BUFF/ED/92/78

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Statement by Mr. Arora on India
Executive Board Meeting 92/145
December 4, 1992

My authorities are in broad agreement with the staff analysis contained in their report EBS/92/175 of November 6, 1992. As an objective and balanced survey of the Indian economic scene the report will have few equals. We are thankful to the staff for their invaluable assistance in steering policy in the right direction.

India's adjustment experience since mid-1991 is a story of robust beginnings. A major balance of payments crisis was overcome by a systematic and consistent strategy to effectively deal with macroeconomic imbalances and with the generous support from the international financial institutions and the donor community. We also started down the long road of market-oriented reform.

The results speak for themselves. Inflation has decelerated substantially, despite major upward adjustment in administered prices of petroleum products and imported fertilizers. We hope to meet the program target of 8 percent. Reduction of the overall fiscal deficit is proceeding in line with the program target of 5 percent of GDP for the Central Government. After a slow start, exports have begun to pick up. Notwithstanding the virtual collapse of trade with the Russian Federation and other republics of the former Soviet Union, developments so far in 1992/93 suggest encouraging response of exports to policy changes instituted by the authorities. Reserve buildup has exceeded the adjusted target, although imports have increased faster than programmed. All is not well with the monetary scene, in part due to larger than anticipated capital inflows, but action is under way to rein in broad money growth. Real interest rates have been positive. The authorities have resisted pressure to substantially reduce interest rates in view of the underlying inflationary pressures. The exchange rate policy described in my BUFF/ED/92/22 of June 26, 1992 has contributed to remarkable stability of the free market rate, thus increasing confidence, and exerting a healthy pressure on inflationary expectations. Ground is being carefully prepared for the unification of the exchange rate.

The stabilization process, structured around fiscal consolidation, has begun to yield dividends. Real GDP is expected to grow by 3.5-4 percent in 1992/93. Investment outlook has improved a good deal and the primary market remains buoyant despite turbulence in the stock markets. The stage has been set for both direct and portfolio investments from abroad. Policy has stimulated movement toward higher productivity.

These are not small gains. Issues of macroeconomic stability have come to acquire a central position in the political process. Painful as the remedy has been and strong though the voices of contention have remained, it is clearly recognized by major social partners that further action would be needed to reduce macroeconomic imbalances for achieving a viable external position. Medium-term fiscal correction is thus firmly inscribed on the national agenda.

The second, and in some ways the more interesting theme of the adjustment story, is the movement away from regulation and control toward competition and efficiency. It is a very complex process. And a difficult one. Experience shows that reforming public sector enterprises, creating a viable, efficient, and competitive financial system, lowering tariffs and taking other steps to foster competition, including foreign competition, present exceptionally severe challenges to policy-makers. India is not unique in facing these challenges but that does not diminish in any way the intensity of pressures on the social and political systems. It is against the background of heightened expectations for the future and contemporary pain that the next stage of structural reform has to be designed.

The staff have identified important elements of the reform process--tax reform, changes in the tariff regime, banking sector reform, restructuring of the public enterprises sector, and labor and land use issues.

In some of these areas preparatory work is being undertaken. I would just mention two examples. In regard to the restructuring of the public sector enterprises, a National Renewal Fund has already been constituted and the authorities are going ahead with the closure of 34 textile mills affecting over 80,000 workers. Negotiations are being held with the World Bank for financing the social safety net that has already been designed. Secondly, notwithstanding the uncertainties caused by the securities scam, the Union Cabinet has already approved major elements of the package for financial sector reform whose implementation should begin in the next financial year.

Work is also under way for introduction of a further installment of tax reform in the forthcoming budget. There has been concerted effort on the part of industry to persuade Government to substantially reduce tariffs on capital goods, raw materials, and intermediate products. The authorities will naturally formulate a suitable response taking into account the factors that have a bearing on deficit reduction targets for 1993/94.

The point that needs to be made is that the next stage in the structural reform will unfold within a medium-term timeframe. My authorities remain irrevocably committed to the objective of building a market-oriented economy that would promote growth while lessening social and economic disparities. In attaining the goal of an open, efficient, and competitive economy, it is essential that the socially vulnerable sections of the society receive a fair deal. The transition then is, broadly speaking, a matter of how one resolves some inherent dilemmas.

In the staff paper covering selected background issues (SM/92/205 of November 23, 1992) a number of factors embedded in the federal structure and in socio-economic institutions as they have evolved over the last 40 years have been analyzed. What comes out vividly is the enormously complicated exercise involved in this transition, touching as it does the demographic, social, political, and economic dimensions of change. To illustrate the point, if one is looking to VAT as a litmus test of an approved model of tax reform, then the road to tax reform in India is going to be frustratingly bumpy.

My authorities are in the process of developing the medium-term framework of structural reform for which we will request assistance under the EFF with an appropriate access under ESAF. I expect that policies formulated under the medium-term strategy would deal convincingly with the difficult and sensitive issues central to the next stage of the reform process. The fact that we would have successfully completed a 20-month stand-by arrangement by early Spring in 1993 cannot but give added strength to the authorities in their endeavor to craft a meaningful strategy and to gather the necessary resolve to implement their policies with the requisite degree of political skill.

As India has observed all the performance criteria for end-September and has also observed the key structural benchmarks for the second review, I would request that the Board accord its approval to the completion of the second review and the associated purchases. What my authorities need more than ever before is the encouragement and the understanding that the Board had shown all along in helping us to persevere in the daunting, but undoubtedly rewarding, task of refashioning our economy.