illustrate that fiscal sustainability would be assured (aided by a decline in interest rates relative to nominal GDP growth), investment and growth would be higher, and external vulnerability would be significantly reduced. Progress would be even more rapid if the adjustment were accompanied by structural reforms to improve productivity.





[1] For supporting analysis see Cashin, Olekalns, and Sahay, "Tax Smoothing, Financial Repression, and Fiscal Deficits in India," and Reynolds, "Fiscal Adjustment and Growth Prospects in India," both in *India at the Crossroads*, (IMF: Washington DC), 2001.

undermined by excess capacity, uncertainty regarding the effect of the elimination of quantitative import restrictions and high real interest rates.



5. **Recent data point to a further slowdown, compounded by the devastating earthquake that struck the state of Gujarat in late January**. Several indicators have increasingly pointed to underlying weakness in domestic investment and consumer demand, including continued sluggishness of the production of capital goods, vehicles, and textiles, the sharp drop in loan growth, and a decline in cement production. The Gujarat earthquake—which caused a massive loss of life and damage to physical infrastructure that is estimated as high as 1 percent of GDP—may also have contributed to the further drop in industrial production growth to 2¾ percent (y/y) in 2001Q1 (Box 2).

6. **Abundant food stocks have mitigated the impact of energy price hikes on inflation**. Wholesale price inflation, which peaked at 8½ percent (y/y) earlier this calendar year, declined to 5½ percent in April owing to the waning base effect of hikes in administered fuel prices—prices were raised in October 1999, and again in March and September 2000. Low agricultural price inflation has helped contain overall consumer prices with CPI inflation averaging only 3 percent in the past six months (Table 2 and Chart 2).

7. **The current account deficit is estimated to have risen to just over 1 percent of GDP in 2000/01, as the effect of high world oil prices was partly offset by weak domestic demand and strong export growth** (Table 3 and Chart 3). Although India is highly dependent on oil imports, which increased by 1¼ percent of GDP in the past year, the effect was offset by weak non-oil imports, especially of food and capital goods, and strong exports of garments, engineering goods, and refined petroleum products. Services receipts have also been robust, reflecting exports of IT-related services, and inward remittances from Indians abroad have been substantial.

8. **However, pressures on the capital account mounted during 2000**. Market confidence and portfolio inflows were undermined by the global turnaround in sentiment toward IT stocks (which represented roughly a quarter of India's market capitalization), concern about the impact of higher oil prices on the balance of payments, and fears that the rupee had lost competitiveness with the dollar's strength against other currencies (Chart 4). The RBI responded to the pressure on the rupee by intervening heavily in spot and forward markets and by tightening domestic monetary conditions (hiking the Bank rate in July). Administrative restrictions on access to foreign exchange were also imposed, including a

Box 2. India: Earthquake in Gujarat

A severe earthquake, the strongest to hit India since 1950, rocked the industrial state of Gujarat on the morning of January 26. Official estimates put the loss of life at over 20,000, with 165,000 injured, and asset losses and reconstruction costs around $4.4 billion (around 1 percent of India's GDP).[1]

Output losses, due to widespread disruption in economic activities, are estimated to be $650 million over three years, with most of the loss concentrated in 2000/01. While the absence of workers, power and telecommunications shortages, transportation problems, and suspension of regular operations in Kandla—the country's busiest port—had an adverse impact, the areas most affected by the earthquake were not major contributors to state GDP, thus limiting the impact on production. Large-scale industrial plants (oil refineries and chemical, textile, and pharmaceutical plants) mostly survived owing to quakeproof construction, and the damage was concentrated on medium- and small-scale industries, especially in the areas of textiles and jewelry.

The Government of India released the equivalent of $100 million in emergency aid during 2000/01, and sought US$1.5 billion from multilateral institutions. The government also imposed a 2 percent surcharge on income tax to help defray the cost of relief and reconstruction efforts, waived excise duty on aid-related imports, and will accelerate central allocations for plan (development) spending in 2001/02. On the financial side, the RBI relaxed its limits on ways and means advances for Gujarat to facilitate the state government's ability to fund the recovery effort, and the state-run insurance companies were directed to expedite the settlement of earthquake-related claims.

According to World Bank and AsDB estimates, **Gujarat's fiscal deficit would increase by 2–3 percentage points of GSDP in each of the next three years, owing to increased expenditure related to relief and reconstruction.** Given the magnitude of the disaster, the state expected to require external resources to help the relief and reconstruction effort, especially for the poorest segment of the population.

Consumption in Gujarat, already adversely affected by the drought of 2000, is expected to decline further in the coming months. The income tax surcharge will impact national disposable income, but **the overall effect of the disaster is expected to be broadly neutral,** with the output loss offset by increase in reconstruction activities, especially in 2001/02. It is noteworthy that in the aftermath of recent earthquakes in other countries—Japan (January 1995), Taiwan POC (September 1999), and Turkey (August 1999)—subsequent output losses tended to be recovered within one or two quarters.

The earthquake and the recent cyclone have prompted renewed emphasis on disaster preparedness.[2] A National Committee on Disaster Management has been formed in order to establish permanent institutional arrangements. The Eleventh Finance Commission report in 2000 also established a National Calamity Contingency Fund for disaster management—the Fund was provided with a capital infusion of Rs 5 billion and was augmented on an ad hoc basis by a 2 percent corporate and personal income tax surcharge. The 2001/02 budget added a 15 percent surcharge on excise duties on cigarettes and hiked specific excises on other tobacco products.

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[1] Gujarat contributes around 6½ percent of India's GDP, has a population of 35 million (3 percent of the total), and accounts for 10 percent of the country's exports. For details of the impact of the earthquake, see *Gujarat Earthquake Recovery Program: Assessment Report,* The World Bank and the Asian Development Bank, March 14, 2001.

[2] In November 1999 a cyclone hit the state of Orissa, leaving 10,000 dead and causing an estimated damage of $1.5 billion.

surcharge on import financing that was in contravention of Article VIII.[1] By end-October gross reserves had fallen by \$3.2 billion to \$34.9 billion (4¾ months of imports).

9. **These pressures eased in late 2000 and into early 2001**. The government's India Millennium Deposit (IMD) scheme—involving a five-year instrument marketed to nonresident Indians—yielded inflows of \$5.5 billion in October. The boost to reserves and the softening of world oil prices helped restore market confidence, and the cut in U.S. interest rates in early 2001 also strengthened sentiment toward the rupee. By end-March, the rupee/dollar rate had recovered some of its earlier losses, portfolio inflows had rebounded, and gross reserves had risen to almost \$43 billion (nearly 6 months of imports and four times short-term external debt).

10. **With the stronger exchange market conditions and signs of industrial weakening, monetary policy was eased**. Money market conditions began to relax in late 2000, and bond yields also fell sharply. Subsequently, in February/March 2001, the RBI lowered its Bank rate by 100 basis points in two steps, and also reduced the cash reserve requirement for commercial banks by 50 basis points. However, financial market confidence remained fragile—although the stock market had recovered part of the sharp losses suffered in early 2000, by end-April, stock price indices remained roughly 40 percent off their early 2000 peak (Charts 5 and 6).

11. **Financial market sentiment was also affected by corruption and stock market scandals**. A stock market scandal broke during March 2001, which involved accusations of insider trading and payment defaults by some brokers, and led to the intervention of an urban cooperative bank (see Section IV.C for details). A major political corruption scandal in the same month also led to the resignation of two cabinet ministers, the withdrawal of an important regional ally from the ruling coalition, and disruptions to parliamentary proceedings.

12. **After widening markedly during the latter half of the 1990s, the public sector deficit is estimated to have fallen by ¾ percent of GDP in 2000/01 to 10½ percent of GDP** (Table 4 and Chart 7).[2] However, this estimate assumes a significant adjustment by the states in line with budget targets—data on the states' outturn are not yet available, and there is a risk of shortfalls.[3] At the central government level, the deficit—defined by the staff to

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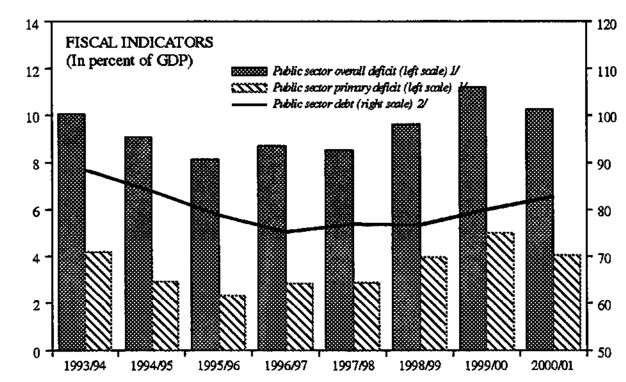
[1] The surcharge was lifted in January 2001.

[2] The deterioration in the 1990s resulted mainly from higher outlays for subsidies, large civil service salary increases awarded in 1997, and increased military spending following the 1999 conflict along the line of control with Pakistan.

[3] State budgets assumed expenditure discipline coupled with significant increases in transfers from the center, but reports suggest that outlays have exceeded targets and revenues have

(continued...)

exclude privatization receipts—was roughly unchanged as a share of GDP, as tax shortfalls and higher-than-budgeted outlays for subsidies were more than offset by strong nontax revenues and a compression of capital and military outlays, relative to budget targets. Although delays in raising domestic fuel prices caused the deficit of the Oil Coordination Committee (OCC) to increase, this was offset by lower-than-expected capital outlays by public sector enterprises. The public sector debt ratio continued to rise, reaching an estimated 83 percent of GDP.



1/ 2000/01 figures are staff estimates.
2/ Staff estimates.

13. **Although containing welcome commitments to structural reform, the 2001/02 budget emphasized growth rather than significant deficit reduction** (Box 3). In particular, the budget reiterated the government's commitment to lowering the central government deficit to 2 percent of GDP by 2006/07, in line with draft fiscal responsibility legislation, and endorsed a number of important structural initiatives. However, the 2001/02 deficit would remain roughly unchanged at about 5¼ percent of GDP, once divestment receipts were excluded from revenues. A broad range of tax cuts was introduced, but these were assumed to be offset by tax buoyancy and increased compliance. A ½ percent of GDP increase in capital expenditure also was largely matched by reductions in current expenditure.

Fiscal Indicators
(In percent of GDP)

	1998/99	1999/00	2000/01		2001/02	
	Actual	Actual	Budget	Est.	Budget	Proj.
Consolidated public sector balance	-9.6	-11.2	-10.6	-10.4	-10.2	-10.9
Central government 1/	-5.4	-5.4	-5.6	-5.3	-5.2	-5.6
Authorities' definition	-6.4	-5.4	-5.1	-5.1	-4.7	-5.1
Oil Coordinating Committee	0.6	-0.1	0.0	-0.3	0.0	0.0
States and Union Territories 2/	-4.3	-4.8	-4.2	-4.2	-4.2	-4.4
Central Public Enterprises	-1.4	-1.8	-1.7	-1.4	-1.6	-1.7
Consolidation items	0.8	1.0	0.9	0.8	0.8	0.8
Memorandum item:						
General govt. revenue balance 3/	-6.3	-6.7	-5.6	...	...	...
General govt. balance	-3.4	-4.3	-3.6	-3.7	-3.3	-3.8

1/ Staff definition treats divestment proceeds as below-the-line financing; authorities' definition includes divestment receipts in revenues. Both definitions exclude small savings on-lending from central government expenditures.

2/ 2000/01and 2001/02 budgets are staff estimates.

3/ Revenues (excluding divestment receipts) less noncapital expenditures.

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fallen short. The fiscal situation has been complicated by the creation of three new states, bringing the total to 28 and requiring the establishment of new administrations.

Box 3. India: The FY 2001/02 Budget

The 2001/02 budget (April–March) targets the overall central government deficit at 5.3 percent of GDP—roughly unchanged from the estimated deficit for 2000/01, if divestment proceeds are treated as below-the-line financing. While new revenue measures are projected to reduce collections by 0.1 percent of GDP, this loss is expected to be more than compensated by tax buoyancy and increased voluntary compliance. On the expenditure side, a 0.4 percent of GDP increase in capital expenditures is expected to be largely offset by reductions in current expenditures. Key fiscal and structural measures include:

Revenue measures

- Further rationalization of the excise duty structure toward a manufacturing-level VAT (CENVAT) with a 16 percent central rate and a 16 percent special excise duty on selected items. A modest start was made toward a longer-term commitment to gradually eliminate individual excise exemptions, although a new exemption was also introduced.
- Increased excise duties on diesel and gasoline.
- Special surcharge on cigarettes and tobacco products for funding the National Calamity Contingency Fund.
- Inclusion of additional service sectors under the service tax net.
- Elimination of the 10 percent customs surcharge, which would lower the peak tariff rate to 35 percent.
- Commitment to reduce the peak tariff rate further to 20 percent within three years.
- Sharp hikes in customs duties on many items subject to removal of quantitative import restrictions in April 2001, including second-hand cars, tea, coffee, and edible oils.
- Reduced customs duties applicable to gold and favored industries, such as IT, film, and jewelry.
- Elimination of the 10 percent surcharge on corporate and high-income noncorporate incomes; however, the new 2 percent surcharge for financing the National Calamity Contingency Fund is retained.
- Measures to widen the income tax net and improve tax administration.
- Withdrawal of some income tax exemptions; however, new tax holidays were also introduced, including for investments in infrastructure and telecommunications.

Expenditure measures

- Measures to reduce civil service wages and salaries over the medium term, including a cap on fresh civil service recruitment, cuts in existing staff as recommended by the Expenditure Reforms Commission, and a new voluntary retirement scheme.
- Plan capital spending budgeted to increase by 0.1 percent of GDP, including for the agriculture and power sectors.
- Defense spending budgeted to increase by 0.1 percent of GDP.
- Administered interest rates on small savings and provident funds cut by 1–1½ percentage points, although government guarantees and tax incentives for these schemes will continue.
- Modest hike in postal rates.

Other measures

- **Food and fertilizer subsidies**: phased reforms in line with recommendations of the Expenditure Reforms Commission; however, no impact on the 2001/02 budget is anticipated.
- **Privatization**: Rs 120 billion (½ percent of GDP) in divestment receipts is targeted for 2001/02, of which Rs 70 billion will be earmarked for restructuring assistance to PSUs, worker safety nets, and debt reduction; Rs 50 billion would be used for additional budgetary support for plan expenditures, conditional on realization of anticipated receipts.
- **Labor market**: an easing of restrictions on contract labor, and a substantial increase in the size of company that must seek government approval prior to layoffs, retrenchment, or closure.
- **Small-scale industries (SSI)**: 14 previously reserved industries to allow production by large-scale producers, and a doubling of the firm size that qualifies for SSI status and tax exemptions.
- **Power sector**: a reform program for State Electricity Boards (SEBs), focused on full metering, energy audits, independent tariff determination, commercialization of distribution, and SEB restructuring, and supported by conditional grants and loans from the central government.
- **Petroleum sector**: the March 2002 deadline for dismantling of the administered pricing mechanism in the petroleum sector will be adhered to.
- **Social security**: introduction of new schemes of group insurance to extend security cover to workers affected by economic liberalization and landless agricultural laborers.
- **Banking sector**: greater autonomy for public sector bank management, including personnel recruitment, and proposed legislation to facilitate foreclosure and asset recovery.
- **Securities markets**: improved systems for transactions clearing, settlement, and dealing.
- **Pension reform**: a reform program to be introduced by October 1, 2001.
- **Capital account liberalization**: easing of restrictions on outward FDI and inward FDI in non-banking financial companies, and an increase in the limit on foreign portfolio investment from 40 percent to 49 percent of firms' equity.

14. **The absolute level of poverty in India remains high, but most social indicators have shown remarkable improvements in the last decade** (Box 4). The most recent official survey indicates that the poverty rate fell sharply between 1993/94 and 1999/00, from 36 percent to 26 percent, and other development indicators, including female literacy and child mortality rates, also have improved considerably. At the same time, however, many analysts have cautioned against drawing strong conclusions regarding recent poverty trends, given the methodological differences across surveys. In addition, signs that regional disparities and rural poverty remain high are a growing concern.

III. OUTLOOK AND VULNERABILITIES

15. **The near-term macroeconomic outlook has been marked down in light of recent domestic developments and signs of a weaker external environment**. In particular, the staff's Spring WEO projections are for growth to remain just under 6 percent in 2001/02 and to recover gradually to its potential rate of 6¼–6½ percent by 2003/04 (Table 5). The current account deficit is projected to rise modestly to 1¼ percent of GDP in 2001/02, as the effect of the withdrawal of quantitative import restrictions and slowing partner country growth offset the effect of lower world oil prices.

India—Spring 2001 WEO Projections
(in percent)

	1999/00	2000/01	2001/02	2002/03
GDP growth (at factor cost)	6.4	5.8	5.9	6.1
WPI inflation	3.4	7.1	5.5	5.5
Current account balance/GDP	-0.9	-1.1	-1.2	-1.3
Public sector balance/GDP	-11.2	-10.4	-10.9	-10.5

16. **Nonetheless, the near-term outlook remains subject to downside risks** (see Annex I for details). Below average monsoons during the past two years have already significantly reduced water tables, and poor weather conditions in the coming season would jeopardize agricultural production on irrigated lands as well as hydroelectric generation.[4] Moreover, the elimination of quantitative import restrictions could have a larger-than-expected impact on domestic industry and the balance of payments.[5] Finally, the impact of the U.S. and Japanese slowdowns and the global downturn in the IT sector on India is expected to be modest, given the closed nature of the economy and the emphasis of its IT exports on services, where India is considered to be highly cost competitive. However, the impact could be larger-than-presently envisaged, especially if regional trade or the demand for IT services were significantly affected.

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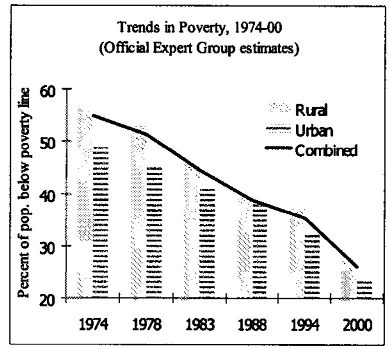
[4] Official estimates in late May were for the monsoon, which hit the south west state of Kerala on May 23, to be 98 percent of the long-term average.

[5] Empirical analysis suggests that the adverse transitional effects of QR removal would be modest, but some light manufacturing industries—including in the area of batteries and fans—as well as investment and business confidence have been adversely affected.

Box 4. India: Recent Trends in Poverty

Over the last three decades, poverty in India has declined significantly. Despite this progress, around 230 million people still live in acute poverty, which continues to present a major policy challenge.

Between 1974–2000, incidence of poverty (percentage of population below the poverty line) fell from 55 percent to 26 percent. This improvement at the economy-wide level, however, masks substantial disparities across sectors, regions, and time. Rural poverty, constitutes roughly ¾ of the total poor, and declined from 56 percent in 1974 to 27 percent in 2000, while during the same period urban poverty dropped from 49 percent to 24 percent. Interstate differentials in poverty remain large, although the differences have narrowed over time. The rate of reduction in poverty has also varied over the years. The largest reduction appears to have occurred in the more recent years, 1994–2000, while in the period 1988–94 poverty remained virtually stagnant.



Measures of poverty in India, however, have not been free of controversy. Although, among developing countries, the quality of data on poverty in India is among the best (and goes as far back as 1951 when the first National Sample Survey (NSS) was conducted), there are a number of areas of concern:

- First, the NSS carries out two types of consumer surveys—an annual survey with limited sample size and coverage, and a more comprehensive survey with a larger sample conducted roughly every 5 years. Although estimates from the smaller samples are made public, they are not officially accepted. Consequently, official poverty estimates are available only in 5-year intervals, making it difficult to study their time series properties.
- The second area of concern is related to the latest (2000) large sample survey. Prior large sample surveys were conducted on a 30-day recall basis. However, in the 2000 survey a 7-day recall questionnaire was added. Some critics have alleged that the two sets of questionnaires may have confused both respondents and enumerators such that even the 30-day recall estimates for 2000 are not comparable with those of the earlier large samples.
- Third, per capita consumption growth based on national account statistics (NAS) shows rapid growth in the 1990s, while the growth of average per capita consumption in the NSS estimates is much lower, which could imply that the NSS estimates understate the decline in poverty.

Despite data shortcomings, poverty in India has been extensively researched. Some of the conclusions from this literature are:

- Growth has been a major contributor in reducing poverty. Empirical studies show that both higher agricultural yield and increases in per capita nonfarm output were significant determinants of rural poverty reduction.
- Other factors, such as human capital and land reforms, particularly tenancy reforms, also played key roles.
- Over the years, the authorities have implemented numerous poverty alleviation programs. While the success of individual schemes has varied considerably, overall government involvement in poverty alleviation, as proxied by public development expenditure, has been another significant factor in reducing poverty.

In recent years, some analysts have raised concerns that the reforms of the 1990s have not benefited the poor. Critics contend that while the liberalization efforts raised GDP growth, the associated decline in poverty was muted, especially when compared to the 1980s. Staff analysis[1] suggests that, on the contrary, growth remained strongly pro poor, even when the 2000 NSS estimate, which shows a surprisingly large decline in poverty, is excluded from the analysis. However, the effects of other poverty-reducing factors (referred to earlier) were much weaker than in the previous decade.

[1] For details, see the background papers.

17. **Risks over the medium term depend significantly on the government's ability to achieve fiscal consolidation.** The baseline scenario assumes modest fiscal adjustment, which would be sufficient to ensure sustainability under associated projections of growth and interest rates. However, given the large debt stock, the debt dynamics and the external position would be vulnerable to lower growth, external shocks, and/or a loss of investor confidence.

18. **The January 2001 FSSA concluded that India's near-term vulnerability to crisis was relatively modest, but also stressed the medium-term risks.**[6] In particular, most vulnerability indicators have improved in recent years—external debt, over a third of which is concessional, has dropped to around 22 percent of GDP, and reserves are well in excess of short-term debt (Table 6). However, the FSSA noted that financial sector deregulation would reduce the ability of the government to access captive sources of low-cost domestic financing and, as capital account and trade liberalization proceed, the economy's exposure to external shocks and shifts in market confidence would increase.

IV. Policy Discussions

19. **The key challenge facing India remains to achieve and sustain the rapid growth rates needed to reduce poverty over the longer term.** Roughly 70 percent of the population is employed in the agricultural sector where productivity and educational attainment are weak and poverty is endemic. Although the service sector has successfully contributed to India's relatively strong growth performance during the past decade, it already accounts for half of India's GDP and the scope for this sector to provide sustained income gains for the rural poor may be limited. Thus, achieving faster growth and poverty reduction will require removing regulatory and other structural constraints on employment and income growth in the manufacturing and agricultural sectors, as well as a significant improvement in public saving in order to provide greater resources for public and private investment and to reduce the risk of fiscal crisis.[7]

20. **Encouragingly, during the past year the authorities have established well-defined agendas for fiscal and structural reform.** In particular, the government has set the goal of halving the poverty rate in ten years, and acknowledged that significant structural changes and improvements in saving and investment rates are needed to achieve the 8-9 percent growth necessary to meet this objective.

- The authorities have proposed **fiscal responsibility legislation**—the Fiscal Responsibility and Budget Management Bill (FRBM)—which would require deficit

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[6] See "India—Financial System Stability Assessment," January 5, 2001.

[7] These issues are discussed extensively in Chapter 5 of Callen, Reynolds, and Towe (eds.), *India at the Crossroads* (IMF, 2001).

reduction by the central government of at least ½ percent of GDP a year, and the achievement of a deficit of 2 percent of GDP by 2005/06. The legislation would also aim to improve fiscal discipline by enhancing transparency and requiring automatic expenditure cuts in the event of budget shortfalls.

- Also, the January 2001 report of the Prime Minister's Economic Advisory Council (EAC) established a well-defined roadmap for "**second-generation reforms**." The report stressed that a sharp reduction in the fiscal deficit and public sector debt and broad-based structural reforms were critical for India to benefit fully from globalization and achieve its full growth potential. Against this background, the report laid out a detailed reform program that covered trade liberalization, the industrial and agricultural sectors, infrastructure, as well as fiscal and social policies (Box 5).

21. **During the discussions, the mission broadly endorsed these goals, but stressed the importance of early and determined implementation.** The steady weakening of activity during the past several years indicates that structural impediments have become an increasing drag on the economy. Significant improvements in productivity and investment will be required to boost the economy's potential growth rate from around 6¼–6½ percent presently to the authorities' longer-term objective, and to achieve faster gains on the poverty front. Encouragingly, market reaction to the 2001/02 budget speech—which endorsed many of the measures proposed by the EAC—was very favorable and suggested an opportunity to seize on a consensus for reform. Against this background, the mission cautioned that delaying implementation of reforms could both jeopardize this support and leave the economy vulnerable to a further erosion of its growth potential.

A. Fiscal Policy

22. **The mission welcomed the commitments to structural reform contained in the 2001/02 budget, but noted that the fiscal situation remained a pressing concern.** Excluding privatization receipts, the central government deficit was targeted to be roughly unchanged as a share of GDP, and adjusting the revenue projections for historical revenue elasticities and the staff's growth projections would increase the deficit by ¼ percent of GDP. Expenditure risks also included possible outlays related to recapitalizing weak banks, dearness allowances for civil service employees, and the new civil service voluntary retirement scheme. With signs of continued fiscal stress among the states, including those related to reconstruction costs in Gujarat, the public sector deficit appeared likely to rise to close to 11 percent of GDP, while public sector debt could reach 85 percent of GDP.

23. **The Ministry of Finance (MoF) officials expressed confidence in the central government's budget targets.** On the revenue side, they felt that the staff's macroeconomic forecast was unduly pessimistic and that recent improvements in tax administration would be sufficient to improve tax buoyancy. They also suggested that there was slack built into the expenditure targets: outlays on wages and salaries would likely come under budget, a substantial amount of outlays (roughly ¼ percent of GDP) were fully contingent on the

Box 5. India: The Prime Minister's Economic Advisory Council Report

A comprehensive program of "second-generation" reforms was recently laid out by the January 2001 report of the Prime Minister's Economic Advisory Council (EAC), and while the government has not formally endorsed the document, many of the policy recommendations were reflected in the 2001/02 budget speech. Some of the specific policy recommendations included:

Industry and agriculture

- **Trade policy**: Phased reduction in average **customs tariffs** from 34 percent to 12 percent, with the initial emphasis on basic intermediate goods.

- **Industrial policy**: The phased elimination of preferences for **small-scale industry** and reform of **bankruptcy law** and **debt recovery** mechanisms.

- **Privatization**: Sharp reduction in government ownership, with revenues received from privatization used to pay down public sector debt.

- **Labor market reforms**: Eventual abolition of legislation requiring government permission for layoffs from firms employing more than 100 workers; increased compensation paid to retrenched workers; and liberalized rules governing contract labor.

- **Agricultural reform**: Elimination of controls on the movement and stocking of agricultural commodities; sharp reduction in government procurement of food products; abolition of controls on the distribution and marketing of sugar; dereservation of agro-processing; and liberalization of fertilizer prices.

Infrastructure

- In the **power sector**, hikes in tariffs for nonindustrial consumers to meet economic costs; privatization of the distribution system to contain costs and improve efficiency; clearing the arrears of the state electricity commissions, which some estimates place at over 10 percent of GDP. Further **telecom reform**, to include rationalization of license fees and tariffs and the opening up of the system to competition. As regards the **transportation system**, improved cost recovery and measures to promote private sector participation in **ports, highways**, and the **railways**.

Fiscal and social policies

- **Fiscal consolidation**: Reduce the combined deficit of the central and state governments to 5 percent of GDP by 2006/07. Consolidation to be achieved by increasing the **tax-to-GDP** ratio by 2 percent of GDP, mainly by broadening the base of the excise duty. In addition, expenditure rationalization would include a sharp reduction and rationalization of the civil service, cuts in **food and fertilizer subsidies**, and hikes in **kerosene prices** and **postal and water charges**.

- **Education and health**: Increased funding for primary education, coupled with sharp cut in implicit subsidy for university education. Increased effort to promote immunization, clean drinking water, and sanitation facilities.

- **Other social policies**: Revamp pension system, including a shift from defined benefit plans toward defined contribution plans. Enhance employment programs, child development services, and micro credit facilities.

realization of divestment receipts, and spending could again be compressed, if necessary. Finally, they noted that—under the authorities' accounting system, which included privatization receipts as revenue—the budget was consistent with the deficit reduction required under the draft Fiscal Responsibility and Budget Management (FRBM) bill.

24. **However, developments since the consultation discussions suggest that the downside risks to the budget projections have increased**. In particular, tax revenues slowed sharply in the last months of 2000/01, leaving revenues as much as ½ percent of GDP below the revised estimates, and only partly offset by further expenditure cuts. Revenues in 2001/02 will also be affected by introduction of new tax concessions following the budget's presentation, including an increase in standard income tax deductions and a slowing of the phased withdrawal of the exemption for export income.

25. **The MoF officials stressed that the FRBM bill would provide an important vehicle for achieving medium-term fiscal consolidation**. Besides the annual deficit targets, the requirement of automatic expenditure cuts in the event of budget shortfalls would provide an effective device for strengthening fiscal discipline. The mission generally endorsed the deficit-reduction targets contained in the legislation, observing that, if matched by similar adjustment at the state government level, they would imply a reduction in the consolidated public sector deficit to 5-6 percent of GDP and place the debt ratio on a firm downward track. However, the legislation's success would hinge crucially on the effective implementation of the requirements for clearer accounting rules, a comprehensive medium-term budgeting framework, and enforceable sanctions for noncompliance (Box 6).

26. **The MoF officials noted that important expenditure reforms were implemented during the last year**. The Expenditure Reforms Commission (ERC) provided recommendations for reducing the civil service and reforming food and fertilizer subsidies, many of which were included in the 2001/02 budget. Interest rates on provident fund deposits also were cut and zero-base budgeting was extended. However, the officials cautioned that the scope for significant expenditure reduction was limited, especially given the need to protect development spending. The mission agreed that deficit reduction could not rest on expenditure cuts, but noted that the EAC report had identified sizable implicit and explicit subsidies where savings could be sought, including with regard to user fees for power and water, as well as railway fares. Moreover, the end-March 2000 increase in minimum support prices for food grains appeared likely to further swell the massive food stocks that had been built up over the past year and impose a significant fiscal burden.

27. **The MoF officials agreed that fiscal consolidation would require tax reform that reversed the decline in the revenue/GDP ratio during the past decade**. They noted that the Eleventh Finance Commission had set the objective of raising the revenue ratio by 2 percent of GDP and, with this objective in mind, exemptions were being reduced and tax administration was being strengthened—notably, the 2001/02 budget had further rationalized excise duties and expanded the base of the services tax. The mission welcomed this emphasis, but noted that achieving a durable and significant increase in the tax ratio would be especially challenging given the phased reduction in tariff rates that had been promised in the

Box 6. India: The Fiscal Responsibility and Budget Management Bill

The Fiscal Responsibility and Budget Management (FRBM) bill was tabled in Parliament in December 2000, and is expected to be brought to a vote by the Fall of 2001. It establishes targets for central government deficit and debt reduction over the medium term, as well as requirements for improved transparency. Its key features include:

- The revenue deficit is to be reduced by at least ½ percent of GDP per year, and eliminated by 2006; thereafter, a surplus is to be built up and used to repay debt.
- The overall deficit is to be reduced by at least ½ percent of GDP per year, and brought to 2 percent of GDP by 2006.
- The deficit reduction targets may be relaxed in case of unforeseen demands owing to national security or natural calamities.
- New central government guarantees are capped at ½ percent of GDP each year.
- The central government is prohibited from borrowing directly from the RBI (except for ways and means advances) after 2004.
- Total liabilities are to be reduced to 50 percent of GDP or lower by 2011.
- Improvements are to be made to transparency and reporting, including submission to Parliament of annual statements on the fiscal strategy, specification of three-year rolling targets for prescribed fiscal indicators and underlying assumptions, and assessments of fiscal sustainability.
- The Finance Minister will be required to report to Parliament quarterly on revenue and expenditure trends, to explain any deviation in fiscal performance from FRBM obligations, and to propose remedial measures. Expenditures are to be "proportionately curtailed" in the event of revenue shortfalls or expenditure overruns.

International experience has illustrated that a successful fiscal rule requires several components, including a high degree of transparency, careful design of targets, short-run contingency measures and a multi-year macro-budget process, and an appropriate institutional framework for implementation.[1] Against this background, several issues will likely arise in establishing the operational framework for the FRBM bill:

- **Transparency and accounting issues:** As the bill notes, important improvements in the transparency of the fiscal accounts would need to be made. In addition to submission of new reports specified by the FRBM, there would also seem merit in preparing estimates of tax expenditures, more carefully delineating current and capital expenditures, and adopting an accrual-based accounting approach.
- **Enforcement:** While proportionate cuts in spending are potentially powerful tools for fiscal correction, the details of how this would be applied remain to be fully specified, including whether all or only a subset of expenditures be cut, or whether contingent revenue enhancements could be sought.
- **Flexibility:** It remains to be determined whether the allowance for deviations from the prescribed adjustment path owing to "national security or national calamity" could provide excessive flexibility, and how other exogenous shocks—including cyclical fluctuations—would be treated. Clarification is also needed on whether deviations from deficit targets in one year would compound the adjustment required in the subsequent year.
- **Multiple targets and the budget framework:** The legislation implies that capital spending could be capped at 2 percent of GDP in the absence of privatization receipts or a sufficient revenue surplus, and care would be needed to ensure that this would not work against India's development needs. Consistency of targets could be usefully checked in the context of a multi-year rolling budget and macroeconomic projections.
- **Long-run objectives:** The legislation does not prescribe deficit targets following the consolidation period ending in 2005/06, nor a target central government debt beyond 2011. Indeed, a sustained overall deficit of 2 percent of GDP would cause the debt ratio to tend toward 20 percent, under reasonable growth and interest rate assumptions.
- **State finances:** Weakness in the finances of state governments has been an important cause of the widening public sector deficit during the last decade. However, the bill is silent on whether fiscal responsibility would be promoted at subnational levels of government, and also does not address whether the central government would be limited from bailing out financially troubled states.

[1] See Kopits, (2001), "Fiscal Policy Rules for India?," *Economic and Political Weekly*, Vol XXXVI, No. 9; and Kopits and Symansky, (1998), Fiscal Policy Rules, IMF Occasional Paper No. 162, (Washington: International Monetary Fund).

budget, as well as the new tax holidays that had been introduced. The mission stressed the importance of continued efforts to expand the base of the services tax and reduce the scope of excise tax exemptions, and also suggested that consideration should be given to ending the tax-free status of agricultural incomes.[8]

28. **MoF officials acknowledged that fiscal discipline at the state government level was equally important for ensuring fiscal sustainability, and their strategy was to make transfers to the states increasingly contingent on reform.** Although this approach had had mixed success in the past, roughly ½ percent of GDP had been earmarked over the coming five years for a Fiscal Reform Facility. Transfers from this facility would be entirely rules-based and in exchange for achieving pre-specified deficit reduction, and efforts were underway to ensure that parallel efforts to finance state-level reform in the power and irrigation sectors, as well as state funding by multilateral and other donors, were consistent with these objectives.[9] While encouraging continued efforts in this direction, the mission noted that present arrangements did not yet appear sufficient to assure adjustments by the states. Success would seem to require a willingness to harden state budget constraints, including by withholding funds if performance fell short and adjusting state borrowing ceilings for unbudgeted inflows from provident funds and small savings schemes. Significant improvements in the center's ability to monitor state fiscal developments would also be essential.

29. **Efforts to implement state-level value-added taxes were ongoing.** In view of the constitutional prohibition against the central government levying sales taxes, the central and state governments had agreed to implement state-level VATs as of April 2002. In preparation for this, and to restrict tax competition, the states had agreed in early 2000 to establish floor rates on existing sales taxes and to prohibit new sales tax exemptions. Discussions with officials from the state of Maharashtra suggested that while preparations were well under way in many states, considerable work would be required to ensure that state tax administrations and the treatment of interstate sales would be sufficient to contain evasion and avoid revenue losses.

30. **MoF officials noted that there was growing concern regarding the extent of unfunded liabilities at both the central and state government levels.** While explicit guarantees totaled 9 percent of GDP as of end-March 1999, this figure comprised the guarantees of only the 17 major states, and did not include implicit guarantees of off-budget

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[8] Agricultural incomes are free from tax at the central government level, and measures to bring this sector under the tax net would require the concurrence of the states.

[9] In 1999/00, the central government had attempted to promote state-level fiscal reform on an ad hoc basis by providing short-term funding to thirteen states. The Eleventh Finance Commission recommended institutionalizing this process, and established a fund from which conditional grants could be apportioned over a five-year period.

state enterprises, the arrears of state public utilities, as well as implicit liabilities related to government pensions. In order to address this concern, a redemption fund had been established in 1999/00 to cover central government guarantees, a funded pension program for new civil service employees would be established in late 2001, and the FRBM would also limit new guarantees. The RBI's recommendation to limit state guarantees had been accepted by most states, in principle, and broader implementation was expected once the RBI established reporting norms—nine states had already established sinking funds.

31. **The 2001/02 budget speech reiterated the authorities' commitment to dismantling the administered pricing mechanism in the petroleum sector by April 2002.** A specific plan for achieving this objective was still to be established, but it would include the deregulation of prices paid to domestic producers of crude oil and explicit accounting for the remaining subsidies on kerosene and LPG in the central government's budget. The mission endorsed these intentions, but noted that outstanding arrears to oil companies used to fund past subsidies exceeded ½ percent of GDP. Mechanisms were still needed to settle these debts and to scale back the still-significant subsidies on kerosene and LPG.

32. **Progress has been made toward privatization and improving the operational efficiency of public sector undertakings (PSUs).** The authorities acknowledged that privatization receipts had been considerably less than hoped for in 2000/01, but the process had been accelerated recently. Several nonviable PSUs had been closed and plans to sell the majority share of roughly 30 other enterprises—including the auto producer Maruti, and the two national airlines Air India and Indian Airlines—had been announced. The officials acknowledged that the sale of a major aluminum producer (BALCO) had attracted considerable political and other opposition—the sale was challenged in the courts and a long strike by workers was settled only after the new owner promised no layoffs—but it was hoped that these disputes would not undermine the government's strategy.

B. Monetary and Exchange Rate Policies

33. **The mission broadly endorsed the RBI's recent easing, and suggested that there could be further room for cuts in interest rates if activity remained weak.** However, the mission cautioned that the large stock of public debt and the fiscal deficit likely implied upward pressure on real interest rates and left monetary policy little room to maneuver without monetizing the deficit. Moreover, while underlying inflation pressures appeared moderate, there was considerable uncertainty about the level of core inflation and where the economy stood relative to its potential.[10] Therefore, care would be needed to ensure that the

[10] Measuring core inflation in India is particularly difficult given the predominance of agricultural supply shocks and administered prices, as well as the poor quality of the CPI data. The RBI has recently estimated a core WPI inflation series based on a "trimmed mean" methodology, which was 5 percent in March 2001, compared with 3 percent for a core series that simply excluded administered prices. Estimates of potential output and the output gap also are subject to considerable uncertainty, given the importance of the agricultural sector

(continued...)

increase in headline inflation over the past year did not become built into inflation expectations and wage demands.

34. **During the discussions, the monetary authorities indicated that the RBI had shifted to a more neutral policy stance, but left open the possibility of further ease.** The February/March actions had been timed with a view to validating the budget's announcement of a cut in rates on administered savings schemes, and the reduction in the cash reserve ratio had been consistent with the longer-term strategy of bringing the ratio down to its statutory minimum. In the RBI's view, the downside risks to growth were manageable, and the uncertainties on the inflation front combined with the need to maintain confidence in the face of the recent stock market turbulence argued for putting policy on hold in the near term. Subsequently, in its April 19 policy statement, the RBI suggested a bias toward further ease, and lowered its repo rate by 25 basis points in late April and again in late May, bringing it to 6½ percent, and also lowered the cash reserve requirement by a further 50 basis points in mid-May.

35. **In its September 2000 report, an RBI advisory group on policy transparency called for an explicit medium-term inflation objective.**[11] The mission observed that the preconditions for a formal inflation target were not in place, particularly given fiscal dominance and difficulties in measuring core inflation in the face of supply shocks, but agreed that a more explicit statement of the RBI's policy objectives would enhance policy credibility. The monetary authorities responded that it would be premature to take this step, especially given the lack of a clear consensus on the optimal inflation rate. Nonetheless, the RBI remained fully committed to reasonable price stability in the medium term, the definition of which had been lowered to inflation in the range of 3-5 percent, given global price developments.

36. **The operational framework for monetary policy was improved during the past year with the introduction of a Liquidity Adjustment Facility (LAF) and daily variable rate repo auctions.** Nonetheless, the authorities acknowledged that access to RBI credit appeared still too generous, especially when the repo rate exceeded the Bank rate, and indicated that exporters and primary dealers would eventually be restricted from access to the RBI's refinancing facilities. However, this would require the development of a pure interbank/call market, the introduction of a Real Time Gross Settlement system, and alternative financing vehicles for nonbank participants. Subsequent to the discussions, the

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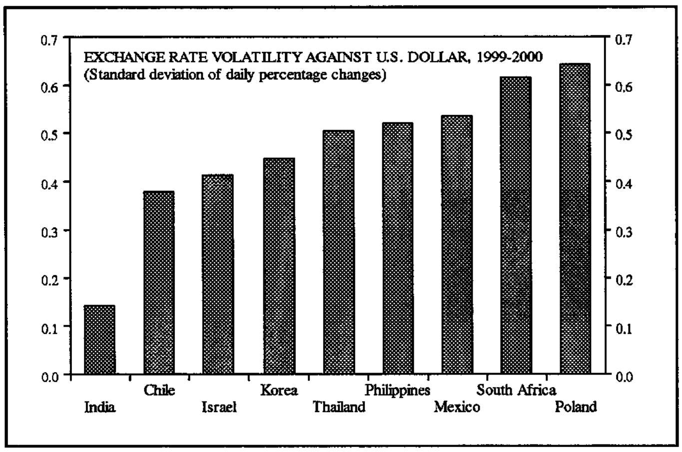
and weather factors, as well as the difficulty in distinguishing between secular and cyclical productivity shocks.

[11] Other measures recommended by the advisory group included institutionalizing the process of policy disclosure, amendments to the RBI Act to clarify the objectives of monetary policy, removing from the RBI its responsibility for debt management, and the establishment of a monetary policy committee.

RBI announced a number of initiatives in this direction, including an increase in the cost of access to the latter third of both its collateralized lending and export credit refinancing facilities to a rate above the reverse repo rate.

37. **The mission questioned whether the lack of day-to-day movement in the rupee/dollar rate was discouraging the development of the foreign exchange market.** In particular, while the exchange rate appeared broadly in line with macroeconomic fundamentals, it appeared unusually stable compared to most other floating exchange rates.[12] This appeared partly to reflect intervention in the foreign exchange market and the use of administrative measures to limit access to foreign exchange—including, at times, measures in contravention of Article VIII. The mission cautioned that the experience of other countries illustrated that efforts to stabilize the exchange rate against a single currency could discourage market participants from developing the instruments and capacity to absorb market volatility and could lead to a build up of speculative pressure. Although the monetary authorities acknowledged that the rupee/dollar rate appeared to be prone to discrete adjustments followed by extended periods of stability, they stressed that they did not target any particular level of the exchange rate and were committed to allowing it to respond to market forces. However, the thinness of the market and the prevalence of large debt, portfolio, and oil-related payments left the market prone to destabilizing temporary supply-demand mismatches. For this reason, they felt that it was necessary to intervene periodically—including with administrative measures—to maintain orderly conditions.



38. **The mission also questioned the appropriateness of using public sector banks to raise official reserves**. In particular, the IMD scheme appeared to combine quasi-fiscal, commercial, and reserve management objectives, since the deposits were a liability of a public sector bank, but half the proceeds were to be invested in government securities.[13] The

[12] The staff's view on the rupee's competitiveness is based on a range of indicators, including a CGER-style analysis of the equilibrium current account deficit, and is discussed in Chapter 3 of Callen, Reynolds, and Towe (eds.), *India at the Crossroads* (IMF, 2001). See also the background papers for a discussion of issues related to exchange market policies.

[13] The IMD was issued by the State Bank of India, which is majority owned by the RBI. Half the proceeds were required to be invested in government securities, and the balance was to be on lent for infrastructure projects.

RBI officials discounted these concerns since such schemes allowed the authorities to quickly tap foreign exchange from nonresident Indians at a cost that did not appear appreciably higher than a possible sovereign issue.

39. **The RBI officials reiterated the importance of maintaining a cautious approach to further capital account liberalization**. Nonetheless, restrictions on inward foreign direct investment (FDI) had been eased significantly in the last year—most FDI that met sectoral foreign ownership caps could enter on an "automatic approvals" basis. The 2001/02 budget further relaxed capital account restrictions—by raising the foreign ownership limit for foreign institutional investors from 40 percent to 49 percent, and by easing restrictions on domestic companies' equity investments abroad—and in early May 2001, restrictions on inward FDI were also liberalized.[14] They also noted that besides the surcharge on import financing, several other restrictions subject to Article VIII had been removed during the past year, including the requirement that dividend remittances from investment in the consumer goods sector be balanced by export proceeds.

C. Financial Sector Issues

40. **The January 2001 FSSA report acknowledged that significant progress was made in the 1990s to strengthen the financial system** (Table 7). In particular, prudential and supervisory systems were tightened, capital market transparency was improved, and the regulatory environment was strengthened. However, the report noted that nonperforming loans remained high and, while risks to the system presently appeared manageable, it cautioned that the system's ability to support India's development needs and its vulnerability were a concern going forward. Key issues included the continued dominance of public sector banks, the need for further improvements in the regulatory system, the lack of a framework for dealing with weak banks, and weaknesses in governance, including in the stock market.

41. **A number of the weaknesses identified in the FSSA became salient at the time of the discussions** (Box 7). A sharp drop in equity prices occurred in March, triggering investigations of insider trading and exposing excessive leveraging by brokerage firms that were unable to settle trades. Deposit runs on several urban cooperative banks also occurred once their large exposure to brokers became apparent. One institution had to be intervened by the RBI and several large commercial banks suffered significant losses on their interbank lending to this institution. Charges of insider trading and lax supervision led to the removal of the chairman and all broker/directors from the Bombay Stock Exchange.

42. **Indian officials stressed that measures had been taken to restore confidence and address the underlying structural weaknesses**. As a first step to stabilize markets, the RBI

[14] Foreign ownership caps were raised to 100 percent in drugs and pharmaceuticals, hotels and tourism, courier services, airports, and mass rapid transport services, to 74 percent for Internet service providers, and to 49 percent for banks.

Box 7. India: The Recent Stock Market Turbulence

A series of stock market scandals occurred in March 2001. These scandals precipitated a sudden sharp decline in market value, which contributed to payment shortages, brokerage insolvencies, depositor runs, and significant losses to urban and commercial banks. As a result, the Reserve Bank of India (RBI) was required to intervene in one urban cooperative bank and offer liquidity support to other institutions. The Chairman of the Bombay Stock Exchange (BSE) resigned owing to allegations of improprieties, and the remaining brokers on the boards of the Calcutta and Bombay exchanges were dismissed for failure to take regulatory action.

The systemic consequences of these events were contained, but financial costs could be significant. Although stock prices fell sharply during March, they have since recovered somewhat, and relatively few financial institutions appear to have been jeopardized. However, the losses facing commercial banks are estimated to be in the order of Rs 2.7 billion (roughly $60 million) and further losses may have been incurred among the urban cooperative banks.

Perhaps more importantly, the events brought to light serious regulatory and structural weaknesses in the Indian financial sector. The weaknesses allowed some market participants to become excessively leveraged and facilitated market manipulation and insider trading. In particular:

- **Market conduct rules:** Although regulations prohibit market manipulation and insider trading, brokers were able to hide the level of their ownership interest in certain stocks and gain inside information. Other market participants gained information regarding the over leveraged position of this former group, and improperly used this information to drive prices down and gain profits.

- **Supervision of stock exchanges:** The stock exchanges responsible for market surveillance and direct regulation of brokers appear to have been unable to detect manipulative trading. The fact that some brokerage firms were undercapitalized and were in violation of margin rules contributed to their vulnerability to market risk, and led to several failures to meet settlement obligations.

- **Settlement practices**. Settlement arrangements on the Indian stock market enabled highly leveraged trading by market participants. In particular, payment and settlement of stock transactions occurred only weekly, and with delays in the payments system itself, settlement could take as long as two weeks to complete. In addition, a "badla" system existed, which provided rolling credit to participants and allowed them to carry forward positions repeatedly into future settlement cycles. These features allowed market participants to build large positions relative to their liquid capital, and exposed others to significant counter-party risk.

- **Bank exposure to capital markets**. Although aggregate advances and guarantees provided by the banking sector to intermediaries and investors in the stock market appeared moderate, individual institutions, particularly some urban co-operative banks and private sector banks, had large exposure. Moreover, urban cooperative banks appear to have been under-supervised and subject to anomalies in their liquidity requirements.

The authorities responded by introducing reforms to address these issues and strengthen capital market institutions and bank regulation. The RBI announced new counter-party and equity exposure rules for banks and proposed a new supervisory regime for urban cooperatives. The Ministry of Finance and the Securities and Exchange Board of India announced tighter margin requirements to reduce the scope for leverage by brokerage firms, and a policy of demutualization of exchanges to remedy poor governance. Most scrips will be moved to a system of rolling settlement on July 2, 2001 in order to reduce settlement risk.

announced its willingness to provide liquidity support to banks if they could not secure necessary funding from the market, and the Securities and Exchange Board of India (SEBI) tightened margin requirements and disclosure rules, and proposed the introduction of a code of conduct for market participants to prevent insider trading. The authorities also announced plans to "de-mutualize" stock exchanges and to expand the system of rolling settlements to cover the scripts that represent the bulk of trading volume.

43. **While the mission agreed that the authorities initial response appeared appropriate, it remained critically important to address deficiencies in market surveillance and governance.** Specific areas that appeared to warrant greater attention included strengthening the surveillance of market intermediaries, improvements in the monitoring of indirect exposure of banks to the stock market and in the supervision over the urban co-operative banks, stricter enforcement of margin requirements in equity trading and financing, and improvements in the loss-sharing arrangements in the payment systems.

44. **The Indian officials stressed their commitment to carrying forward financial sector reform, broadly along the lines identified in the FSSA report.**[15] The 2001/02 budget announced that seven more Debt Recovery Tribunals would be established, and legislation was planned to repeal the Sick Industrial Companies Act, replace the Board for Industrial and Financial Restructuring (BIFR) by Company Law Tribunals, and facilitate foreclosure and enforcement of securities in cases of default. In order to strengthen mechanisms for loan recovery and debt restructuring, the intention was still to establish asset reconstruction companies that would purchase nonperforming assets from the banking sector.

45. **Officials also pointed to the recent progress toward restructuring public sector banks through voluntary retirement schemes (VRS).** These were expected to result in a 15 percent reduction in staff and substantial improvements in operational efficiency and, in order to lock in these gains, bank management was given greater autonomy in the area of recruitment. The mission acknowledged the significance of these measures but noted that they would need to be buttressed by providing banks greater scope to rationalize their branch networks. The mission also cautioned that plans to allow banks to mitigate the impact of VRS costs on capital adequacy ratios appeared inconsistent with international accounting standards and could undermine confidence in prudential norms.

46. **The mission questioned the progress toward reducing the government's ownership and control of public sector banks.** In late 2000, legislation was proposed that would reduce the minimum government ownership of public sector banks—which comprise roughly 80 percent of the system—from 51 percent to 33 percent. However, the voting share of any single private shareholder would be limited to 1 percent, with a view to retaining the "public sector character" of these banks. MoF officials argued that this restriction would not

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[15] Annex II provides a summary of the status of financial sector reforms. See also the background papers for an assessment of the banking sector.

necessarily constrain the ability of banks to operate independently or to improve their efficiency, since the government would only be permitted to appoint seven out of 15 bank directors. Nonetheless, it remained important for banks to continue to fulfill their social responsibility.

47. **Formal restructuring plans for three "weak banks" identified in the 1999 Verma Committee report have yet to be established.** However, RBI officials noted that considerable progress had been made in improving their operations, including by staff retrenchment and rationalization of branch networks. While agreeing that capital injections should be based on clearly-specified conditions, the mission cautioned that repeated recapitalization of banks should be avoided, and nonviable institutions should be closed or merged. It would also be important to implement the proposed Prompt Corrective Action framework, which had been delayed owing to concern that the RBI lacked the authority to intervene in public sector banks.

48. **The authorities have established plans to deepen the debt market.** These include legislation that would facilitate the development of a retail market for government debt and securitization. The draft fiscal responsibility legislation would also preclude the RBI's direct participation in primary auctions of government securities, in order to improve the independence of monetary policy from debt management considerations. A clearing corporation for debt securities would be set up and an electronic Negotiated Dealing System would be made operational by the RBI to facilitate transparent electronic bidding in auctions and dealing in government securities on a real-time basis.

49. **Encouraging progress has also been made toward liberalization of the insurance sector.** Legislation in 2000 opened the life insurance industry to private companies, with a 26 percent cap on foreign ownership. The Indian officials noted that 12 licenses were issued and additional requests were in the pipeline. It was expected that the new entrants would improve service standards and efficiency, which had been adversely affected by regulatory constraints on premiums and reluctance on the part of the public sector insurer to settle claims without a court settlement. In their view the requirement that new entrants write 15 percent of their policies in priority sectors by their fifth year of operation would not represent a significant burden.

D. Structural Policies

50. **During the discussions on structural policies, the Indian officials underscored the government's commitment to reform.** Significant strides were made in the last year, including the elimination of all remaining quantitative import restrictions (QRs), a substantial easing of restrictions on inward foreign direct investment, the opening up of the insurance sector to private competition, deregulation of the telecom sector, and privatization of government enterprises. Moreover, the 2001/02 budget had carried forward many of the recommendations contained in the report of the Economic Advisory Council, clearly signaling the government's commitment to the underlying framework. However, they cautioned that forging a national consensus and legislative approval for many of the reform

measures would not be easy, and while they agreed that careful prioritization would be preferred, it would be unrealistic to assume that the reform process would be rapid or its sequencing ideal.

51. **Officials stressed that resolving problems in the power sector was particularly critical for sustaining growth and addressing the fiscal situation.** This sector—which is chiefly controlled at the state level—has faced severe financial strain, with financial losses estimated at around 1 percent of GDP per annum owing to highly subsidized agricultural tariffs, over-staffing, and distribution losses that approached 50 percent due to corruption and technical deficiencies. These problems were compounded by long-term contracts between state electricity boards and independent power producers (IPPs) that appeared highly disadvantageous.[16]

52. **However, reforming the power sector had proven more difficult and costly than expected.** A key thrust of the effort thus far was to encourage states to dismantle their state electricity boards (SEBs) in favor of electricity commissions, which would be empowered to set tariffs to cover costs, and to encourage states to unbundle and privatize their transmission, generation, and distribution systems. However, tariff increases faced significant political impediments, and the cost of financial rehabilitation of SEBs was proving to be larger than anticipated. In order to further encourage reform, the Power Ministry began providing states with funding conditional on achieving specific milestones, including metering, energy audits, commercialization of distribution, and tariff increases.

53. **Indian officials agreed that deregulation and liberalization of the industrial sector were critical.** As the EAC report highlighted, employment and income gains in the industrial sector were severely constrained by extensive regulatory burdens, and the sector would come under increasing competitive pressure with the elimination of QRs, planned tariff reductions, and the pending dismantlement of the multi-fiber agreement. The budget responded by withdrawing a further 14 items from the list of goods reserved for small scale industry, increasing funding for technological upgrades, increasing the number of Debt Recovery Tribunals, and promising a revamping of bankruptcy legislation. The government

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[16] For example, Maharashtra's contract with an IPP owned by Enron—which is now in dispute—carries a per unit charge that is three times that of power from the national power company. A dispute between Enron and Maharashtra regarding the terms of the contract has involved the central government, which provided counter guarantees to the contract, and has raised questions about the prospect for completion of the second phase of the generation project.

had also taken on the politically contentious issue of labor market reform—legislation would be introduced to ease restrictions on layoffs and the employment of contract labor layoffs.[17]

54. **The mission agreed with the multi-pronged approach to industrial sector restructuring and welcomed the commitment to improving labor market flexibility.** However, the proposal to increase the separation compensation to employees from 15 days of salary to 45 days of salary per year of service was in excess of the EAC's recommendation and appeared generous, and the mission cautioned against allowing social safety nets to undermine market flexibility. Similarly, premiums for the proposed unemployment insurance system should be set high enough to fund costs, but not so high as to discourage employment growth.

55. **The budget speech and the EAC acknowledged the importance of boosting agricultural productivity and incomes, given that the majority of the population and the poor remained in rural areas.** However, important measures remain to be addressed, including the removal of controls on trade and movement of agricultural commodities, the sharp reduction in the role of government procurement agencies, and the dereservation of agro-processing. Moreover, the end-March hike in minimum support prices for wheat appeared inappropriate since food stocks were already excessive, and the effect would either be to increase food subsidies or to impose higher costs on the poor.

56. **The Indian officials explained that an important thrust of the government's policy was to reform and expand the old-age security system.** New programs were announced in the budget that would require the government-owned Life Insurance Company (LIC) to provide subsidized life insurance and other benefits to the rural poor, and by October 2001 the pension system for new government employees would be put on a defined-contribution basis and recommendations for reform of the provident fund system would be announced. The mission welcomed the authorities' efforts in this area but stressed the importance of ensuring that subsidies provided by the LIC should be treated transparently in the budget. Reforms to the provident fund and postal savings systems should also include reducing the generosity of the tax preferences provided to depositors, liberalizing the investment options available to fund managers in order to ensure a sufficient rate of return on assets, and developing mechanisms for interest on deposits to adjust to market forces.[18]

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[17] Presently, legislation virtually prohibits layoffs in the case of firms employing 100 persons or more, and amendments would be proposed that would raise this limit to firms of 1,000 persons or more.

[18] An expert committee was established in mid-April to review the system of administered interest rates, and is to report by August 2001. For a further discussion of these issues, see the background papers.

57. **Planning Commission officials stressed that important strides had been made toward poverty alleviation.** Nonetheless, they acknowledged that problems with the survey methodology meant that the recent data probably exaggerated the decline. In drawing lessons for the future, they agreed that the effectiveness of many poverty alleviation programs had been undermined by weak governance and targeting. In their view, measures to improve rural infrastructure, as well educational and health systems would be key to sustained poverty reduction, and involving the private sector in delivering these services would be crucial.

E. Trade Policy

58. **The Indian officials noted the significant strides taken in recent years toward trade liberalization.** In line with WTO commitments, all remaining QRs were removed in April 2001, custom duty surcharges were reduced as part of the budget, and the authorities were committed to lowering the peak tariff rate from 35 percent to 20 percent by 2004/05. Although average duty rates had been lowered significantly since 1990, this latter measure was seen as particularly important, since India's average tariff was one of the highest in the world—around 34 percent in 1999/00 (on a simple-average basis)—and had contributed to inefficiency and an anti-export bias.

59. **The authorities were mindful of the fact that trade liberalization would place increased pressures on domestic producers.** Thus far, the withdrawal of QRs appeared to have adversely affected only a small number of industries, but pressures would mount with the elimination of remaining QRs, particularly from regional competitors. They responded to the mission's concern that India's active use of antidumping (AD) remedies would undermine the potential gains from trade liberalization by noting that clear and transparent judicial processes were followed before such remedies were implemented. In their view, nontariff barriers among industrial countries were a much greater concern—developing countries often lacked the financial and other resources necessary to challenge AD complaints abroad, and phytosanitary and other standards appeared discriminatory.

60. **The 2001/02 Exim policy that was announced following the mission introduced a number of safeguards against import surges.** Although QRs were lifted, measures were introduced in April to mitigate the potential adverse effects on domestic industry. These included the requirement that some sensitive commodities could only be imported through state trading companies, that agricultural products be subject to import permits based on sanitary and phytosanitary provisions, that imports of second-hand cars older than 3 years would be banned, and hikes in tariff duties on certain agricultural products.[19]

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[19] In early May 2001, it was announced that imports of 300 consumer goods could enter only through 11 entry points, but this requirement was withdrawn by end-May. Details regarding trade policy developments are provided in the background papers.

F. Other Issues

61. **Indian officials noted that they attached substantial importance to benchmarking India against international standards and codes.** A standing committee had been established to identify and monitor international developments in this area and ten advisory groups had been charged with comparing India's adherence to international standards and preparing recommendations for improvements. During the past year, India had also participated in a Fiscal ROSC (which was published in March 2001) and the FSAP, which were viewed as having been useful exercises. At the same time, however, the officials noted that it was important to recognize that many of these international standards were not universally applicable, and that assessments had to be mindful of the particular circumstances of developing countries.

62. **The mission commended the authorities' efforts in this area, and noted that it would be especially important to address weaknesses in the quality of India's macroeconomic data** (Annex III). The deficiencies with regard to the transparency, coverage, and timeliness of the fiscal data were especially worrisome given the large fiscal imbalance. The officials noted that many of these issues had already been identified by the recent National Statistics Commission, and that this partly reflected the fact that statistical and data-gathering systems had not kept pace with economic liberalization. Officials of the Central Statistical Organization agreed to consider the possibility of a Statistics ROSC in the coming year.

V. Staff Appraisal

63. **India's recent macroeconomic performance has been robust, and there have also been encouraging signs of a strengthened commitment to reform.** Despite a series of adverse shocks, including the devastating earthquake in Gujarat, GDP growth has continued to outstrip that in most other countries, the balance of payments has improved, and recent data have provided reassuring evidence that growth and reform during the past decade have yielded significant poverty reduction. On the policy front, welcome steps also have been taken to address some of the deep-seated structural problems confronting India. Fiscal responsibility legislation has been proposed that would establish an enforceable schedule for reducing the central government deficit, and the Economic Advisory Council (EAC) has laid out an impressive and broad-based blueprint for structural reform, much of which was endorsed in the government's 2001/02 budget.

64. **However, the near-term outlook has become less favorable.** While inflation pressures have eased and the external position appears comfortable, growth has slowed recently and appears likely to remain somewhat disappointing in the coming year. Although the global slowdown is expected to weigh on activity in the period ahead, there also are worrying signs that domestic structural constraints and the fiscal situation have adversely affected investment and the economy's underlying potential.

65. **Reversing the recent decline in growth and sustaining rapid progress toward poverty alleviation will require determined implementation of the authorities' policy agenda**. The fiscal situation continues to be worrisome, and ambitious fiscal consolidation is still needed to crowd in private investment and allow resources to be redirected from servicing public debt toward development and social programs. Far-reaching structural reform also remains to be introduced that would reduce subsidies and allow private sector activity to fill the gap left by fiscal consolidation. To be sure, the macroeconomic environment for taking these steps may be difficult. However, delaying action would risk a further erosion of growth and could undermine the present social consensus for reform.

66. **Although the 2001/02 budget contained impressive commitments to structural reform, the overall public sector deficit appears likely to remain very high**. The slowdown in economic activity will make it difficult to achieve the central government's revenue targets, and pressures on the expenditure side may also arise, including those related to bank restructuring and civil service reform. The states' fiscal situation also remains dire, especially given the reconstruction costs in Gujarat and the difficulties in the power sector. As a result, the overall public sector deficit in 2001/02 could remain well above 10 percent of GDP, with the debt ratio rising to over 85 percent.

67. **It remains critically important, therefore, to place the fiscal situation on a sustainable path**. The proposed FRBM legislation has set the welcome medium-term objective of lowering the overall deficit to 2 percent of GDP. If matched by a similar adjustment at the state level, this would mean a reduction in the overall public sector deficit to around 5-6 percent of GDP, taking it to levels not seen in decades and helping to reverse the sharp increase in the debt ratio and the associated interest burden. Achievement of these targets will require several supporting elements:

- **Improved fiscal discipline and transparency will be essential for ensuring year-to-year adherence to the FRBM's fiscal targets**. As was stressed in the recent Fiscal ROSC, there is considerable scope for improving the budget framework, and the improvements in accounting rules and the rolling three-year budgets that are required under the FRBM should be implemented as soon as possible. Clarification of long-term targets, flexibility provisions, and enforcement mechanisms will also help ensure the legislation's credibility and durability.

- **Fiscal reform at the state level will also need to be promoted actively**. Funding through the fiscal reform facility should be coupled with a hardening of state budget constraints—including by adjusting the limits on market borrowing for unbudgeted inflows from provident and small saving schemes, by increasing the share of state borrowing from the market, and by promoting fiscal responsibility legislation at the state level.

- **The 2001/02 budget took welcome steps toward expenditure rationalization, but considerable scope for further measures remains**. In this regard, the Expenditure Reforms Commission and the EAC have provided useful suggestions for cutting fiscal subsidies, including those for food, fertilizer, power, water, kerosene, and railway fares, for improving the delivery and targeting of poverty reduction programs, for downsizing government, and for increasing the efficiency of plan spending.

- **Revenue reform that achieves a significant boost to the revenue ratio will also be critical, especially in view of the commitment to lower peak customs tariff rates**. The emphasis must remain on eliminating exemptions on income and excises taxes, but services and agricultural sectors—which make up almost 80 percent of GDP—also remain lightly taxed. It will be important to ensure that tax administrations at the state level are strong enough to ensure that the planned VATs do not result in revenue losses.

68. **The recent easing by the Reserve Bank of India appears appropriate, given signs that underlying inflation pressures remain moderate**. Moreover, with the further reduction in international interest rates and signs that domestic demand remains weak, there may be further room for ease. However, the large public sector borrowing requirement narrows the scope for reducing interest rates without undermining the credibility of the authorities' commitment to price stability. Against this background, the suggestion of the advisory group on monetary policy transparency to establish a more explicit medium-term inflation objective has considerable merit.

69. **Exchange rate flexibility will be particularly important in the period ahead.** Although the rupee appears broadly in line with macroeconomic fundamentals, the real effective exchange rate will need to be allowed to respond, if necessary, to the effects of capital account and trade liberalization, domestic deregulation, proposed fiscal consolidation, and a more difficult external environment. Against this background, the rupee's day-to-day stability against the dollar—which partly reflects the periodic use of administrative measures—risks retarding market development and complicating the adjustment to shifts in underlying economic forces.

70. **Recent developments have illustrated the importance of determined and consistent progress in the area of financial sector reform**. While the authorities responded effectively to the recent stock market scandal, the incident exposed significant weaknesses in supervisory and regulatory systems, and it will be important to strengthen payments and settlement systems and improve governance. Improvements in the efficiency of the financial system also are needed to support India's broader development needs, and the authorities are strongly encouraged to carry forward plans to reduce government ownership in the banking sector and to further strengthen mechanisms for debt recovery.

71. **Implementation of the reform agenda laid out by the EAC is essential for successful fiscal consolidation and for promoting growth and poverty reduction**. Power sector reform is a particular priority, given the sector's important macroeconomic and fiscal implications, and will need to include tariff increases for agricultural consumers and measures to reduce theft and other distribution losses. In the industrial sector, reform of bankruptcy legislation, reducing preferences for small-scale producers, privatization of government enterprises, and liberalization of labor laws are needed to improve productivity

and competitiveness. In the agricultural sector, difficult measures also remain to be implemented including those that would ease restriction on the trade and movement of agricultural commodities, sharply reduce the role of government procurement agencies, and improve cost recovery. The authorities' emphasis on establishing social safety nets to ease the adjustment to reform is appropriate, but care will be needed to ensure that these do not undermine efficiency or impose fiscal costs.

72. **The government's emphasis on reforming and extending the old-age security system is welcome.** However, to the extent that new schemes are administered by the financial system, any subsidies involved should be transparently borne by the budget. Reforms of existing provident schemes also are needed to ensure that their long-term liabilities are funded, to reduce the generosity of tax preferences provided to depositors, and to allow for returns to reflect market forces.

73. **Encouraging steps have been taken toward capital account and trade liberalization during the past year.** Looking ahead, it will be important to carry forward the commitment to reducing customs duties in a timely manner, while ensuring that the potential gains from trade liberalization are not undermined by the overuse of antidumping or other measures, such as tariff peaks. The recent withdrawal of the surcharge on import financing—which had been in contravention of Article VIII—is welcome, and the authorities are encouraged to eliminate remaining payments restrictions as soon as possible.

74. **India has actively participated in the international effort to promote standards and codes.** At the same time, however, India's macroeconomic and fiscal data continue to suffer from significant weaknesses that undermine economic analysis and policy making. It will be important to continue to address these shortcomings in the period ahead.

75. **It is proposed that the next Article IV consultation with India take place on the standard 12-month cycle.**

Table 1. India: Social and Demographic Indicators

	Units	India		Comparator groups		
		15-20 years ago	Most recent estimate	South Asia	Low-income countries	Lower-middle-income countries
General						
Land area	000 km^2	3,287	3,287	4,781	41,383	36,096
Arable land	Percent of land area	54.8	54.7	42.4	12.4	9.2
GNP per capita	U.S. dollars	270	440	430	520	1740
Population characteristics						
Population	Millions	703	991	1,305	3,536	887
Population density	Per km^2	214	301	273	85	25
Population growth rate 1/	Percent per annum	2.1	1.3	1.5	1.3	0.9
Life expectancy at birth	Years	55	63	62	63	68
Age dependency ratio 2/	Percent	71	60	70	60	60
Urban population	Percent	24	28	28	30	58
Labor force						
Labor force participation rate 3/	Percent	43	43	44	50	44
Females in labor force	Percent	33	32	33	41	40
Labor force growth 1/	Percent per annum	2.1	2.0	2.1	1.6	1.6
Health and nutrition						
Physicians	Per thousand people	0.4	0.4	0.4	1.0	2.0
Hospital beds	Per thousand people	0.8	0.8	0.7	1.8	5.1
Immunisation from measles	Percent of children under 12 months	16	81	81	80	89
Safe water	Percent of population with access	54	85	81	69	78
Total fertility rate	Births per woman	4.8	3.2	3.4	3.1	2.5
Infant mortality rate	Per thousand live births	108	70	75	68	35
Education						
Male literacy	Percent of male population 4/	45	67 5/	51	54	84
Female literacy	Percent of female population 4/	29	41 5/	37	42	78
Primary school enrollment	Percent of school-age population	65	92 5/	77	86	94

Source: *World Bank, World Development Indicators.*

1/ For the most recent estimate for India and comparator groups, figures are the estimated average annual growth rates for 1998-2010.
2/ Ratio of dependents (total number of individuals aged less than 15 years and greater than 64 years) to working age population (number of individuals aged between 15 and 64 years).
3/ Total labor force as a percentage of population.
4/ Fifteen years or older.
5/ Data from *Selected Educational Statistics, 1997-98* (Government of India, Dept. of Education).

Table 2. India: Summary Indicators 1/

Nominal GDP (1999/00): US$452 billion
Population (1999/00): 991 million
GDP per capita (1999/00): US$455.8
Quota: SDR 4,158.2 million

	1998/99	1999/00	Est. 2000/01	Proj. 2001/02	2000 Dec.	2001 Jan.	Feb.	Mar.	Apr. 2/
Growth (percent change)									
Real GDP (at factor cost)	6.6	6.4	5.8	5.9	...	...	...	...	...
Real GDP (at factor cost, calendar year basis)	6.5	6.1	6.2	5.6	...	...	...	...	...
Industrial production 3/	4.1	6.6	5.0	...	5.8	5.6	5.3	5.0	...
Prices (percent change, period average)									
Wholesale prices (1993/94 weights)	6.0	3.4	7.1	5.5	8.6	8.6	7.5	5.5	5.5
Consumer prices	13.1	3.4	3.9	4.4	3.5	3.2	3.0	2.5	...
Saving and investment (percent of GDP)									
Gross domestic saving	22.0	22.3	22.9	22.7	...	...	...	...	...
Gross investment 4/	23.0	23.3	24.0	23.8	...	...	...	...	...
Fiscal position (percent of GDP)									
Central government deficit 5/	5.4	5.4	5.3	5.6	...	...	...	...	...
Consolidated public sector deficit	9.6	11.2	10.4	10.9	...	...	...	...	...
Consolidated public sector debt	76.7	80.0	83.5	85.5	...	...	...	...	...
Money and credit (percent change, end-period)									
Broad money	19.2	13.6	16.2	...	15.6	16.1	15.4	16.2	17.3
Credit to commercial sector	14.2	16.4	16.0	...	17.9	18.6	16.0	16.0	16.2
Financial indicators (percent, end-period)									
91-day Treasury bill yield	8.8	9.2	9.2	...	8.8	8.9	8.4	9.2	7.9
10-year government bond yield	12.0	10.7	10.4	...	10.9	10.5	10.3	10.4	10.2
Stock market (percent change, end-period) 6/	-3.9	33.7	-27.9	...	0.7	10.1	-4.8	-12.6	-1.3
External trade (percent change) 3/ 7/									
Exports (in U.S. dollar terms)	-3.9	11.6	17.9	10.0	19.1	19.6	18.8	...	...
Imports (in U.S. dollar terms)	-7.1	16.5	13.9	10.4	10.2	9.2	7.5	...	...
Balance of payments (US$ bn.) 8/									
Current account balance	-4.0	-4.2	-5.2	-6.0	-0.5	...	...	...	...
(in percent of GDP)	-1.0	-0.9	-1.1	-1.2	-0.4	...	...	...	...
(in percent of GDP, calendar year basis)	-1.7	-0.6	-1.1	-1.2	-0.4	...	...	...	...
Foreign direct investment	2.4	2.1	2.1	2.5	0.5	...	...	...	...
Net portfolio investment (equity and debt)	-0.1	3.0	2.4	2.8	-0.4	-0.5	-0.1	0.3	0.7
Overall balance	4.2	6.4	5.9	4.6	4.2	...	...	...	...
External indicators									
Gross reserves (US$ bn. end-period)	32.5	38.0	42.3	46.8	40.0	40.9	41.8	42.3	42.7
(in months of imports) 9/	5.8	5.9	5.9	6.0	5.8	5.8	5.9	5.9	6.0
Net of forward liabilities (US$ bn. end-period)	31.7	37.4	...	...	38.4	...	...	...	...
External debt (percent of GDP, end-period)	23.4	21.8	22.2	21.4	...	...	...	...	...
Of which: short-term debt 10/	2.7	2.2	2.3	2.2	...	...	...	...	...
Ratio of gross reserves to short-term debt (end-period	2.9	3.8	3.9	4.1	...	...	...	...	...
Gross reserves to broad money (percent; end-period)	14.1	14.9	15.3	...	14.9	15.1	15.3	15.3	...
Debt service ratio 11/	19.3	17.8	14.5	13.4	...	...	...	...	...
Real effective exchange rate (y/y percent change, period average)	-6.2	1.1	6.2	...	6.5	5.9	4.8	3.9	...
Exchange rate (rupee/US$, end-period)	42.4	43.6	46.6	...	46.7	46.5	46.6	46.6	46.8

Sources: Data provided by the Indian authorities; and staff estimates and projections for the Spring 2001 WEO.

1/ Data are for April-March fiscal years.
2/ Latest available figures.
3/ Monthly figures are year-to-date changes.
4/ Statiscal discrepancy adjusted.
5/ Onlending of small savings collections to state governments excluded from expenditures and net lending; divestment proceeds treated as below-line financing.
6/ Monthly figures are month-on-month changes.
7/ Monthly data are on a customs basis; annual data are on a bop basis.
8/ Figures for December 2000 are for Q4 2000; net portfolio investment figures for January-April 2001 are monthly estimates.
9/ Imports of goods and services projected over the following twelve months.
10/ Residual maturity basis, except contracted maturity basis for medium and long-term non-resident Indian accounts.
11/ Percent of current account receipts excluding grants.

Table 3. India: Balance of Payments 1998/99-2002/03 1/

(In billions of U.S. dollars)

	1998/99	1999/00	2000/01 Proj	2001/02 Proj	2002/03 Proj	1999/00 Q3	1999/00 Q4	2000/01 Q1	2000/01 Q2	2000/01 Q3
Current account balance	-4.0	-4.2	-5.2	-6.0	-7.4	-0.2	-1.1	-2.1	-1.4	-0.5
Trade balance	-13.2	-17.1	-17.9	-20.0	-21.9	-3.8	-5.7	-4.7	-4.5	-4.0
Exports, f.o.b.	34.3	38.3	45.1	49.7	54.8	10.2	10.3	10.4	11.3	11.2
Imports, c.i.f.	47.5	55.4	63.1	69.6	76.7	14.0	16.0	15.1	15.8	15.1
Oil	6.4	10.5	16.4	15.8	15.2	2.7	3.0	4.0	4.4	4.1
Non-oil	41.2	44.9	46.7	53.9	61.6	11.2	13.1	11.2	11.5	11.0
Customs	36.0	36.5	41.7	48.9	56.6	9.3	9.0	8.7	8.5	8.4
Noncustoms	5.1	8.4	5.0	5.0	5.0	2.0	4.0	2.4	2.9	2.6
Nonfactor services balance	2.2	3.9	3.3	4.2	4.3	1.1	2.2	0.4	0.6	1.0
Receipts	13.2	15.7	18.1	19.9	22.0	4.0	5.2	3.3	4.4	5.6
Travel	3.0	3.0	...	...	...	0.8	0.9	0.7	0.7	0.9
Transportation	1.9	1.7	...	...	...	0.4	0.5	0.4	0.5	0.5
Insurance	0.2	0.2	...	...	...	0.1	0.1	0.1	0.1	0.1
Government nie	0.6	0.6	...	...	...	0.2	0.2	0.1	0.2	0.2
Miscellaneous	7.4	10.1	...	...	...	2.5	3.6	2.0	2.9	3.9
Payments	11.0	11.9	14.8	15.7	17.7	2.9	3.0	2.9	3.8	4.6
Travel	1.7	2.1	...	...	...	0.5	0.5	0.7	0.6	0.7
Transportation	2.7	2.4	...	...	...	0.6	0.5	0.9	0.8	0.8
Insurance	0.1	0.1	...	...	...	0.0	0.0	0.0	0.0	0.0
Government nie	0.3	0.3	...	...	...	0.1	0.1	0.1	0.1	0.1
Miscellaneous	6.2	6.9	...	...	...	1.6	1.8	1.2	2.3	3.0
Net investment income	-3.5	-3.6	-3.8	-3.9	-4.1	-0.8	-0.9	-1.2	-0.9	-0.7
Credits	1.9	1.9	2.6	2.1	2.3	0.5	0.5	0.5	0.6	0.6
Debits	5.5	5.5	6.4	6.0	6.4	1.3	1.5	1.7	1.5	1.3
Transfers, net	10.6	12.6	13.2	13.7	14.4	3.3	3.4	3.4	3.4	3.2
Capital account balance	8.6	10.2	11.4	10.6	11.1	1.9	4.0	1.3	1.2	4.1
Direct investment, net	2.4	2.1	2.1	2.5	3.0	0.4	0.6	0.6	0.5	0.5
Portfolio investment, net	-0.1	3.0	2.4	2.8	3.1	0.3	1.3	0.6	0.1	-0.4
Of which: FIIs and others	-0.4	2.2	1.9	2.2	2.3	0.2	0.9	0.2	-0.2	-0.4
GDR/ADR issues	n.a.	1.2	0.5	0.6	0.8	0.3	0.4	0.4	0.3	...
External assistance, net	0.8	0.9	0.4	1.2	-0.1	0.4	0.4	-0.4	0.0	0.3
Commercial borrowing, net	4.4	0.3	4.4	2.9	3.8	-0.1	0.4	-0.4	-0.2	5.1
Short-term credit, net	-0.7	0.4	1.0	0.0	0.0	0.0	0.1	0.4	0.6	-0.5
NRI deposits, net	1.7	2.1	1.6	2.0	2.0	0.6	0.7	0.8	0.6	-0.4
Rupee debt	-0.8	-0.7	-0.7	-0.7	-0.7	0.0	-0.1	-0.5	0.0	0.0
Other capital	0.9	2.1	0.2	0.0	0.0	0.4	0.6	0.1	-0.3	-0.6
Errors and omissions	-0.3	0.3	-0.3	0.0	0.0	0.4	0.3	-0.2	-0.2	0.6
Overall balance	4.2	6.4	5.9	4.6	3.7	2.1	3.3	-1.0	-0.4	4.2
IMF, net	-0.4	-0.3	0.0	0.0	0.0	-0.1	0.0	0.0	...	...
Increase in gross reserves (-)	-3.8	-6.1	-5.8	-4.6	-3.7	-2.0	-3.3	1.0	0.4	-4.2
Memorandum items:										
Foreign exchange reserves	32.5	38.0	42.3	46.8	50.5	34.9	38.0	36.7	35.4	40.0
In months of next year's imports (g & s)	5.8	5.9	5.9	6.0	42.2	5.6	5.9	5.5	5.2	5.8
Export value (in US$ terms; percent change)	-3.9	11.6	17.9	10.0	10.4	23.5	7.9	27.6	17.4	9.9
Import value (in US$ terms; percent change)	-7.1	16.5	13.9	10.4	10.2	19.8	43.1	23.0	21.3	8.3
Exports (in volume terms; percent change)	-0.3	12.8	16.1	9.7	8.8	...	...	...	...	...
Imports (in volume terms; percent change)	-2.4	10.8	8.0	10.7	9.6	...	...	...	...	...
Current account (percent of GDP) 2/	-1.0	-0.9	-1.1	-1.2	-1.3	-0.2	-0.8	-1.8	-1.4	-0.4
External debt (percent of GDP)	23.4	21.8	22.2	21.4	20.7	...	...	...	...	...
Short-term external debt (percent of GDP)	2.7	2.2	2.3	2.2	2.2	...	...	...	...	...
Debt service in percent of exports (g & s)	19.3	17.8	14.5	13.4	13.2	...	...	...	...	...

Sources: Data provided by CEIC and staff estimates.

1/ Indian authorities' presentation. Fiscal year runs from April 1-March 31.

2/ For quarterly data, GDP at market prices is estimated from quarterly GDP at factor costs.

Table 4. India: Central Government Operations, 1996/97-2001/02

	1996/97	1997/98	1998/99	1999/00	Budget 2000/01	Rev. Est. 2000/01	Budget 2001/02	Proj. 2001/02
				(In billions of rupees)				
Total revenue and grants	1,317.7	1,406.5	1,576.8	1,905.1	2,134.0	2,187.9	2,460.0	2,388.3
Net tax revenue	937.0	956.7	1,046.5	1,282.7	1,462.1	1,459.0	1,650.3	1,578.6
Gross tax revenue	1,287.6	1,392.2	1,438.0	1,717.5	2,002.9	1,983.2	2,266.5	2,167.9
Less: States' share	350.6	435.5	391.5	434.8	540.8	524.2	616.2	589.4
Nontax revenue	368.7	439.6	520.4	611.3	664.6	721.6	802.7	802.7
Grants	11.9	10.2	9.9	11.1	7.3	7.3	7.0	7.0
Total expenditure and net lending	1,989.5	2,304.8	2,769.0	3,238.8	3,666.8	3,650.6	4,103.2	4,103.2
Current expenditure	1,644.2	1,870.8	2,246.5	2,581.0	2,908.3	2,961.6	3,248.2	3,248.2
Of which: Major subsidies	140.4	182.4	212.4	233.9	214.9	259.3	278.5	278.5
Interest payments	594.8	656.4	778.8	902.5	1,012.7	1,006.7	1,123.0	1,123.0
Wages and salaries	190.5	259.3	289.0	315.0	328.4	290.8	307.3	307.3
Capital expenditure and net lending 1/	238.6	276.7	284.6	388.4	438.5	371.0	494.9	494.9
Overall balance	-565.2	-741.0	-954.3	-1,064.4	-1,212.7	-1,144.7	-1,283.1	-1,354.9
Financing	565.2	741.0	954.3	1,064.4	1,212.7	1,144.7	1,283.1	1,354.9
External (net)	29.9	10.9	19.2	11.8	-0.4	5.7	18.7	64.7
Domestic (net)	535.3	730.1	935.1	1,052.6	1,213.2	1,139.0	1,264.5	1,290.2
Of which: Divestment receipts	3.8	9.1	58.7	17.2	100.0	25.0	120.0	120.0
				(In percent of GDP)				
Total revenue and grants	9.6	9.2	9.0	9.7	9.9	10.1	9.9	9.9
Total expenditure and net lending	14.5	15.1	15.7	16.6	16.9	16.9	16.6	17.1
Current expenditure	12.0	12.3	12.8	13.2	13.4	13.7	13.1	13.5
Of which: Major subsidies	1.0	1.2	1.2	1.2	1.0	1.2	1.1	1.2
Wages and salaries	1.4	1.7	1.6	1.6	1.5	1.3	1.2	1.3
Interest payments	4.3	4.3	4.4	4.6	4.7	4.7	4.5	4.7
Capital expenditure and net lending 1/	1.7	1.8	1.6	2.0	2.0	1.7	2.0	2.1
Overall balance	-4.1	-4.9	-5.4	-5.4	-5.6	-5.3	-5.2	-5.6
Memorandum items								
Military expenditure	2.2	2.3	2.3	2.4	2.7	2.5	2.5	2.6
Primary balance	0.2	-0.6	-1.0	-0.8	-0.9	-0.6	-0.6	-1.0
Revenue balance 2/	-2.4	-3.1	-3.8	-3.5	-3.6	-3.6	-3.2	-3.6
Overall balance (authorities' definition) 3/	-4.9	-5.8	-6.4	-5.4	-5.1	-5.2	-4.7	-5.1
Consolidated public sector balance 4/	-8.7	-8.5	-9.6	-11.2	-10.6	-10.4	-10.2	-10.9
Central government	-4.1	-4.9	-5.4	-5.4	-5.6	-5.3	-5.2	-5.6
OCC	-0.7	0.1	0.6	-0.1	0.0	-0.3	0.0	0.0
States and Union Territories	-2.7	-2.9	-4.3	-4.8	-4.2	-4.3	-4.2	-4.4
Central Public Enterprises	-2.1	-1.8	-1.4	-1.8	-1.7	-1.4	-1.6	-1.7
Consolidation items 5/	1.0	0.9	0.8	1.0	0.9	0.9	0.8	0.8
Consolidated public sector debt 6/	75.4	76.8	76.7	80.0	...	83.5	...	85.5
Nominal GDP (Rs billion)	13,679	15,223	17,583	19,570	21,649	21,605	24,748	24,030

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

1/ Excludes onlending to the states from Small Savings collections in all years. (This represents a change in accounting treatment relative to the last consultation cycle; see footnote 3/ below.)

2/ Total receipts (excluding divestment proceeds) less non-capital expenditures.

3/ Authorities' definition includes divestment receipts in revenues, rather than in domestic financing; onlending to states from the Small Savings collections is included in capital expenditure and net lending through 1998/99, and excluded thereafter.

4/ The consolidated public sector comprises the central government, OCC, state governments, and central public enterprises. State government figures for 2000/01 Rev. Est. and 2001/02, and OCC figures for 2001/02 are staff estimates.

5/ Above-the-line items in central government accounts that cancel out in the consolidation (e.g., loans to states).

6/ Staff estimates and projections.

Table 5. India: Forecast Summary 1/

					Est.	Projections			
	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05
Growth (percent change)									
Real GDP (at factor cost)	7.8	4.8	6.6	6.4	5.8	5.9	6.1	6.3	6.4
Real GDP (at factor cost, on calendar year basis)	7.7	5.5	6.5	6.1	6.2	5.6	6.1	6.2	6.4
Prices (percent change, period average)									
Wholesale prices (1993/94 weights)	4.7	4.3	6.0	3.4	7.1	5.5	5.5	5.5	5.5
Consumer prices	9.4	6.8	13.1	3.4	3.9	4.4	6.0	6.0	6.0
Saving and investment (percent of GDP)									
Gross domestic saving	23.2	24.6	22.0	22.3	22.9	22.7	22.7	22.9	22.7
Gross investment 2/	24.5	25.0	23.0	23.3	24.0	23.8	24.1	24.1	24.2
Fiscal position (percent of GDP)									
Central government deficit	4.1	4.9	5.4	5.4	5.3	5.6	5.3	5.0	4.7
Consolidated public sector deficit	8.7	8.5	9.6	11.2	10.4	10.9	10.5	10.1	9.7
Consolidated public sector debt	75.4	76.8	76.7	80.0	83.5	85.5	86.8	86.7	86.9
External trade (percent change)									
Exports (in U.S. dollar terms)	5.6	4.5	-3.9	11.6	17.9	10.0	10.4	10.4	10.2
Imports (in U.S. dollar terms)	12.1	4.6	-7.1	16.5	13.9	10.4	10.2	9.4	10.8
Balance of payments (US$ bn.)									
Current account balance	-4.5	-5.5	-4.0	-4.2	-5.2	-6.0	-7.4	-7.1	-10.1
(in percent of GDP)	-1.2	-1.3	-1.0	-0.9	-1.1	-1.2	-1.3	-1.2	-1.5
(in percent of GDP, calendar year basis)	-1.3	-0.7	-1.7	-0.6	-1.1	-1.2	-1.3	-1.2	-1.4
Foreign direct investment	2.7	3.5	2.4	2.1	2.1	2.5	3.0	3.8	4.5
Net portfolio investment (equity and debt)	3.3	1.8	-0.1	3.0	2.4	2.8	3.1	3.8	4.6
Overall balance	6.8	4.5	4.2	6.4	5.9	4.6	3.7	3.5	5.3
External indicators									
Gross reserves (US$ bn. end-period)	26.4	29.4	32.5	38.0	42.3	46.8	50.5	54.1	59.3
(in months of imports) 3/	5.3	6.0	5.8	5.9	5.9	6.0	5.9	5.7	5.6
External debt (percent of GDP, end-period)	24.3	22.8	23.4	21.8	22.2	21.4	20.7	19.5	18.9
Of which: short-term debt 4/	3.5	2.9	2.7	2.2	2.3	2.2	2.2	2.8	2.0
Ratio of gross reserves to short-term debt (end-period)	1.9	2.5	2.9	3.8	3.9	4.1	4.2	3.2	4.5
Debt service (percent of current acct. receipts)	22.2	19.3	19.3	17.8	14.5	13.4	13.2	15.2	10.6

Sources: Data provided by the Indian authorities; and staff estimates and projections for the Spring 2001 WEO.

1/ Data are for April-March fiscal years.
2/ Statiscal discrepancy adjusted.
3/ Imports of goods and services projected over the following twelve months.
4/ Residual maturity basis, except contracted maturity basis for medium and long-term non-resident Indian accounts.

Table 6. India: Indicators of External Vulnerability, 1991/92 - 2000/01 1/

	1991/92 1994/95 Average	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01 2/	
Financial indicators								
Public sector debt (percent of GDP)	87.5	78.8	75.4	76.8	76.7	80.0	83.5	(Estimate)
Broad money (percent change, 12-month basis)	18.9	13.7	15.2	18.0	19.2	13.6	16.2	
Private sector credit (percent change, 12-month basis)	15.6	17.7	9.2	15.1	14.2	16.4	16.0	
91 day T-bill yield (percent; end period)	10.0	13.0	8.0	7.4	8.8	9.2	9.2	
91 day T-bill yield (real, percent; end period) 3/	--	4.7	3.1	2.9	2.6	5.6	1.9	
External Indicators								
Exports (percent change, 12-month basis in US$) 4/ 5/	10.2	20.3	5.6	4.5	-3.9	11.6	18.8	(Feb-01)
Export volume (percent change, 12-month basis) 5/	8.2	12.8	9.2	11.2	-0.3	12.8	16.1	(Estimate)
Imports (percent change, 12-month basis in US$) 4/ 5/	8.8	21.6	12.1	4.6	-7.1	16.5	7.5	(Feb-01)
Import volume (percent change, 12-month basis) 5/	8.5	13.4	13.4	12.6	-2.4	10.8	8.0	(Estimate)
Terms of Trade (percent change, 12 month basis) 5/	1.5	-0.5	-2.1	1.3	1.4	-5.9	-3.8	(Estimate)
Current account balance (percent of GDP) 6/	-0.8	-1.7	-1.2	-1.3	-1.0	-0.9	-1.1	(Dec-00)
Capital and financial account balance (percent of GDP)	2.3	0.8	2.7	2.3	1.9	2.3	2.3	(Estimate)
Of which: Net portfolio investment (debt and equity)	0.6	0.8	0.9	0.4	-0.0	0.7	0.5	(Estimate)
Other investment (loans, trade credits etc.)	0.9	0.2	1.7	1.1	1.2	0.6	1.4	(Estimate)
Net foreign direct investment	0.2	0.5	0.7	0.9	0.6	0.5	0.4	(Estimate)
Foreign currency reserves (billions of US$)	15.9	21.7	26.4	29.4	32.5	38.0	42.3	
RBI forward liabilities (billions of US$)	--	-2.2	-0.3	-1.8	-0.8	-0.7	-1.4	(Feb-01)
Official reserves in months of imports (of goods and services)	4.8	4.7	5.3	6.0	5.8	5.9	5.9	(Estimate)
Ratio of foreign currency reserves to broad money (percent)	10.0	12.4	13.6	14.1	14.1	14.9	15.3	
Total short-term external debt to reserves (percent)	94.4	55.1	51.6	40.4	34.5	26.6	25.6	(Estimate)
Total external debt (percent of GDP)	32.0	26.4	24.3	22.8	23.4	21.8	22.2	(Estimate)
Of which: Public sector debt	22.1	17.8	15.5	14.3	14.5	13.3	13.0	(Estimate)
Total external debt to exports of goods and services (percent)	344.9	236.3	224.6	207.3	205.7	182.3	166.3	(Estimate)
External interest payments to exports of goods and services (percent)	14.9	9.9	9.7	9.8	9.9	9.1	8.5	(Estimate)
External amortization payments to exports of goods and services (percent)	18.9	22.0	19.8	15.3	14.3	13.3	9.5	(Estimate)
Exchange rate (per US$, period average)	28.4	33.5	35.5	37.2	42.1	43.3	46.6	
REER (change in percent; end period)	-6.3	-3.2	7.0	-1.6	-3.2	4.8	4.8	(Feb-01)
Financial Market Indicators								
Stock market index (end period)	--	3,367	3,361	3,893	3,740	5,001	3,604	
Foreign currency debt rating								
Moody's Investor Services:	--	Baa3	Baa3	Baa3	Ba2	Ba2	Ba2	
Standard and Poor's:	--	BB+	BB+	BB+	BB+	BB	BB	

Sources: Data provided by the Indian authorities; Information Notice System; and staff estimates and projections.

1/ April-March fiscal year.
2/ Latest date available or staff estimate, if noted.
3/ Nominal yield less actual WPI inflation.
4/ Latest data for 2000/01 are on a customs basis, whereas data for previous years are on a BOP basis.
5/ Merchandise trade only; volumes are derived from partner country trade price deflators from the WEO database.
6/ Latest estimate is the cumulative balance over the last four quarters.

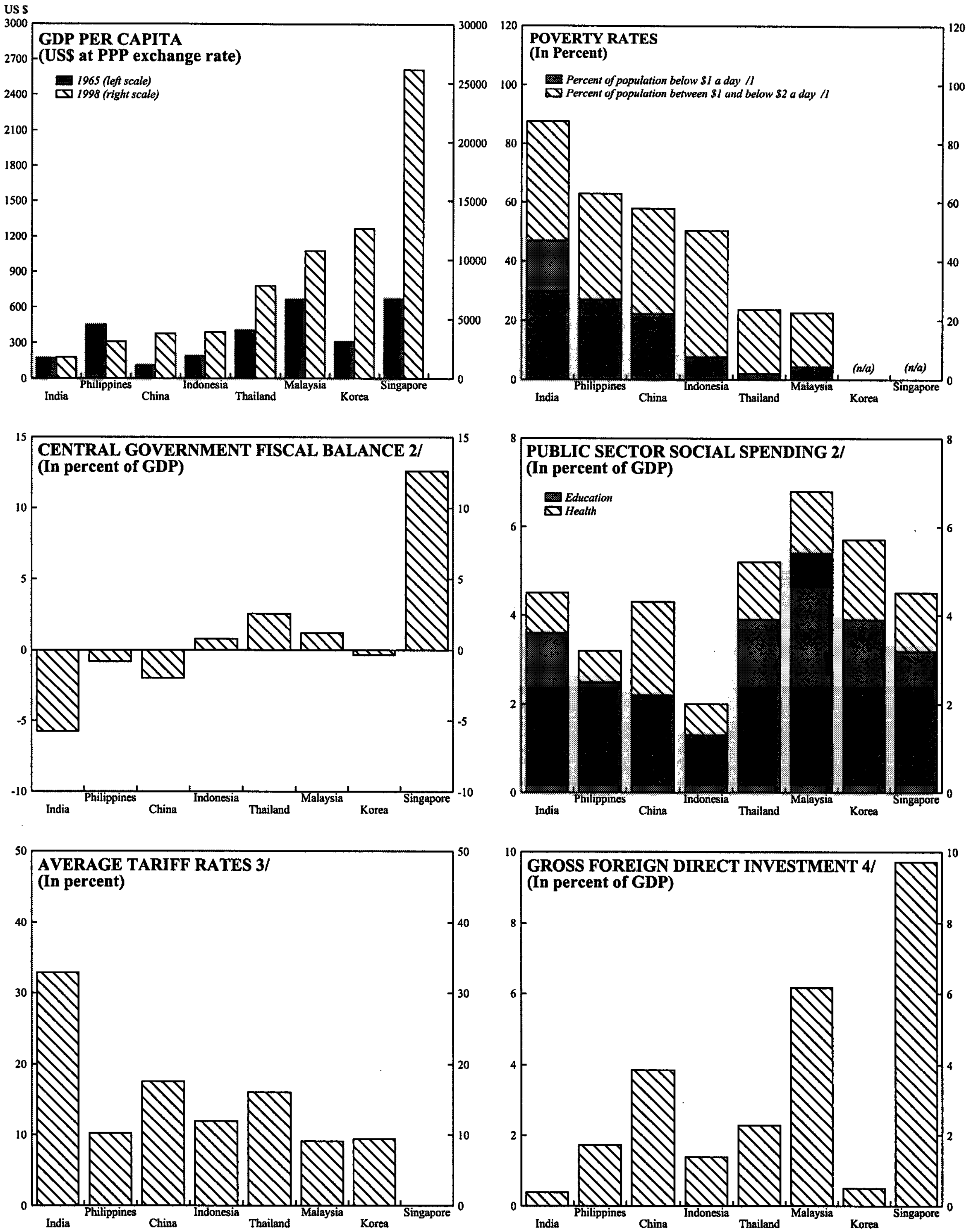
Table 7. India: Indicators of Financial System Soundness, 1995/96 - 1999/00

	1995/96	1996/97	1997/98	1998/99	1999/00
Measures of financial strength and performance 1/					
Risk-weighted capital ratio	...	10.4	11.6	11.2	11.1
Public sector banks	8.7	10.0	11.5	11.2	10.7
Old private sector banks	...	11.7	12.5	12.0	12.4
New private sector banks	...	15.3	13.2	11.8	13.4
Foreign banks	...	10.4	10.4	10.8	11.9
Number of institutions not meeting 9 percent RWCR					
Public sector banks	15	6	3	1	1
Old private sector banks	10	7	6	5	3
New private sector banks	0	0	0	1	0
Foreign banks	12	8	6	3	0
Net nonperforming loans (percent of outstanding loans) 2/					
Public sector banks	8.9	9.2	8.2	8.1	7.4
Old private sector banks	...	6.7	6.5	9.0	7.3
New private sector banks	...	2.0	2.6	4.5	2.9
Foreign banks	1.3	1.9	2.3	2.9	2.4
Number of institutions with net NPLs above 10 percent of advances					
Public sector banks	8	10	10	9	5
Old private sector banks	3	3	4	7	7
New private sector banks	0	0	0	0	0
Foreign banks	1	3	9	13	10
Net profit(+)/loss(-) of commercial banks (percent of total assets)	0.2	0.7	0.8	0.5	0.7
Public sector banks	-0.1	0.6	0.8	0.4	0.6
Old private sector banks	1.1	0.9	0.8	0.5	0.8
New private sector banks	1.9	1.7	1.6	1.0	1.0
Foreign banks	1.6	1.2	1.0	0.7	1.2
Balance sheet structure of commercial banks					
Loan/deposit ratio	59.1	54.6	50.3	47.9	49.3
External deposits (percent of total deposits) 3/	5.6	4.1	11.5	13.1	12.8
Of which: Foreign currency deposits (percent of total deposits)	...	...	5.0	6.4	6.2 4/
Foreign currency loans (percent of total) 5/	6.2	5.0	4.6	4.3	4.0
Real estate loans (percent of private credit)	0.5	0.6	0.6	0.5	0.4

Source: Data provided by the Indian authorities.

1/ Loan classification and provisioning standards do not meet international standards.
2/ Gross nonperforming loans less provisions.
3/ External deposits comprise foreign currency deposits and non-resident (external) rupee accounts (NRE accounts) which can be freely repatriated abroad. Several classes of deposit were reclassified as external in June 1997.
4/ As of August 1999
5/ Refers only to commercial bank purchase or discount of foreign bills. No other information is available.

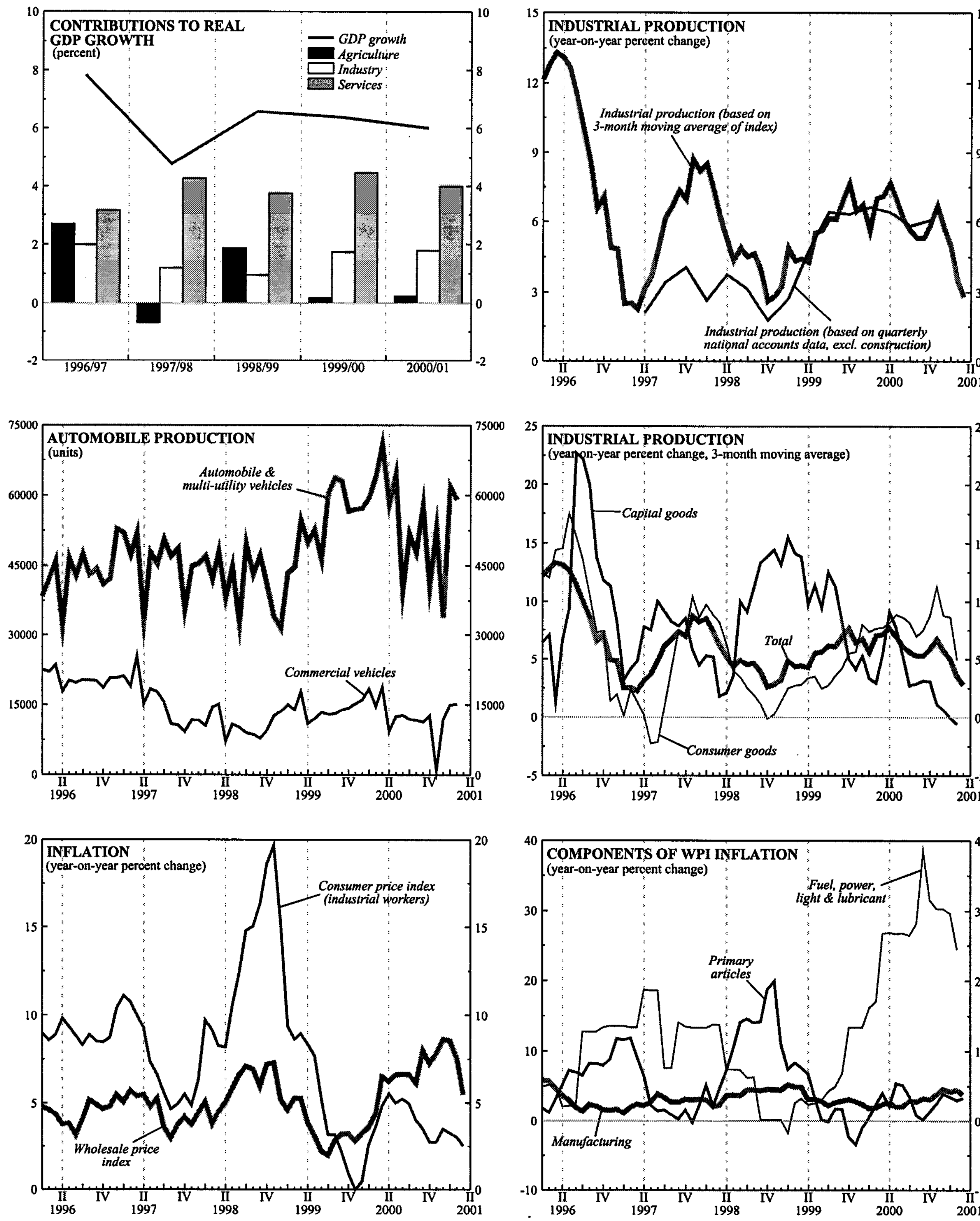
Chart 1. India: Comparative Indicators for Selected Asian Countries



Sources: IMF: World Economic Outlook, Government Finance Statistics and Balance of Payments databases; World Bank: World Development Indicators 2000.

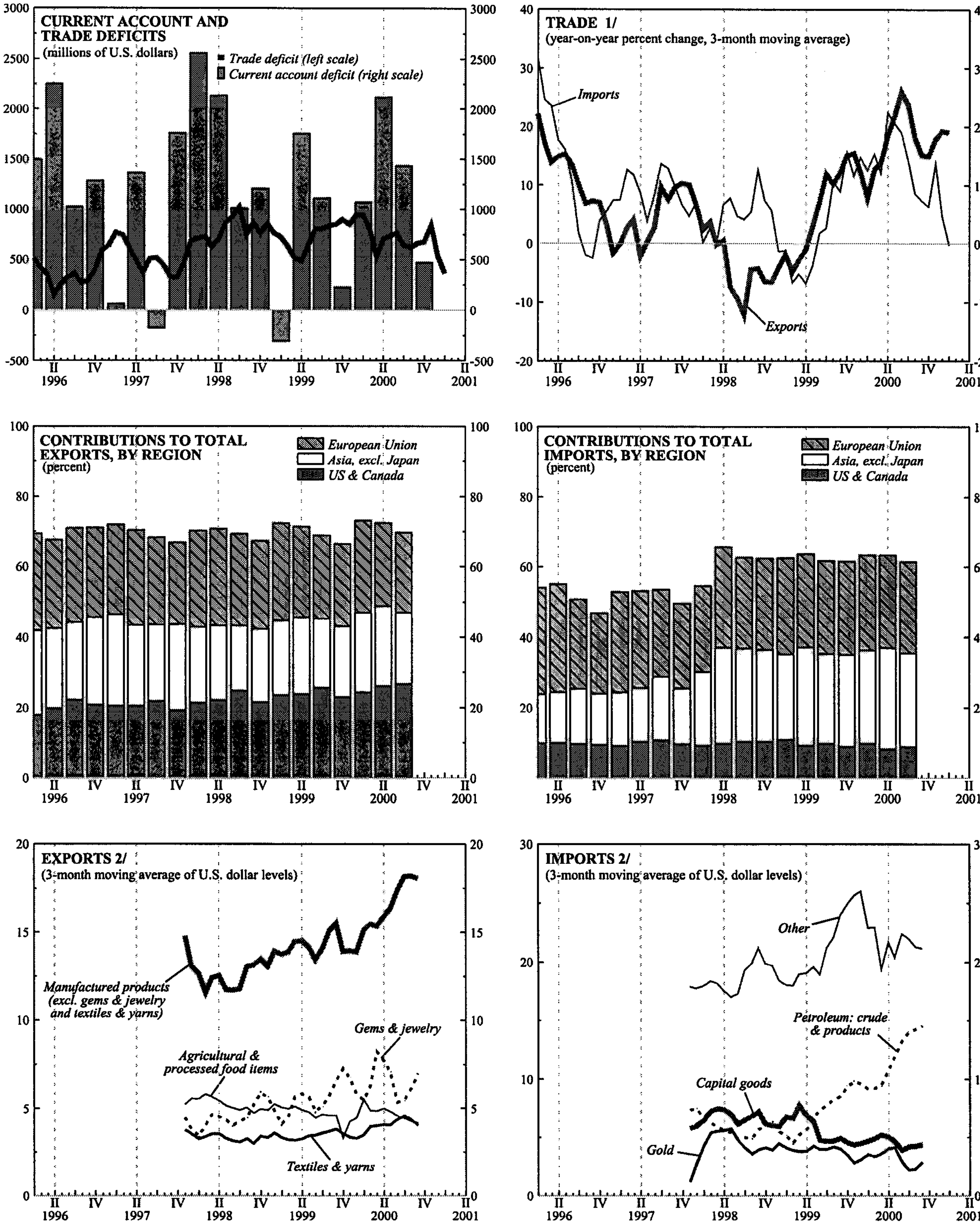
1/ In 1985 prices, coverted at PPP exchange rates.
2/ Average, 1990-96.
3/ 1999.
4/ Average, 1990-98.

Chart 2. India: Selected Indicators, 1996-2001



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

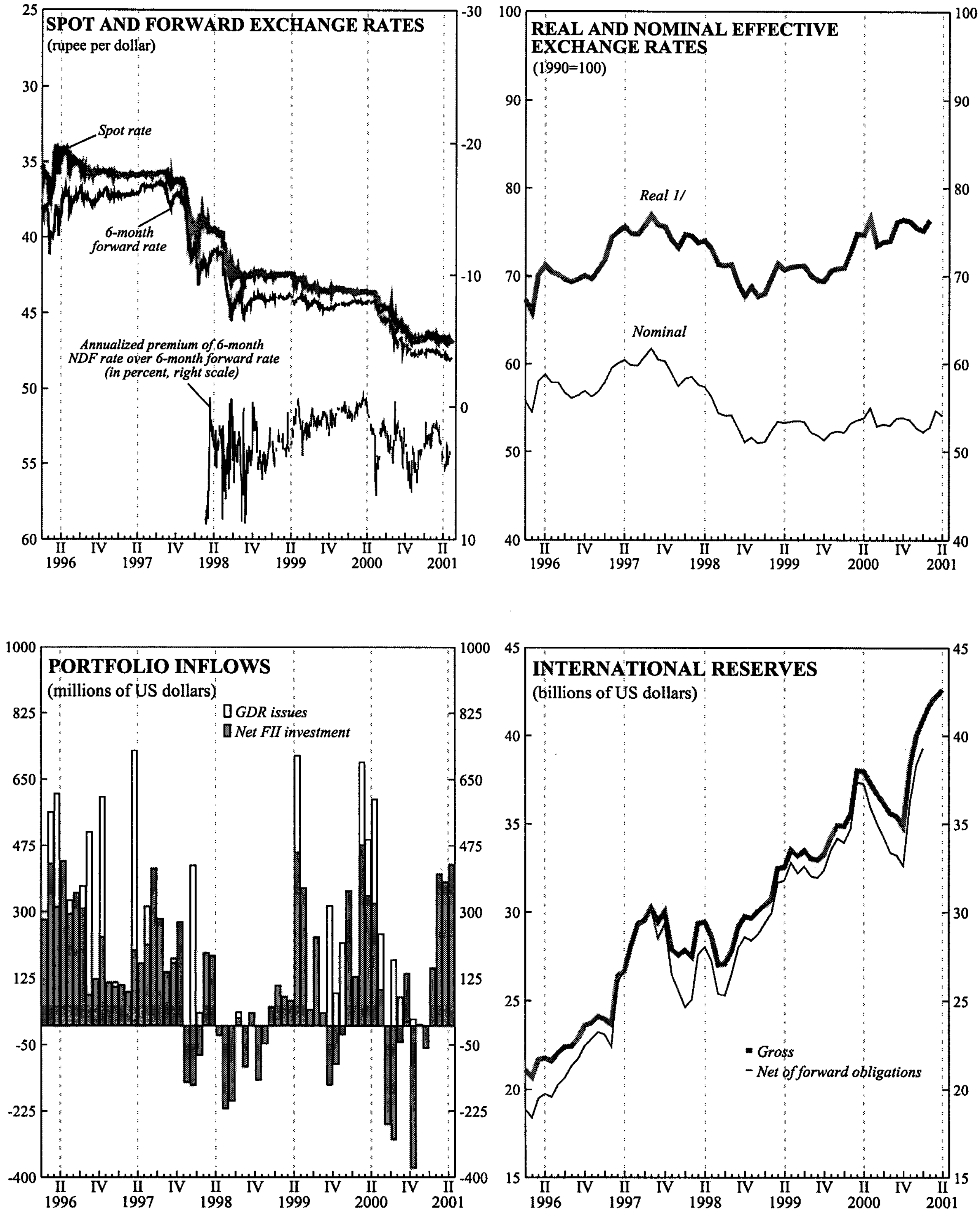
Chart 3. India: Selected Trade Indicators, 1996-2001



Sources: Data provided by the Indian authorities; IMF, Direction of Trade Statistics; and staff estimates.

1/ Customs data; based on U.S. dollar values.
2/ In billions of U.S. dollars.

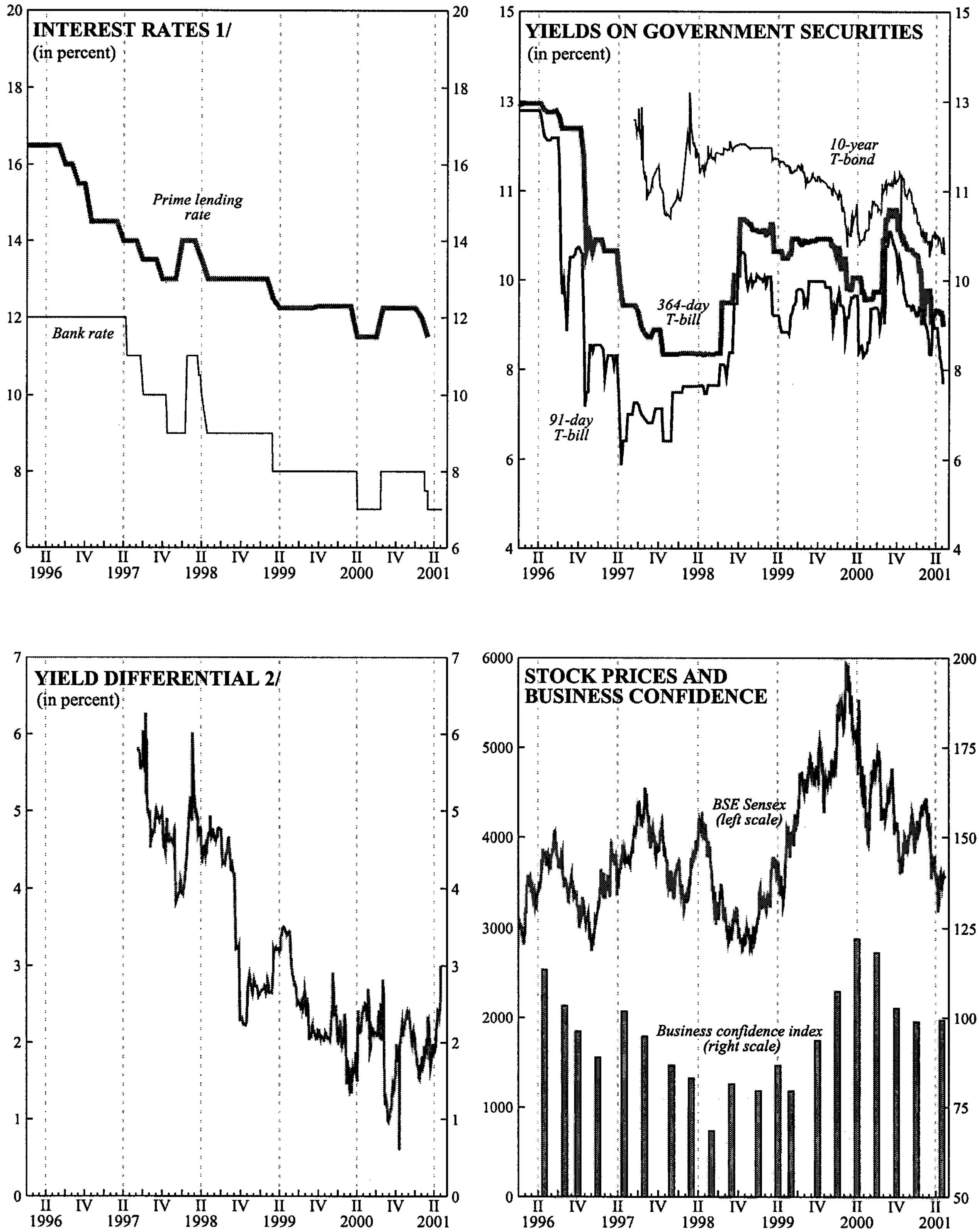
Chart 4. India: Selected External Indicators, 1996-2001



Sources: Data provided by the Indian authorities; IMF, Information Notice System; and WEFA.

1/ Index based on WPI for India and CPI data for partner countries.

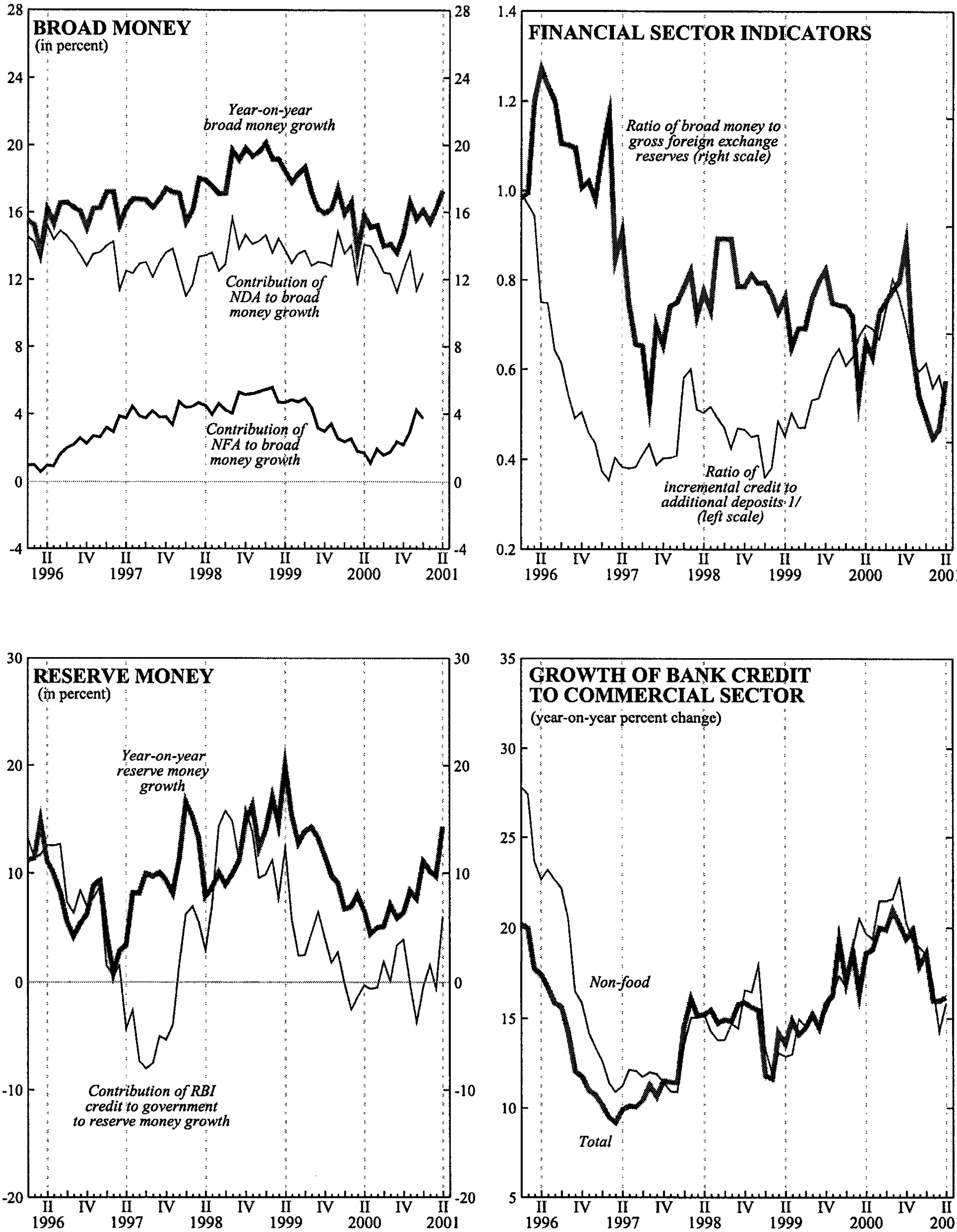
Chart 5. India: Financial Market Developments, 1996-2001



Sources: Data provided by the Indian authorities; and Reuters.

1/ Prime lending rate of the State Bank of India.
2/ Difference between 10-year bond yield and the 91-day Treasury Bill yield. Increases indicate a steeper yield curve.

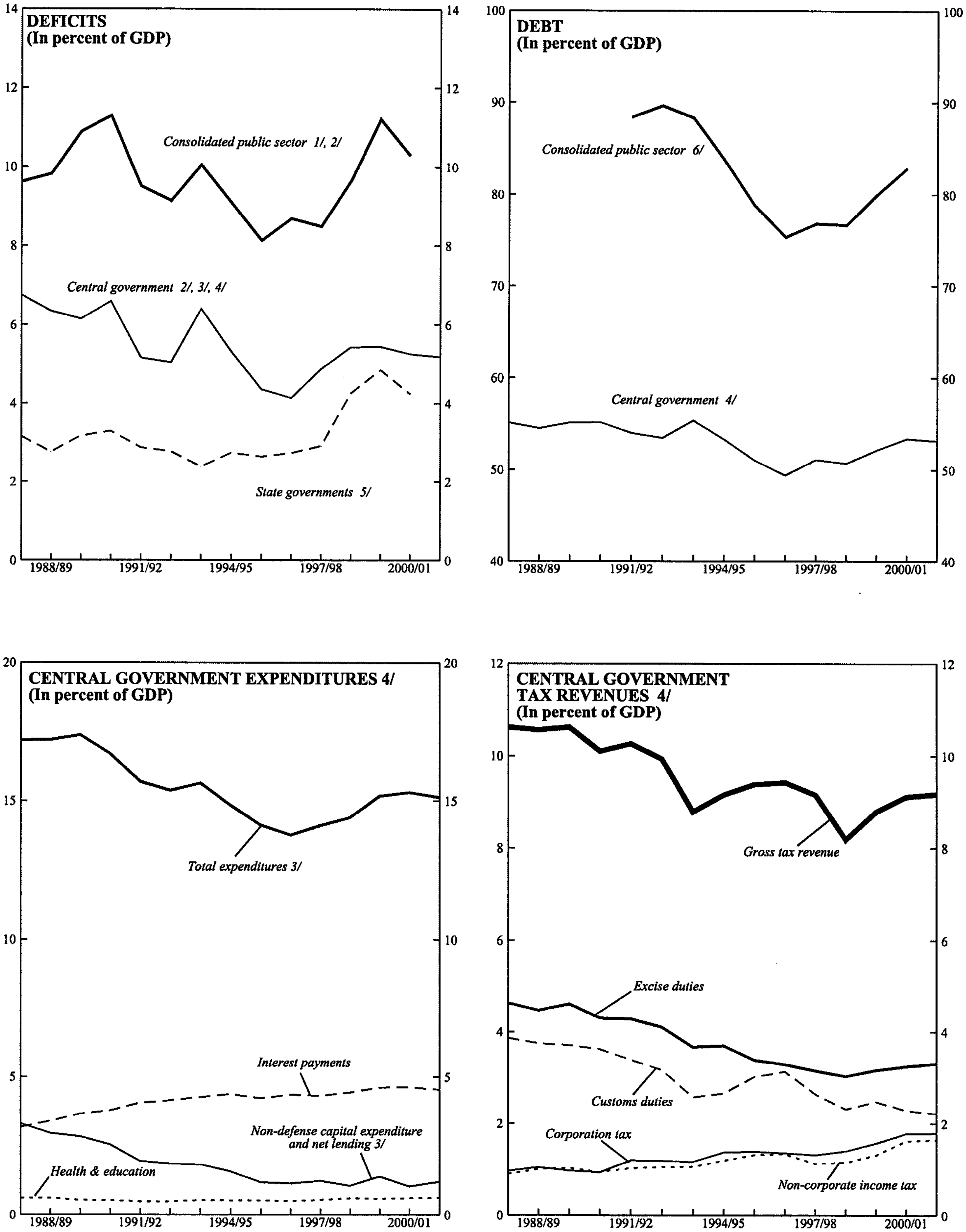
Chart 6. India: Selected Monetary Indicators, 1996-2001



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

1/ Twelve-month increase in credit to to the private sector as a ratio of the twelve-month increase in commercial bank deposits.

Chart 7. India: Fiscal Trends, 1987/88-2001/02



Sources: Reserve Bank of India, IMF: Government Finance Statistics, and staff estimates.

1/ 2000/01 and 2001/02 figures are staff estimates.
2/ Divestment proceeds are excluded from revenues.
3/ Small savings onlending is excluded from expenditures.
4/ 2000/01 figure is a revised estimate; 2001/02 figure is a budget estimate.
5/ 2000/01 figure is budget estimate.
6/ Staff estimates.

India: Medium-Term Macroeconomic Outlook and Risks

Recent indicators point to a modest deceleration of the economy in the second half of 2000/01. Slower growth is projected to continue into 2001/02, before rebounding towards potential over the medium term. Staff projections of key indicators are provided below:

- **Growth:** Real GDP growth is projected to increase only modestly from 5¾ percent from 2000/01 to just under 6 percent in 2001/02. Although agriculture production is projected to rebound, on the assumption that drought conditions abate, industrial production is projected to remain sluggish, as domestic remains weak and external demand slows. Over the medium term, GDP growth would gradually return to its potential rate of 6¼-6½ percent, as the aforementioned demand and supply constraints ease.

- **Inflation:** WPI inflation averaged about 7 percent in 2000/01, reflecting increased energy prices. With the pass-through to other domestic prices (including consumer prices) being mitigated by weakening demand and large food stocks, inflation is projected to fall to 5½ percent during 2001/02 and remain at that level over the medium term.

- **Balance of payments:** In 2000/01, the **current account deficit** is estimated to have widened modestly to just over 1 percent of GDP, and over the medium term the deficit is projected to increase gradually to about 1½ percent of GDP. The effect of trade liberalization and a recovery of domestic demand growth is expected to more than offset the effect of the rebound abroad, lower oil prices, and gains in market share in response to trade and structural reform. Over the medium term, net private capital inflows are expected to increase at a modest pace, leaving the overall balance of payments in modest surplus, so that gross reserve cover would decline slightly to 5¾ months of goods and services imports by 2003/04.

- **Fiscal deficit:** The deficit of the consolidated public sector (comprising central and state governments, central public enterprises, and the oil pool account) is projected to rise from 10½ percent of GDP in 2000/01 to almost 11 percent in 2001/02. The increase reflects the effect of the economic slowdown on central government tax revenues, which would also affect revenues at the state level, and reconstruction in Gujarat, financed by Rs 46 billion in relief from the World Bank and AsDB. Beyond 2001/02, the public sector deficit would decline slowly, by slightly less than ½ percent of GDP per year.

- **External indicators:** In the baseline forecast, external debt is projected to remain about 22 percent of GDP in 2000/01 and fall gradually over the medium term. Short-term debt is projected to remain about 2-2¼ percent of GDP and the debt-service ratio to fall under 14 percent in the medium term, except in 2003/04 and 2005/06 when repayment of the Resurgent India Bond ($4.2 billion) and the IMD ($5.5 billion), respectively, are due.

- **Key downside risks:**

  - Considerable uncertainty attaches to estimates of **potential output growth**, especially in view of the apparent marked slowdown in investment demand in recent years. Although most estimates place potential growth at around 6 ¼-6½ percent, this largely reflects the effect on trends of the strong growth in the mid-1990s, which has not been sustained in recent years.

  - Agricultural activity and rural incomes could be adversely affected if **drought conditions persist**. Through March 2001, water levels in the 70 major reservoirs had fallen to 63 percent of the average over the last 10 years. The states that have been most affected include Gujarat, Himachal Pradesh, Madhya Pradesh, Orissa, and Rajasthan—which together usually account for over 20 percent of food grain production. Moreover, low water tables also threaten hydroelectric power generation—hydropower accounts for a quarter of India's power and in March hydro generation had dropped by almost 24 percent over the previous year.

  - **External trade-related risks** are considered by most analysts to be relatively modest, given that India is a relatively closed economy. On the trade side, goods and services exports are only about 13 percent of GDP, and exports to the U.S. and IT-related exports are only around 18 percent and 10 percent of total exports, respectively. Moreover, the impact on India of a global downturn in the IT sector is expected to be moderated by the emphasis of its IT exports on services, where India is considered to be highly cost competitive. Key uncertainties, however, are related to the extent to which regional trade is affected by the slowdown in industrial countries, and whether the removal of the remaining quantitative import restrictions leads to faster-than-expected growth in non-oil imports.

  - If **oil prices** remain high or increase further, pressures on the balance of payments, the exchange rate, inflation, the fiscal position, and manufacturing profitability could be substantial. Staff estimates suggest that if oil prices were $5 per barrel higher than the IMF baseline forecast ($25.50 in 2001), GDP growth would be 0.4 percentage points lower than the baseline forecast, while inflation and the current account deficit would be, respectively, 1.3 percentage points and 0.5 percent of GDP higher.

  - **Portfolio inflows** remained strong in early 2001, despite the stock market scandal, and India's experience during the Asia crisis and the 2000 turnaround in global market sentiment have illustrated India's resilience to such shocks, especially given the low level of net private capital inflows and sizable reserves. The shift of the MSCI index to a "free float" beginning in November 2001, is expected to reduce India's weight from 7.5 percent to 5.0 percent and could adversely affect capital inflows. However, most market analysts have discounted the impact, which is likely to be moderated by a recent government decision to ease limits on foreign portfolio investment.

INDIA
FINANCIAL SECTOR REFORM: PRIORITIES AND PROGRESS

Areas of reform	Objectives and benchmarks[1]	Implementation Status
Commercial banks	Further de-regulate interest rates and reduce government pre-emption of asset allocation.	Effective from April 19, 2001, the RBI relaxed the requirement of the Prime Lending Rate (PLR) being the floor rate for loans above Rs 200,000. Banks are now able to offer loans at below-PLR rates to exporters or other creditworthy borrowers. The interest rate on eligible Cash Reserve Ratio (CRR) balances will be aligned with the Bank Rate in two stages. In the first stage, effective from April 21, 2001, interest rate increased to 6 percent from 4 percent. In the second stage, interest paid will be at the Bank Rate. The RBI has also indicated its intention to lower the CRR (from the current level of 8 percent) gradually to its statutory minimum of 3 percent.
	Improve the financial performance and operating efficiency of Public Sector Banks (PSBs).	Voluntary Retirement Schemes (VRS) have been implemented, which are expected to reduce staffing by 15 percent. The 2001-2002 budget also announced that Banking Services Recruitment Boards would be abolished and future recruitment would be done by banks themselves.
	Reduce government ownership of PSBs and increase their autonomy.	A bill to allow government ownership in PSBs to be reduced to 33 percent is being discussed by a parliamentary standing committee. However, the government stated that the new equity sales would be done "without changing the public sector character of the banks". The proposed legislation stipulates that private sector voting rights will be restricted to one percent, irrespective of the equity holding of investors.
	Restructure weak banks and resolve those banks that cannot be revived.	A recent report by the Talwar committee recommended that recapitalization of weak banks should be conditional on meeting well-specified benchmarks. Government decision on the implementation of these recommendations is yet to be made.
	Divest RBI's shareholding in banks and discontinue its participation on banks' boards to avoid the potential conflict of interest.	The RBI has indicated its willingness to transfer its shareholdings to the central government, but no decision has been made.
Development Finance Institutions (DFIs)	Improve the risk management capacities of DFIs, and introduce consolidated accounting.	The Asset/Liability Management Systems for DFIs have been implemented, and regular returns have been submitted to the RBI. However, the systems are not yet fully operational. Consolidated accounting has not been introduced in DFIs.

[1] Based on recommendations of the Narasimham II Committee on the financial system; the Khan Committee on DFIs and banks; the Vasudevan Committee on technology; the Verma Committee on restructuring weak public sector banks; Advisory Groups for the Standing Committee on International Financial Standards and Codes; and the Financial System Stability Assessment of the IMF.

	Restructure weak DFIs.	IFCI restructuring has met with difficulties and its financial problems have not been resolved.
	Harmonize the roles and operations of DFIs and banks.	A high-level Standing Coordination Committee has been set up under the aegis of the IDBI to coordinate the activities of DFIs and banks, including the adoption of common approaches to the operational issues in jointly-financed projects. The RBI has issued guidelines for conversion of DFIs to universal banks, but a recent ICICI proposal to become a universal bank is no longer being actively considered.
Loan recovery	Initiate legal and institutional reforms to facilitate debt recovery, including the establishment of an effective and efficient insolvency framework, and an overhaul of the Sick Industries Companies Act.	A bill has been drafted to repeal the Sick Industries Act and replace the Board for Industrial and Financial Restructuring by Company Law Tribunals, and legislation is also proposed to facilitate foreclosure and enforcement of securities in cases of default. Another proposed draft law aims to create an enabling environment for the establishment of Asset Reconstruction Companies (ARCs) by the private sector that would purchase non-performing assets from the banking sector. These draft laws have yet to be submitted to parliament.
	Improve the effectiveness of Debt Recovery Tribunals (DRTs).	The 2001-2002 budget announced that seven more DRTs would be set up during 2001-2002, in addition to the existing 22 DRTs.
	Set up a credit information bureau (CIB).	A CIB has been set up with a paid up capital of Rs 250 million, but is not yet fully operational. The existing legal framework does not permit disclosure of information except in cases where there is explicit consent of the constituent or where suits have been filed. Amendments to the existing laws relating to banking sector or enactment of a master legislation would be necessary to form a full-fledged credit information bureau (CIB).
Banking regulation and supervision	Further raise minimum capital adequacy requirement.	The RBI has stated that the minimum capital adequacy ratio would be raised to 10 percent, but the issue is being reviewed in the context of preparing for the adoption of the new Basel capital accord.
	Further tighten loan classification and provisioning norms.	Banks will be required to classify loans overdue 90 days (as against the current rule of 180 days) as substandard effective from the year ending March 31, 2004.
	Introduce capital charge for market risk based on Basel methodology.	Under consideration in the context of preparing for the adoption of the new Basel capital accord. A new valuation norm for the investment portfolio has been introduced effective from September 30, 2000.
	Tighten rules on exposures to single and large borrowers.	Effective from March 31, 2002, off-balance sheet exposures will be included in the measurement of large exposures, the limit of which will be reduced from 20 percent of "capital funds" to 15 percent of the sum of Tier I and Tier II capital for single borrowers, and from 50 percent to 40 percent for a group of related borrowers.

	Introduce a Prompt Corrective Action framework for dealing with weak banks.	A draft framework was issued in 2000 but its implementation has been delayed. The RBI does not have sufficient legal power to intervene in public sector banks (such as change management).
	Introduce consolidated supervision of banks.	Banks are required to voluntarily build in the risk-weighted components of their subsidiaries into their own balance sheet on notional basis, at par with the risk weights applicable to the bank's own assets and earmark additional capital in their books, in phases, beginning from the year ending March, 2001. Public sector banks are also required to annex the financial statements of their subsidiaries to their own annual accounts. A Working Group has been set up to look into the introduction of consolidated accounting.
	Move toward risk-based supervision.	A consultant has submitted a report on the implementation of a risk based supervisory framework, including the sequencing and time frame for implementation. The report is being reviewed by the RBI.
Regulation and supervision of NBFCs	Develop a supervisory framework for NBFCs that reconciles the constraint of limited supervisory resources with the need to maintain a competitive and sound NBFC sector.	NBFCs have been broadly categorized into three major groups on the basis of their regulatory status and deposit acceptance activities, viz., companies accepting public deposits, companies not accepting public deposits and core investment companies. The supervisory framework focuses on the large deposit-taking companies through annual on-site examinations, whereas smaller deposit-taking companies receive less frequent on-site examinations. The supervision of other companies mainly takes the form of off-site monitoring.
	Transform systemically important NBFCs into banks.	The RBI revised its entry norms of new banks in January 2001 and indicated that NBFCs with good track record can become banks, subject to specified criteria. Currently two NBFCs meet these criteria, but have not expressed interest.
	Avoid extending guarantee to deposits at NBFCs.	To promote depositor confidence in the sector, a separate legislation for NBFCs is being considered by the government.
Capital markets regulation	Introduce greater clarity and improvement of SEBI's authority and enforcement powers.	Consideration is being given to amend the SEBI Act, but press reports indicate that there has been some resistance to granting greater powers to SEBI for the conduct of on-site investigations. SEBI's governance structure appears to be under discussion as well.
	Strengthen SEBI oversight of exchanges and address ineffective self-regulation.	The SEBI removed the chairman and all broker/directors of the Bombay Stock Exchange after allegations of insider trading during the stock market turbulence in March 2001, and has proposed to introduce a code of conduct for market participants to prevent insider trading. The government has also announced plans to de-mutualize all stock exchanges.
	Address inadequate capitalization of	SEBI announced higher margin requirements to address some over-leverage in the market.

	brokers and improve licensing standards.	However, there has been no discussion of changes to capital or licensing standards.
	Reduce risk in settlement system.	The Ministry of Finance announced that rolling settlement would be implemented beginning July 1, 2001. Press reports suggest that the carry forward system will also be phased out.
	Bring UTI legally under the purview of SEBI.	The UTI is reported to be technically ready to be in compliance with SEBI regulations on mutual funds, including the regular disclosure of the net asset value of its largest fund US-64. A group of experts have been consulted within the UTI on the legal issues to bring the UTI formally under the purview of SEBI, but no government decision on this issue has been made.
Deposit Insurance	Strengthen the autonomy and transparency of the Deposit Insurance and Credit Guarantee Corporation (DICGC) and introduce risk-based premium.	A new DICGC Act was drafted and forwarded to the government for comments in 2000, but a response is pending.
Payment systems	Introduce the Real Time Gross Settlement (RTGS) system and achieve its integration with the clearing and settlement of government securities.	The parameters of the RTGS system have been finalized. Tenders for system specification and software design have been issued. Trial runs of the system are expected to start in February/March 2002, and the system is expected to be functional by July 2002.
	Discontinue the practice of periodic settlement and fully implement rolling settlements in capital markets.	The government has announced plans to adopt rolling settlements for 200 scripts that represent the bulk of trading volume by July 2001. Press reports suggest that the carry forward system will also be phased out.
Market development	Further develop the primary and secondary market for treasury bills to lengthen the money market yield curve. Transform the call market into a true inter-bank market.	Nonbank corporates will be denied access to the call money market by the end of June 2001. Access of other nonbank institutions (including development finance institutions, mutual funds and insurance companies) will be gradually reduced in four stages, and will be terminated at a date to be announced in the future. In the meantime, the RBI is taking measures to encourage the participation by non-bank entities in the repo market.
	Broaden the investor base, promote secondary market liquidity, and increase efficiency and transparency of the government securities market.	A new Government Securities Act has been drafted to replace the Public Debt Act. A Clearing Corporation for debt securities and forex transactions will be set up by the authorities by June 2001. An electronic Negotiated Dealing System will be set up by the RBI by mid 2001 to facilitate electronic bidding in auctions and dealing in government securities on a real time basis. To promote retail access to government securities, an order-driven screen-based trading system on the stock exchanges will be introduced in consultation with the SEBI. The authorities are also exploring the development of mutual funds that specialize in government securities to promote retail participation in such securities.

	Separate debt and monetary management to enhance the credibility and transparency of monetary policy.	The Fiscal Responsibility and Budget Management Act would place limits on RBI's direct participation in primary auctions of government securities.
	Establish mechanisms to link more closely interest rates on nonmarketable government instruments to market-related rates.	The government has proposed in the 2001-2002 budget to set up an Expert Committee to explore a system for the determination of interest rates on provident funds and small savings schemes.
	Liberalize investment options for managers of mandatory pension and contractual savings schemes, and allow employees greater choice among pension plans.	Reform proposals are expected to be released in 2001.

India: Statistical Issues

1. India has an elaborate system for the compilation of economic and financial statistics, and produces a vast quantity of data covering virtually all sectors of the economy. Important progress has been made in recent years in the publication of key economic data towards meeting India's commitments under the Special Data Dissemination Standard (SDDS). Many key financial variables are available on a weekly or monthly basis, most of which are published in official documents or disseminated through press releases. Nevertheless, the statistical system suffers from a number of weaknesses, many of which have been identified in the February 2001 *Interim Report of the National Statistical Commission*. These weaknesses include:

- **Statistical methods are cumbersome**, and reporting methods have not kept pace with the shift to a more market-oriented economy following the elimination of industrial licensing. Computerization of data systems is being introduced slowly.

- **Decentralization of data collection** implies that the Central Statistical Office (CSO) has little control over statistical techniques used in other agencies. This greatly complicates the task of achieving consistency across the sectoral accounts.

- There are still **shortcomings in the timeliness, periodicity, coverage, and quality** of many data series.

2. Recent developments and important shortcomings in the areas of national accounts, monetary and financial statistics, balance of payments, and government finance are discussed below:

- **National accounts:** The CSO rebased the annual national accounts statistics and began publishing quarterly data from early 2000. However, quarterly data are only available from 1996Q2. Also, data are subject to substantial historical revisions, and generally when data are revised, only partial historical series are released to the public, significantly hampering analysis. Information on major expenditure categories is only available with considerable delay (at least ten months after the end of the fiscal year), providing limited guidance for short-term policies. Saving and investment estimates are particularly weak, reflecting an outdated estimation method and a lack of information on activity outside the organized sector of the economy. Estimation of real output in public administration and defense may be biased upwards in recent years, as it is based on the government's wage bill (with arrears counted in the year that they are paid) deflated by the Wholesale Price Index (WPI).

- **Industrial production index (IIP):** In May 2000, the CSO took the welcome step of releasing a completely revised time series for IIP, using the new WPI (base year 1993/94) series as a deflator. However, the new series has been subject to major errors and revisions in recent months.

- **Price statistics:** The Consumer Price Index (CPI) is based on weights that are more than fifteen years old, and do not fully capture price developments in the economy. There are three CPIs, each based on the consumption basket of a narrow category of consumers (namely industrial workers, urban and non-manual employees, and agricultural laborers). The CPIs are published with a lag of about two months. Greater reliance is placed on the WPI, which is published weekly with a lag of about two weeks. A new WPI series was published last year with updated weights, new categories, and a revised base year (1993/94).

- **Balance of payments:** A significant improvement has been made in the timeliness of the quarterly balance of payments data, which are now released with a lag of three months.[1] However, trade data, which are currently based on an international transactions reporting system (ITRS), have valuation, timing, and coverage problems. Further, information on trade prices and volumes is not regularly available on a timely basis. Starting January 2001, external debt statistics are now available on a quarterly basis with a six month lag. Estimates of short-term external debt, however, are usually presented in the debt statistics on an original maturity basis and only occasionally on a residual maturity basis (and even then, excluding residual maturity of medium- and long-term non-resident Indian accounts).

- **Central Bank Statistics:** The RBI website and bulletin publish a wide array of financial and monetary statistics, including interest rates, exchange rates, reserves, monetary survey, and results of debt securities auctions. The frequency and quality of data dissemination has improved substantially in recent years. However, some crucial data, e.g., RBI's forward liabilities, are still published with lags of two to three months. The authorities began reporting data according to the Data Template on International Reserves and Foreign Currency Liquidity for the first time in December 2000, although some items in the template, including details on reserves and reserve liabilities, are not reported.

- **Fiscal operations:** The Ministry of Finance posts selected monthly fiscal data and quarterly debt data of the central government on its website. However, no monthly data on fiscal performance at the state level are available, and annual data are available only with an 8-10–month lag. Consolidated information is unavailable on local government operations. In addition, although data on the functional and economic classification of expenditures are available with considerable lag, the typical presentation of fiscal accounts does not provide a particularly useful classification for macroeconomic analysis. For example, classification of government expenditure between developmental/nondevelopmental and plan/nonplan obscures the economic nature and impact of fiscal actions.

3. Despite the improvements made to published statistical data in recent years, important shortcomings hamper the timely analysis of trends in the Indian economy, and hence the conduct of policy and Fund surveillance. India subscribed to the SDDS in January 1997 and presents its metadata on the Data Dissemination Bulletin Board. To fully meet the SDDS, India will need to continue with a number of initiatives aimed at overcoming some of the above shortcomings.

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[1] The STA missions that visited India in November/December 1997 and February 1998 made comprehensive recommendations to improve the timeliness, scope, and classification of India's balance of payments statistics.

India: Core Statistical Indicators

as of April 30, 2001

	Exchange Rates	International Reserves	Reserve/ base money	Central Bank balance sheet	Broad money	91-day T-bill Interest rates	Wholesale price index	Exports/ Imports	Current account balance	Central government balance	GDP/GNP	External Debt
Date of Latest Observation	4/30/01	4/20/01	4/20/01	4/20/01	4/6/01	4/27/01	4/14/01	February 2001	2001 Q4	February 2001	2001 Q4	September 2000
Date Received	4/30/01	4/28/01	4/28/01	4/28/01	4/28/01	4/28/01	4/28/01	April 2001	3/28/01	March 2001	3/30/01	February 2001
Frequency of data 1/	D	W	W	W	Fort-nightly	W	W	M	Q	M	Q	Q 2/
Frequency of reporting 1/	D	W	W	W	Fort-nightly	W	W	M	Q	M	Q	Q 2/
Source of data 1/	C	N	N	N	N	C	N	N	N	N	N	N
Mode of reporting 1/	O (Reuters)	W	W	W	W	O (Reuters)	W + O	O + F	W	W	W + O	W + O
Confidentiality	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted
Frequency of Publication 1/	D	W	W	W	Fort-nightly	W	W	M	Q	M	Q	Q 2/

1/ Frequency: D-daily, W-weekly, M-monthly; Source of data: C-commercial data, N-official publication; Mode of reporting: F-facsimile, W-website, O-other.
2/ Only partial data on a quarterly basis. Complete data on an annual basis.

India: Fund Relations
(As of April 30, 2001)

I. **Membership Status:** Joined 12/27/45; Article VIII.

II. **General Resources Account:**	SDR Million	% Quota
Quota	4,158.20	100.0
Fund holdings of currency	3,669.60	88.2
Reserve position in Fund	488.64	11.8

III. **SDR Department:**	SDR Million	% Allocation
Net cumulative allocation	681.17	100.0
Holdings	7.74	1.1

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
Stand-by	10/31/1991	06/30/1993	1,656.00	1,656.00
Stand-by	01/18/1991	04/17/1991	551.92	551.92
EFF	11/09/1981	05/01/1984	5,000.00	3,900.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	4/30/2001	2001	2002	2003	2004	2005
Charges/Interest	--	19.6	25.6	25.6	25.6	25.5
Total	--	19.6	25.6	25.6	25.6	25.5

VII. **Exchange Rate Arrangement:**

Since March 1, 1993, the Indian rupee has floated against other currencies, although the Reserve Bank of India intervenes in the market periodically. On August 20, 1994, India accepted the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement. Currently, India still maintains some restrictions on the making of payments and transfers for current account transactions which are subject to approval under Article VIII, Section 2: (i) restrictions related to nontransferability of balances under the Indo-Russia debt agreement; (ii) restrictions arising from unsettled under inoperative bilateral payments agreements with three Eastern European countries; (iii) a restriction on remittances for overseas TV advertising by nonexporters and exporters without an adequate track record; and (iv) a restriction on transfer of amortization payments on loans by nonresident relatives.

VIII. Article IV Consultation:

The previous Article IV consultation discussions were held in November 1999 and March 2000. The staff report (SM/00/90, 5/16/00) was discussed by the Executive Board on June 19, 2000.

IX. Technical Assistance

Department	Purpose	Date of Delivery
MAE	Government securities market	2/94
MAE	Foreign exchange market	2/95
FAD	Expenditure control	5/95
FAD	Public expenditure management	8/95
FAD	Public expenditure management (follow-up)	5/96
MAE	Government securities market (follow-up)	7/96
STA	SDDS and statistics	12/96
STA	Balance of payments statistics	12/97
STA	SDDS and statistics	2/98

X. Resident Representative

A resident representative's office was opened in November 1991. Mr. James Gordon is the current Senior Resident Representative.

India: Relations with the World Bank Group

1. India is one of the largest borrowers from the World Bank Group. The Bank's program of assistance comprises a diversified lending program and considerable ongoing economic and sector work (ESW). The ESW includes completed or planned reports as well as technical assistance activities on macroeconomic and state fiscal management issues; on sector-level reforms (governance, agriculture, education, finance, health, nutrition, and power); and on poverty. The Comprehensive Development Review (the Bank's first), completed in June 1999, covers the fiscal and structural constraints to achieving high, sustained growth, with particular emphasis on poverty, health and education, governance, and private participation in infrastructure. Lending from IBRD, IDA, and the IFC seeks to support poverty reduction, acceleration of human resource and infrastructure development, and the reform process at the state level. Particular emphasis is being made on leading reforming states. A multi-sectoral investment loan was approved in mid-1998 to support state-level fiscal reform in Andhra Pradesh. A similar program of assistance, comprising a development program loan (sub-national adjustment loan) and sectoral investment operations to support comprehensive reforms in Uttar Pradesh was approved in April 2000. Other states have also shown strong interest in programs supporting state level reforms. New commitments increased significantly in the year 2000/01 as sanctions on nonbasic human needs projects were *de facto* lifted.

2. Financial operations since 1992/93 are summarized below:

(In millions of U.S. dollars)

Indian FY 1/	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/2001
Commitments 2/	1,427.0	1,533.0	1,754.8	1,870.6	836.2	2,439.7
IBRD	442.8	661.1	635.0	1,207.8	190.0	1,315.2
IDA	984.2	871.2	1,119.8	662.8	646.2	1,124.5
Disbursements 3/	1,318.3	1,591.5	1,398.9	1,442.9	1,468.5	1,027.0
IBRD	589.1	685.5	568.8	576.5	644.2	423.0
IDA	729.2	906.0	830.1	866.4	824.3	604.0
Repayments 3/	1,169.7	1,074.0	1,144.3	1,129.8	1,228.2	1,064.0
IBRD	943.4	839.9	894.1	841.8	898.6	807.0
IDA	226.3	234.1	250.2	288.0	329.6	257.0
Debt outstanding and disbursed	27,347.8	26,387.8	26,049.8	26,676.1	26,745.9	26,111.0
IBRD	9,848.7	8,772.0	8,138.1	8,114.4	7,816.2	7,197.0
IDA	17,499.1	17,615.8	17,911.7	18,561.7	18,929.7	18,914.0

Source: Data provided by the World Bank.

1/ The Indian fiscal year starts on April 1.
2/ Based on loan effectiveness date.

India: Relations with the Asian Development Bank

1. The Asian Development Bank (AsDB) operations in India began in 1986. Cumulative commitments totaled $7.9 billion (net of cancellation) as of December 31, 2000 for 55 public sector loans and 10 private sector loans (the latter without government guarantee). These funds have been provided from the Bank's ordinary capital resources (OCR).[1] Also, AsDB has approved 19 equity investments and a line of equity. The AsDB's lending and equity activities are summarized below.

(In millions of U.S. dollars, as of December 31, 2000)

Calendar Year	OCR Loan Commitments 1/	Private Equity	Disbursements
1986	250	--	--
1987	394	8	12
1988	497	3	56
1989	504	3	81
1990	717	2	205
1991	924	--	496
1992	874	--	394
1993	878	1	223
1994	150	18	510
1995	630	45	600
1996	763	15	607
1997	563	30	675
1998	250	--	621
1999	626	--	607
2000	1,330	--	487
Total	**9,349**	**106**	**5,574**

1/ Public and private sector operations.
Source: Data provided by the Asian Development Bank

2. The AsDB's operations in India have focused on promoting sustainable growth, while reducing poverty and its debilitating effects. The Bank has supported policy reforms in public resource management and fiscal consolidation at the national and state levels, power sector reform, and private sector participation in the transportation sector. In line with its overarching objective of poverty reduction, projects addressing basic human needs have been prioritized in AsDB's year 2000 operations, in addition to a steady infrastructure development the Bank has cultivated in India.

[1] India does not have access to the Bank's concessional resources from the Asian Development Fund (ADF).

Public Information Notice (PIN) No. #
FOR IMMEDIATE RELEASE
[June, 20, 2001]

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with India

On June 20, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with India.[1]

Background

India's macroeconomic performance during the 1990s was favorable. The economy recovered strongly from the 1991 balance of payments crisis and—despite the Asia crisis, international sanctions that followed the testing of nuclear devices in 1998, various natural disasters, and an oil shock—growth averaged nearly 6½ percent during the second half of the 1990s. Moreover, while India is estimated to be home for roughly one third of the world's poor, recent data have shown a substantial improvement in many social indicators, providing encouraging evidence of the beneficial effects of growth and reform during the 1990s.

However, the economy has shown a decelerating trend in recent years. Overall GDP growth (at factor cost) had reached just over 6½ percent in 1998/99 (the fiscal year begins April 1), with a rebound in agricultural production and substantial fiscal stimulus. However, growth slowed to under 6½ percent in 1999/00 and eased further to 5¾ percent (four-quarter basis) in the third quarter of 2000/01, owing to the waning effects of large civil service salary hikes in previous years, ongoing drought conditions in some states, and the effect of energy price hikes on business and consumer demand. Business investment and confidence also have been adversely affected by infrastructure constraints, excess capacity, uncertainty regarding the

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June 20, 2001 Executive Board discussion based on the staff report.

effect of the elimination of quantitative import restrictions on competitiveness, and high real interest rates.

Recent data point to continued weakness, compounded by a devastating earthquake that struck the state of Gujarat in late January. The earthquake caused a massive loss of life, and damage to physical infrastructure is estimated as high as 1 percent of GDP. The region is an industrial center for the country, which may have contributed to the further decline in industrial production growth to 2¾ percent (y/y) in the first quarter of 2001. However, the continued sluggishness of the production of capital goods, vehicles, and textiles, as well as the sharp drop in loan growth point to underlying weakness in domestic investment and consumer demand; a decline in cement production also indicates weak construction activity.

Abundant food stocks have mitigated the impact of energy price hikes on inflation. Wholesale price inflation, which peaked at 8½ percent (y/y) earlier this calendar year, declined to 5½ percent in April owing to the waning base effect of hikes in administered fuel prices—prices were raised in October 1999, and again in March and September 2000. Low agricultural price inflation has helped contain overall consumer prices with CPI inflation decreasing to only 3 percent (y/y) in the past six months.

The current account deficit is estimated to have risen to just over 1 percent of GDP in 2000/01, as the effect of high world oil prices was partly offset by weak domestic demand and strong export growth. Although India is highly dependent on oil imports, which increased by 1¼ percent of GDP in the past year, the effect was offset by weak non-oil imports, especially of food and capital goods, and strong exports of garments, engineering goods, and refined petroleum products. Services receipts have also been robust, reflecting exports of IT-related services, and inward remittances from Indians abroad have been substantial.

However, pressures on the capital account mounted during 2000. Market confidence and portfolio inflows were undermined by the global turnaround in sentiment toward IT stocks (which represented roughly a quarter of India's market capitalization), concern about the impact of higher oil prices on the balance of payments, and fears that the rupee had lost competitiveness with the dollar's strength against other currencies. The RBI responded to the pressure on the rupee by intervening heavily in spot and forward markets and by tightening domestic monetary conditions, hiking the Bank rate in July. Administrative restrictions on access to foreign exchange were also imposed, including one that was deemed in contravention of Article VIII. By end-October gross reserves had fallen by $3.2 billion to $34.9 billion (4¾ months of imports).

These pressures eased in late 2000 and into early 2001. The government's India Millennium Deposit (IMD) scheme—involving a five-year instrument marketed to nonresident Indians—yielded inflows of $5.5 billion in October. The boost to reserves and the softening of world oil prices helped restore market confidence, and the cut in U.S. interest rates in early 2001 also helped strengthen the sentiment toward the rupee. By end-March, the rupee/dollar rate had recovered some of its earlier losses, portfolio inflows had rebounded, and gross reserves had risen to almost $43 billion (nearly 6 months of imports and four times short-term external debt).

With stronger exchange market conditions and signs of industrial weakening, monetary policy was eased. Money market conditions began to relax in late 2000, and bond yields fell sharply. The RBI subsequently moved to lower its Bank rate by 100 basis points in February/March, and reduced the commercial banks' cash reserve requirement by 50 basis points. However, financial market confidence remained fragile—although the stock market had recovered from the sharp losses suffered in early 2000, a stock market scandal, which involved accusations of insider trading and payment defaults by some brokers, and led to the closing of an urban cooperative bank, contributed to further declines and by end-April stock indices were roughly 40 percent off their early 2000 peak.

After widening markedly during the latter half of the 1990s, the public sector deficit is estimated to have fallen by ¾ percent of GDP in 2000/01 to 10½ percent of GDP. This is explained by adjustment at the state level—although data on their outturn is not yet available, their budgets aimed for substantial deficit reduction, mainly in response to increased transfers from the center. At the central government level, the deficit—defined by the staff to exclude privatization receipts—was roughly unchanged as a share of GDP, as tax shortfalls and higher-than-budgeted outlays for subsidies were more than offset by strong nontax revenues and a compression of capital and military outlays, relative to budget targets. Although delays in raising domestic fuel prices caused the deficit of the Oil Coordinating Committee (OCC) to increase, this was offset by lower-than-expected capital outlays by public sector enterprises. The public sector debt ratio continued to rise, reaching 83 percent of GDP.

Although containing welcome commitments to structural reform, the 2001/02 budget emphasized growth rather than significant deficit reduction. In particular, the budget reiterated the government's commitment to lowering the central government deficit to 2 percent of GDP by 2006/07, in line with draft fiscal responsibility legislation, and endorsed a number of important structural initiatives. However, the 2001/02 deficit would remain roughly unchanged at about 5¼ percent of GDP, once divestment receipts were excluded from revenues. Although a broad range of tax cuts were introduced, these were assumed to be offset by tax buoyancy and increased compliance. A ½ percent of GDP increase in capital expenditure also was largely matched by reductions in current expenditure.

Executive Board Assessment

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

India: Selected Economic Indicators 1/

	1997/98	1998/99	1999/00	2000/01 2/
		In percent		
Domestic Economy				
Change in real GDP at market prices	4.8	6.6	6.4	5.8
Change in industrial production	6.6	4.1	6.6	5.0
Change in wholesale prices 3/	4.3	6.0	3.4	7.1
Change in consumer prices 3/	6.8	13.1	3.4	3.9
		In billions of U.S. dollars		
External Economy				
Exports, f.o.b.	35.7	34.3	38.3	45.1
Imports, c.i.f.	51.2	47.5	55.4	63.1
Current account balance	-5.5	-4.0	-4.2	-5.2
(In percent of GDP)	-1.3	-1.0	-0.9	-1.1
Direct investment	3.5	2.4	2.1	2.1
Portfolio investment, net	1.8	-0.1	3.0	2.4
Capital account balance	9.8	8.6	10.2	11.4
Gross official reserves 3/	29.4	32.5	38.0	42.3
(In months of imports) 4/	6.0	5.8	5.9	5.9
External debt (in percent of GDP) 3/	22.8	23.4	21.8	22.2
Short-term debt (in percent of GDP) 3/ 5/	2.9	2.7	2.2	2.3
Debt service ratio (in percent of current receipts)	19.3	19.3	17.8	14.5
Change in real effective exchange rate (in percent) 3/	5.6	-6.2	1.1	...
		In percent of GDP		
Financial Variables				
Central government balance 6/	-4.9	-5.4	-5.4	-5.3
Consolidated public sector balance 6/	-8.5	-9.6	-11.2	-10.4
Change in broad money (in percent) 3/	18.0	19.2	13.6	16.2
Interest rate (in percent) 3/ 7/	7.4	8.8	9.2	9.2

1/ Data are for April-March fiscal years, and are those that were available at the time of the Board meeting.

2/ Preliminary estimates.

3/ End of period.

4/ Imports of goods and services projected over the following twelve months.

5/ Residual maturity basis, except contracted maturity basis for medium- and long-term nonresident Indian accounts.

6/ Excluding divestment receipts from revenues and onlending from small saving collections in expenditures and net lending.

7/ 91-day Treasury Bill rate.