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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/145

2:30 p.m., October 31, 1991

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
G. K. Arora	L. E. N. Fernando
	Deng H., Temporary
C. S. Clark	G. C. Noonan
T. C. Dawson	Q. M. Krosby
	J. Prader
	G. H. Spencer
R. Filosa	N. Kyriazidis
	S. K. Fayyad, Temporary
M. Fogelholm	I. Fridriksson
H. Fukui	
B. Goos	
J. E. Ismael	T. Sirivedhin
A. Kafka	
J.-P. Landau	I. Martel
A. Mirakhor	O. Kabbaj
L. B. Monyake	L. J. Mwananshiku
	P. Wright
	Z. Trbojevic
	A. R. Ismael, Temporary
A. Torres	R. Marino
A. Végh	A. G. Zoccali

J. W. Lang, Jr., Acting Secretary
B. J. Owen, Assistant

Also Present

IBRD: J. Khalilzadeh-Shirazi, Asia Regional Office. Central Asia Department: H. Neiss, Director; B. B. Aghevli, Deputy Director; Y. Horiguchi, O. J. Evans, D. J. Goldsbrough, P. Gotur, U. R. Patel, R. S. Teja. Southeast Asia and Pacific Department: K. Saito, Director; L. M. Koenig, Deputy Director. European Department: M. C. Deppler. Exchange and Trade Relations Department: J. T. Boorman, Director; T. Leddy, Deputy Director; J. C. Di Tata, S. M. Schadler. External Relations Department: S. J. Anjaria, Director; A. Mountford, H. P. Puentes. Fiscal Affairs Department: R. Hemming. Legal Department: W. E. Holder, Deputy General Counsel. Middle Eastern Department: P. Chabrier. Research Department: N. N. Choudry. Secretary's Department: C. Brachet, Deputy Secretary; M. J. Papin, A. Tahari. Treasurer's Department: G. Wittich, Deputy Treasurer; D. Gupta, D. K. Kar, S. M. Thakur. Western Hemisphere Department: A. S. Linde. Special Advisor to the Managing Director: P. R. Narvekar. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, L. E. Breuer, M. B. Chatah, L. Dicks-Mireaux, M. Galán, M. J. Mojarrad, M. Nakagawa, Y. Patel, D. Powell, A. Raza, B. Szombati. Assistants to Executive Directors: B. Abdullah, J. R. N. Almeida, P. Bonzom, M. Da Costa, S. Gurumurthi, E. Haller Pedersen, M. A. Hammoudi, K. M. Heinonen, P. K. Kafle, P. Kapetanovic, F. Moss, M. Mrakovcic, S. Shimizu, D. Sparkes, J. C. Westerweel.

1. REPORT BY MANAGING DIRECTOR

The Managing Director said that he wished to express once more his thanks to Mr. Ismael, Mrs. Sirivedhin, and the Thai authorities for their extraordinarily efficient management of the arrangements for the Annual Meetings in Bangkok, ensuring that they were both a pleasant occasion and a success.

He had taken advantage of his stay in the region to visit Mongolia as a new member of the Fund, the Managing Director continued. He had met the President, the Prime Minister, Finance Minister, members of the Cabinet, union leaders--of both the former, official unions and the new, independent unions--and members of the parliamentary majority and opposition. He had been impressed by the national consensus for radical change and by the fact that the search for that change was also part of the rediscovery of Mongolia's historic national identity. The country faced extreme difficulties consequent upon the breakdown of trade with the U.S.S.R., including the loss of aid, export income, and imported spare parts, and the authorities had expressed deep gratitude for the important international support they continued to receive.

In discussing with the authorities the present course of adjustment in Mongolia, the Managing Director said, he had urged them to continue their efforts and to try to achieve a good track record, because future support from the international community would depend on it. Mongolia needed such support, as well as substantial technical assistance in almost every field. Cooperation with the staff was excellent, albeit at the cost of a heavy burden on the Fund. There were plenty of possibilities for private and development bank investment in industry and utilities, but the World Bank had still to identify projects; meanwhile, a great part of the burden fell on the bilateral donors and the Fund, and would continue to do so through the spring.

He had spent one day in Beijing, on the occasion of the signing of the agreement establishing the Fund resident representative's office, the Managing Director continued. His visit had given him the opportunity to have good discussions with the Governor of the People's Bank of China, and to meet with Prime Minister Li Peng, at the request of the latter, who had promised his active cooperation on the pending matter of the third amendment. The Prime Minister had emphasized two points: first, how strongly recent developments in the Soviet Union had increased his conviction that a gradual path toward economic reform was the prudent approach for big countries; and second, his concern that the Fund should not be distracted by developments in the Soviet Union and Eastern Europe from helping the developing countries. In response, he had explained the Fund's action in developing countries and expressed interest in the important efforts of China in several of those countries.

In India, the authorities at all levels had expressed their gratitude for the way in which the Fund had helped that great country at a very difficult time of its economic history, when a new Government had taken office following the assassination of former Prime Minister Gandhi and the subsequent complex political transition, the Managing Director recalled. The crisis atmosphere had passed, and reserves were increasing. In his conversations with many people, including those outside official circles, as well as the country's leaders, from the President to the Permanent Secretaries and Vice President of the Planning Commission, he had been impressed by the use of a key word: irreversibility. There was a clear wish on the part of the authorities to move to an extended arrangement in due course. There were problems in the labor sector and with the exit policies required by the rehabilitation of a large public sector, but the authorities were committed to moving ahead; moreover, since the Prime Minister took office, apparently the de facto majority supporting his policy had distinctly broadened.

In both India and Pakistan the authorities had taken the initiative to discuss with him the issue of military expenditures, the Managing Director noted. He had been impressed by their recognition that the matter was one of appropriate concern to the Fund. He had made clear that it was not the Fund's intention to impose conditionality, but that in view of the heavy burden that such expenditures had imposed over time on development in those two countries, it was important to make sure that the reassessment made possible by the global reduction of tensions, and their common efforts to reduce tensions in their own area, could lead sooner rather than later to a reduction of such a heavy burden on development in India and Pakistan. He had obtained positive responses in that respect, although no one had minimized the extreme difficulty of the issue.

He had met in Pakistan with the authorities, from the President to Finance Ministry officials, and with members of the opposition, including Mrs. Bhutto, the Managing Director added. The Government was strongly committed to structural reform for growth. He had stressed the importance of macroeconomic control and a reduction of Pakistan's vulnerability to external shocks, including the possible volatility of aid flows. It was clear that, following completion of negotiations on the third annual arrangement under the structural adjustment facility (SAF), the authorities were contemplating the need to deepen their reform efforts and to obtain financing under an enhanced structural adjustment arrangement that could be discussed some time during the spring. There was a recognized need for fiscal improvement--in India as well--to reduce reliance on trade taxes for financing the budget. At the time of his visit, the Fund had conducted a successful seminar in Lahore on macroeconomic policy and structural adjustment.

While in Pakistan, he had been invited to go to the border of Afghanistan, to view the historical Khyber Pass in Peshawar, the Managing Director concluded. To have seen some of the three million Afghan refugees there, having in mind also that there were five million more refugees in Iran, had been a terrifying human experience, illustrating the immense consequences of the war. He had been somewhat reassured by the hopes of people he met there in possible progress in peace negotiations initiated, in particular, by the United States and the U.S.S.R.

2. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Fogelholm on the completion of his service as Executive Director.

3. INDIA - 1991 ARTICLE IV CONSULTATION; AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1991 Article IV consultation with India, together with India's request for a stand-by arrangement in an amount equivalent to SDR 1,656 million (EBS/91/176, 10/9/91; and Sup. 1, 10/29/91). They also had before them India's letter of intent and memorandum on economic policies (EBS/91/143, 8/27/91), and a background paper on recent economic developments in India (SM/91/207, 10/18/91)

Mr. Arora made the following statement:

My authorities are in broad agreement with the appraisal in the staff report for the 1991 Article IV consultation and would like to thank the staff for its cogent and comprehensive discussion of the basic issues confronting the Indian economy.

In my statement at EBM/91/121 (9/12/91), when the Board discussed India's request for a drawing under the compensatory and contingency financing facility, the main features of the program for 1991/92 were described. The macroeconomic objectives of the program revolve round three inter-related elements: first, a strong emphasis on the reduction of inflation to about 6 percent by the end of 1992/93, down from an anticipated 9 percent in 1991/92; second, a major effort to ease the external liquidity constraint affecting the Indian economy through a rebuilding of gross international reserves to a level of one and one half months of imports by the end of 1992/93; and third, the establishment of conditions that would permit a steady growth of about 5 percent and above without giving rise to internal and external financial imbalances. The financial program for 1991/92 has been designed to achieve these objectives.

Simultaneously with the adoption of measures to correct fiscal imbalances, a far-reaching program of structural change was also initiated. Attention is invited to EBS/91/143 (8/27/91) which describes in detail policies relating to fiscal correction, monetary targets, trade liberalization, industrial deregulation, public enterprise reform, and financial sector reform.

Taken as a whole, the policies and measures constituting the adjustment program in India represent a major point of departure. Conceptually, the return to macroeconomic prudence is a restoration of the time-honored tradition of macroeconomic management that has characterized Indian policy making since Independence.

Seen in this perspective, recent developments relating to fiscal and monetary relaxation were a sort of aberration that would have to be corrected. However, from another point of view, the new adjustment program is different from the ones India undertook in response to external crises. Whereas the earlier programs, including the one in the mid-1970s, focused largely on macroeconomic stabilization, the program in the 1990s gives equal emphasis to the processes of deregulation and liberalization, with the objective of exploiting the potential for robust growth inherent in our economy. Global economic circumstances are not exactly propitious for a major undertaking of this kind. What could have yielded larger gains with relatively less pain when the expansion phase of industrial economies in the mid-1980s was in full swing would now perhaps be productive of much less reward with perhaps a larger degree of dislocation. Nevertheless, the prospects facing the Indian economy do not offer any viable alternative to that of more or less rapid integration with the world economy. It is not, therefore, in a spirit of resignation that India has chosen to tread the path of reform; it is from intellectual conviction that we are making the transition from an overprotected and overregulated economy to a market-based system. Once again, it falls to me to thank the International Monetary Fund, the World Bank, and the donor community for their generous and spirited support to a process that promises a better future for over 800 million people in my country.

Since my statement of September 12, 1991, there have been some developments that give us reason for thinking that the strategy we have chosen is the right one. First, inflation has begun to turn down. Admittedly, the deceleration is not dramatic, but a tight monetary policy and serious fiscal adjustment are slowly but surely beginning to produce results.

Second, as Supplement 1 to EBS/91/176 indicates, both net and gross official reserves have risen significantly since late August. There are indications that external sector policies are beginning to show results. We have some basis for thinking that commercial banks and investment companies may show tangible interest in India in not too distant a future.

Third, and more important, the process of political consensus building has advanced quite significantly. As an example, I would cite the statement of our Finance Minister at the Annual Meetings in Bangkok when he quite unequivocally envisaged the closure of patently unviable public sector units. There was muted protest back home but overall the country prepared itself to come to terms with the new reality. In the assessment of my authorities, policy reform is steadily gaining ground, paving the way for stronger and more radical steps to follow.

Between now and the presentation of the 1992/93 budget, several issues would have to be addressed. First and foremost, the full implementation of the 1991/92 budget and its accompanying fiscal deficit target would have to be ensured. The Board has the categorical assurance of my authorities that whatever needs to be done to keep the budget on track would be done. Second, if things continue to shape up well, as they have so far, steps for easing import restrictions would be taken to minimize disruptions in industrial production. Third, serious thought would be given to the emerging issues relating to financial sector reform and tax reform. Concrete policies would be formulated on the basis of such examination for which data and recommendations will be provided by the two high level committees that are already at work. And finally, the process of elaborating structural policy reform in a medium-term framework would be taken in hand. The results would be reflected partly in the budget for 1992/93, and partly in decisions occurring at different points of time in 1992/93. The objective of policymakers is to speed up the reform process. There are no halfway houses in our reckoning.

All this presupposes that commitments for exceptional financing would materialize in the specified time frame. We shall do our part and trust that our partners will do theirs.

Before I request the Board to make available to India its generous support for our bold and courageous adjustment program, I would like to place on record the deep appreciation of my authorities for the spirit of understanding and cooperation shown by the staff in the process of negotiation leading up to the stand-by arrangement. It is to the Board that we turn now in the hope that its decision would give to the financial markets the sense of security they need in overcoming their inhibitions in regard to assisting the reform process in India.

Mr. Mirakhor made the following statement:

I would like to take this opportunity to convey the sympathies of my authorities, as well as my own, to Mr. Arora and his authorities for the tragic consequences of the recent earthquake.

Turning to the matter at hand, I join Mr. Arora in complimenting the staff for its concise analysis of the present state of the Indian economy and the economic reform program. The authorities should be commended for their courageous and decisive handling of the recent economic crisis and for their determined efforts to restore macroeconomic stability. Faced with large internal and external financial imbalances, the new Government that took office in late June moved rapidly and firmly to implement a short-run strategy of stabilization and a medium-term program of adjustment and reforms. To date, notable progress has been made not only in economic stabilization but also in the areas of expenditure restraint, industrial policy, the elimination of structural inefficiencies and rigidities, and the promotion of external competitiveness.

As I am in agreement with the thrust of the staff report, I will limit my comments to two areas, namely, fiscal, and exchange and trade policies. As I understand it, the major objectives of the authorities' program are export promotion, improved productivity, and demand restraint. The exchange rate has been used to shift relative prices in favor of tradable goods to achieve export competitiveness while restrictive financial policies have been relied upon to control the expansion in domestic demand. In the coming months, expenditure cuts and substantial tax efforts are envisaged to reduce the public sector deficit. India's public sector, however, is a large and complex one and the Union government has a somewhat rigid relationship with the States that is mandated by the Constitution. The States enjoy a degree of independence in fiscal matters which, together with the intricacies of the political fabric of the society, gives an indication not only of the enormity of the task ahead but also of the importance of what the authorities have already accomplished. Thus far, the firm policy stance of the authorities has placed the major burden of adjustment on restrictive monetary policy, which has resulted in high interest rates. Moreover, the staff is of the opinion that interest rates may have to move even higher to protect the recent gains in the external position. Given the relatively high outstanding stock of domestic public debt, vigilance will be required to ensure that a sufficient reduction in the fiscal deficit is achieved so that rising interest rates do not lead to an increase in debt-servicing obligations which would have direct implications for the fiscal objectives. In this regard, I was pleased to read in Mr. Arora's helpful statement of the assurance that the necessary actions will be taken to ensure that the budget will be kept on track.

With respect to exchange and trade policy, the program envisages a gradual reduction of tariffs, following the July devaluation of the rupee. The staff report indicates that the authorities' intention is to keep the rupee stable at its current level in order to bolster confidence. However, current and projected inflation, as well as the existence of the 30 percent premium for the EXIM scrips, indicates that, even with the July devaluation, there is still an excess demand for foreign exchange. Furthermore, the staff notes that the external reserve position, even though somewhat eased, remains extremely tight, internal and external confidence are not fully restored, and the continuation of external financing gaps is projected for the next several years.

For these reasons, it would appear that a policy which focused more on the external competitiveness of the economy by means of a sustainable exchange rate policy accompanied by a rapid reduction of tariffs, which now cover more than 40 percent of imports, would be more likely to strengthen confidence. It may be worth noting that the revenue impact of such tariff reductions need not be as onerous as it might first appear since the flexible exchange rate policy would also generate revenues via an automatic adjustment of the valuation basis for duties. In our view, a policy sequence that aims at substantial tariff reductions in conjunction with the elimination of restrictions on external transactions will likely elicit the kind of confidence response desired by the authorities, as well as serve the stated objective of rapid integration of the Indian economy with the world economy. Furthermore, by implementing a reduction in exemptions as well as an extension of coverage, the impact of tariff reductions on revenue could be minimized and tariff distortions reduced.

Now that decisive steps have been taken to implement comprehensive reform policies, and given the fact that India is well endowed with all the necessary ingredients required for economic growth and development, including a skilled labor force, a vibrant entrepreneurial class, and a resourceful and talented pool of public servants, I am confident that pulling these resources together into harmony with market forces will energize and propel the economy forward to meet the challenges it is currently facing and enable it to achieve its full potential. The authorities deserve a vote of confidence from the Fund for their handling of the economic situation thus far and for their comprehensive medium-term program. We support the decision and request Mr. Arora to convey to his authorities our best wishes for a successful implementation of their program.

Mr. Fukui made the following statement:

First of all, I would like to join Mr. Mirakhor in expressing sympathy about the tragedy of the earthquake in India.

At the outset, I would also like to commend the staff for formulating two drawings under the compensatory and contingency financing facility (CCFF) and two stand-by programs within a rather short time span this year. At the same time, I highly appreciate the efforts of the Fund, major donor countries, and other financial institutions in implementing cooperative measures to resolve the foreign reserve crisis of India. There is no need for elaboration, but Japan provided India with extraordinary financial assistance, such as concessional terms of loans, parallel lending with the World Bank, and gold collateral lending by The Bank of Japan to the Reserve Bank of India. These efforts and cooperation on the part of the international financial community, together with the Indian authorities' decisive actions. have enabled India to more or less manage to get through its difficult situation so far.

Before commenting on policy matters, first and foremost, I would like to point out that the current foreign reserve crisis in India should not be deemed as a temporary or cyclical one but rather as one rooted in the highly regulated and unorthodox economic policies which the authorities implemented for as long as two decades. In retrospect, if the Indian authorities had executed the economic reforms of the programs agreed with the Fund under the extended arrangement approved in November 1981, and if the authorities had also fully implemented the liberalization measures formulated by the Gandhi Cabinet in the mid-1980s, the shape of the economy could have been much different.

It is a matter for regret that, while most Asian countries--such as the newly industrializing economies and the member countries of the Association of South East Asian Nations (ASEAN) have been enjoying a favorable economic upswing in recent years, only India has had a stagnant economy that is likely to take rather a long time to get back onto a steady growth path. Consequently, the Japanese authorities expect the Indian authorities to implement the structural reform measures as presented with the most serious commitment, in the realization that sustainable growth of the Indian economy in the coming years depends upon the successful implementation of these reform measures under the coming stand-by program. I sincerely hope that the Indian authorities will make full use of this opportunity and make sure that the Indian economy turns the decisive corner--passing the point of no return.

I would like to make some comments on the policy issues for the purpose of encouraging the Indian authorities to pursue the original targets. The largest and most difficult problem is the reduction of the overall public sector deficit. I note that the Union government deficit in terms of GNP deteriorated further in the 1980s and recently reached approximately 13 percent of GNP. The most decisive action is required in this area. The elimination of subsidies and liberalization of administered prices is appreciated. However, I am somewhat skeptical about the expected cut in defense expenditure, as the proposed action is rather to defer the equipment purchases; as stated on page 12 of the staff report, "the bulk of the savings will be generated by a slowdown in equipment purchases." Does this really mean an actual cut of military expenditure on a long-term basis? I would appreciate any comment on this point by the staff or the authorities. The reduction of defense expenditure within the macroeconomic framework advocated by the Managing Director received general support at the

Bangkok Annual Meetings. Under the circumstances, the Indian authorities will be expected to take the initiative to reduce military expenditures in the region.

In addition, I would like to ask the staff and the authorities to clarify the concrete policy measures to reduce expenditure by an additional Rs 8.0 billion in the 1991/92 budget, a reduction that is critical to meet the end-year performance criterion.

As regards the reform of public enterprises, I appreciate the authorities' intention to reduce the central public enterprise deficit by a sizable amount. However, it would be better if the reduction were implemented not by cutting capital expenditure, as suggested in the staff report, but by eliminating overemployment or streamlining inefficient management, considering the need to build up the infrastructure.

As for the structural reform of the corporate sector, I appreciate the intention but regret the absence of a concrete reform plan. In addition, I would like to comment that automatic approval for up to 51 percent foreign equity ownership is not likely to be effective in inducing foreign direct investment. I would appreciate it if the staff would evaluate the effectiveness of this new incentive.

Let me turn to financial sector reform. The staff and the authorities intend to use interest rates to allocate credit more effectively, and to establish efficient capital markets as well. Here again, I appreciate the intention. However, given that the public sector is a dominant borrower of total credit and that the financial position of most of the private banks is weak, it is imperative to give priority to carrying out public sector reform and to strengthening the banks' financial position before attaching importance to the interest rate structure.

On policy design to attain the short-term economic targets of India, fiscal consolidation should be continued by all means. Consequently, the remaining, effective measures concern monetary and exchange rate policy. Since restraining inflation is earmarked as the first priority target, the exchange rate should be maintained at the current level or appreciated somewhat as a nominal anchor. In this context, monetary policy should be a major policy instrument and the current level of tightness should be maintained or tightened further if necessary.

Finally, I would like to point out I am not alone in being concerned about the estimated huge financing gap remaining to be filled in 1992/93 and 1993/94, even with the sizable stand-by arrangement. In this context, I would like to conclude my statement by emphasizing that the international financial community, including Japan, expects the Indian authorities to take the opportunity they are being given with the utmost seriousness and to use all means available to implement adjustment measures.

With these comments and expectations, I support the proposed decisions.

Mr. Wright made the following statement:

I should say immediately that I fully support this stand-by arrangement, which is critical in providing support to the Indian authorities in their macroeconomic stabilization efforts. I have a number of detailed comments on the policies outlined in the staff paper, but I would like, first, to make some more general comments.

The Indian authorities have now embarked firmly on a wide-ranging program of economic reforms. These mark a clear break with the interventionist policies of the past which stifled enterprise and stood in the way of efforts to overcome poverty. India is by no means insolvent; its external debt stock, much of which is concessional, remains, for the moment, at a comfortable level as a proportion of total national income. However, debt service payments as a proportion of foreign exchange earnings have increased recently to levels which indicate a considerable immediate liquidity problem.

If this reform program is fully implemented--by which I mean not only the policies identified in the staff paper, but also the essential follow-up measures which are as yet only under consideration--and if there is no letup in the pace of reform, then the budget deficit will be reduced, inflation will be brought under control, and the current account deficit will return to a sustainable level. India will retain its access to international capital markets, and its medium-term growth prospects will be correspondingly enhanced. India is a classic case of a member country requiring prompt technical and financial support from the Fund, a country which is fully committed to paying its debts on time, with an immediate liquidity problem, but which is ready to take the measures required to correct the imbalances that have steadily built up over time within its economy.

As Governor Singh reminded us in Bangkok, it would be a most regrettable irony if, in our efforts to find solutions to the problems of those countries which do not pay their debts, we allowed ourselves to lose sight of those such as India which, despite facing severe difficulties, continue to honor in full their international obligations. It is important that the international community should signal its support to such countries, which deserve our strong financial support during the implementation of a reform program. For this reason, we fully support the present arrangement, and would encourage the authorities to adopt the necessary strong measures to support, in due course, an extended arrangement. In this connection, this chair has already indicated that it would be willing to consider an ESAF arrangement with an appropriately significant level of access, anything up to 50 percent of quota, provided the program warrants it.

With this as background, I turn to the specifics of the program. I congratulate the Indian authorities on the impressive measures they have taken in a relatively short space of time. And similarly, I commend the staff which, in an even shorter period, has written a very clear paper. But for India, this is a just a start: the distortions in the Indian economy are so deep rooted and ubiquitous that the measures taken so far--welcome and impressive though they are--are really only a first step. Much more remains to be done, especially before the first review of the program comes to the Board.

On fiscal policy, I welcome the commitment to reduce significantly the deficit of the Union Government during the current fiscal year, and the projected further reduction next year. But this is only half the story. The deficit of the States and the Union territories is barely projected to fall at all, and the deficit of the public enterprises is expected to prove disturbingly stubborn. While I recognize the difficulty of controlling the fiscal behavior of the States, it is not an area that can be ignored, and I would urge the authorities to take advantage of all the tools at their disposal, particularly by limiting State borrowing, to exercise fiscal restraint in the public sector as a whole. The difficulty of controlling public expenditure outside the Central Government makes it all the more important that those elements of spending which are under central control--and like Mr. Fukui, I would particularly mention defense spending in this connection--be kept under the most rigorous scrutiny.

On the revenue side, India still relies too heavily on import tariffs, and there continue to be problems with excessive exemptions, and widespread tax evasion. I therefore look forward to the report of the tax reform committee ahead of the 1992/93 budget. While I recognize that it is necessary to proceed with care in such a complex area, the timetable does not seem fully to match the urgency of the situation. I would have liked to see greater immediate action to increase the efficiency of tax collection. As far as fundamental reform is concerned, there can be no slippage, and the timetable should be accelerated if at all possible.

The deficit of the public enterprises is projected to fall by only one half percent of GDP this year and the same amount next year. I would urge the authorities to speed up the privatization program and at the same time bring greater urgency to reducing central government transfers to those enterprises which remain in the public sector. The establishment of a satisfactory exit policy to close down loss-making public enterprises and the setting of hard budget constraints for the remainder should be a matter of priority.

The recent increase in interest rates was good news. However, I regret that all deposit rates were not also raised. I would urge that the current system of administered interest rates be replaced as soon as possible by a system which relies more heavily on market forces. This will lead to a more efficient allocation of savings. And I agree with the staff that a tight and flexible monetary policy will be necessary to bolster the tight fiscal policy, if the laudable goal of using the exchange rate as a nominal anchor is to be a fully credible strategy. The exchange rate could well be tested further in the coming months, in which case the authorities will need to demonstrate a willingness to take prompt and firm action in the monetary area, however unwelcome this may be.

On structural reforms, again I welcome what has been done so far, especially the abolition of cash export subsidies, and the partial substitution of quantitative import restrictions by a tradable import entitlement. However, further liberalization of prices, trade, investment and industrial policy is essential in order to increase efficiency generally. I would urge the authorities to proceed quickly with measures to reform the financial sector. There is a need to adopt measures to strengthen the regulatory framework and capital base of the financial sector, and I hope that the privatization of the state banks will ultimately return to the agenda. I also suspect that the continued link between dividend remittances and a firm's foreign exchange earnings, while an understandable short-term expedient, can only have a disincentive effect on much-needed foreign direct investment.

Overall, I am bound to say that it is hard to avoid the impression that, while this program is long on promises and plans, it is perhaps shorter than we might have wished of clearly specified actions and timetables. This is rather clear from the list of structural benchmarks for the first review. However, I am satisfied that this does not reflect any lack of commitment; rather, I think it reflects the speed with which the program is being put together, which in turn reflects the urgency of the immediate liquidity problem, and the sheer size of the problem at hand. The Indian authorities have restricted their undertakings so far to what they know they can deliver, which makes sense; but it is all the more important that what has been agreed is implemented fully and that developments are closely monitored, particularly in the area of the budget, so that any adverse performance can be quickly remedied.

The next couple of months will be crucial to the success of the program. I am confident that the authorities will continue to move forward in this crucial process of reform. It is encouraging to know that the changes under way are regarded as irreversible. This, it seems to me, is half the battle, and it bodes well for India's future progress.

The Chairman said that Mr. Wright had made an important point in expressing interest in the next program being an enhanced structural adjustment program. As far as the level of access under such a program was concerned, the size of the need and the quality of the program would have to be evaluated.

Mr. Wright responded, first, that he had made precisely that point with respect to the nature of the program and the conditions; and second, that he was merely restating the position of his chair on what it would regard as a potential level of access.

Mr. Dawson made the following statement:

I would like to join other Directors in expressing our sympathy to the Indian authorities and people over the recent earthquake.

The response to India's severe external liquidity crisis has been well managed. Under very difficult political circumstances, the Indian authorities earlier this year undertook emergency steps to arrest a rapid deterioration in the country's liquidity position. Even before the new Government was organized, plans were formulated for more fundamental policy adjustments, providing the newly elected Government with the basis for prompt decisions when it took office on June 21. The Government has since shown impressive determination not only to address the immediate liquidity problem, but more importantly, to initiate a fundamental reorientation and restructuring of the economy.

As evidence of determined management and political resolution has solidified, the international financial community has come forward to support India's efforts. The Fund, the World Bank, and the donor community have all extended themselves on an accelerated timetable and deserve credit. This demonstrates that the Fund is not so committed to other more publicized regions that India has not been able to benefit from the Fund's technical and financial assistance.

With reserves having stabilized, and recently increased a little, there is some evidence that the cash crisis aspect of India's difficulties is past its worst. There is also some evidence that inflation has crested. Crisis abatement must now give way to economic stabilization and structural adjustment. The stand-by arrangement we are reviewing lays out an economic program extending over 20 months. As Mr. Arora states, this program is a major point of departure for India. In macroeconomic management terms, it is, as he notes, a return to a time-honored policy of prudence. This is essential. No adjustment program can succeed without the necessary fiscal and monetary discipline. Disciplined macroeconomic management is not easy but past performance gives a good basis for expecting that India will find the means to implement the required stabilization measures.

The more dramatic departure in the program is the authorities' commitment to a fundamental reorientation of the economy, away from overregulation and overprotection and toward deregulation and liberalization. Major changes have already been announced in the areas of industrial policy, trade policy, and financial policy. More, and more detailed, reforms are promised. This sea change in India's economic orientation holds out the prospect of not only moving India onto a path of external viability but also of reinvigorating the domestic economy, thereby expanding the prospects for improving economic welfare for all Indians.

Reorientation of the Indian economy will be a long-term undertaking. Sustained political support will be required. We are encouraged that Mr. Arora is able to report that the process of political consensus building has advanced quite significantly in recent months. Much has been done since June, but it is not surprising that, at this stage, the authorities have not yet been able to formulate the full details of the broad agenda of reforms they have set for themselves. But, as the necessary consensus develops, we would urge the authorities to build on the momentum they have established and move forward aggressively to implement quickly the reforms they are contemplating.

In previous reviews of India's economic situation, we have had an opportunity to comment on the monetary and fiscal elements of the stabilization program, so I can be brief on this part of the program. The fiscal adjustment called for in this year's budget is substantial, the more so since it is to be compressed into the later part of the fiscal year. The one-year target of reducing the public sector deficit by 2.5 percent of GDP will be a major first step but will still leave the deficit at 10 percent of GDP. A further 1.5 percent reduction is scheduled for the following year.

It is our impression that the adjustment in the out years could, and should, be more ambitious. More space needs to be opened up for private sector expansion. External viability argues for reduced reliance on external transfers. Stronger adjustment within the state enterprise sector seems called for, a point I would like to return to in a moment.

There are still some gaps in the fiscal program for this year, so we are quite pleased to read Mr. Arora's categorical assurances that whatever needs to be done to keep the budget on track will be done.

A firm monetary policy has been adopted and will continue to be necessary both to keep inflation moving down and to defend the external reserve position. In this context, the authorities' explicit commitment to tighten monetary policy further, should net international reserves fall below the targeted floor, is reassuring.

We agree that policy-induced nominal exchange stability is an appropriate orientation for exchange rate policy following the steep devaluation earlier this year. Given the very weak reserve position, however, we do not believe it would be appropriate to overcommit the authorities by trying to peg the exchange rate formally.

Like the staff, we believe there is a good deal of scope for improving the functioning of monetary policy through greater flexibility of interest rates. This should certainly be an objective of the anticipated structural reforms of the financial system. But even before these reforms are adopted, the need to attract both internal and external savings argues for improved returns to savers.

The staff report contains some forceful criticisms of the state enterprise sector. On p.14, for example, it is stated that the central public enterprises "have for years been plagued by mismanagement and inefficiency, leading to poor returns and a need for budget support." The state government enterprises are also said to have been "subject to inefficiency and mismanagement." Good returns in the petroleum sector enterprises may be due more to their monopoly position than to efficient operation. Given the drain that state enterprises place on scarce resources and the desire of the Government to instill greater market orientation, the proposed adjustments in the public enterprise sector are disappointing. The targeted reduction in their deficit by 0.5 percent of GDP is extremely modest, even taking into account that this would be achieved in addition to a reduction of transfers from the Central Government equivalent to 0.3 percent of GDP. It is particularly disappointing that reduced capital spending would bear much of the proposed adjustment. Hardened budgets for state enterprises will undoubtedly tighten discipline but will do little to reorient the economy in a more competitive and market-oriented direction.

Likewise, the proposal to offer up to 20 percent of the shares of some state enterprises to private investment through holdings by mutual funds will not do much to instill self-reliant, private initiative in these companies, even though it will provide revenue for the Government. Similarly, the proposals for dealing with problems in State Electricity Boards seem off the mark. These Boards are characterized as having a "noncommercial orientation and uneconomic pricing." As a result, they persistently run up arrears to suppliers. The proposal to earmark government transfers for the payment of arrears to suppliers seems to be an exercise in subsidizing inefficiency rather than correcting it.

In our view, the overall orientation of the Indian economic strategy calls for a far more radical reform of the public enterprise sector. We would encourage the authorities to exercise as much boldness as the emerging political consensus permits.

While we are enthusiastic about the sweep of the intended deregulation and liberalization of the economy, we note a good deal of tentativeness and indefiniteness in the proposed implementation. For example, the trade regime is characterized as "amongst the most restrictive in Asia," yet dismantling the system is expected to extend over the next three to five years. It was particularly unsettling to read that the "eventual" inclusion of the consumer goods sector in the trade liberalization is a recommendation of the staff, rather than an intention of the authorities.

In another area, the necessity of an exit policy to support industrial restructuring is recognized. At this stage, however, the authorities are only able to express their determination to formulate such a policy. If the momentum that now exists is to be sustained, an exit policy should be adopted--and implemented--promptly.

In all these policy areas, we believe India is pointed in the right direction. Gradualism and half-measures will only frustrate achievement of the objectives the Indians have set for themselves, which is why we urge the authorities to be as bold as the emerging political consensus permits. India has earned the support of the international community, and we are happy to support the proposed stand-by arrangement. We wish the Indian authorities every success in their historic undertaking.

Mr. Landau made the following statement:

In September, this chair expressed its deep appreciation of India's new policies and intentions which aim at restoring the conditions for the sustainable growth of the economy. These include a reduction in external and internal imbalances, and the restructuring of the whole system of economic management--which, to use Governor Singh's words during the Annual Meetings, had clearly "outlived its utility." We totally concur with the staff in its assessment that in the last few months, India has made a very "promising start" on the difficult but rewarding path it has chosen.

The objectives of fiscal policy and the courageous measures already taken in this field are most welcome and will hopefully help wean the country from the excessive reliance that it developed, particularly during the 1980s, on budgetary deficits. One cannot but be impressed by the magnitude of the adjustment process decided upon for 1991/92, which should allow for a decline in the Union Government's overall deficit of 2.5 percentage points of GDP to a still high level of 6.5 percent of GDP. The staff report gives a full description of the different measures taken, or to be taken, to achieve this aim, both on the revenue and on the expenditure sides of the budget. It also rightly stresses the need for additional measures in the range of 0.3 percent of GDP. In this regard, due attention should certainly be paid to the rise in current expenditures, which is scheduled to reach 17 percent this fiscal year with another increase of 10 percent next year when capital spending will be virtually frozen. The authorities' resolve in this area will continue to be a key factor in the restoration of confidence. I am very heartened by the categorical assertion made on this point by Mr. Arora in his statement.

Effective control of public expenditures at the States' level will also prove crucial since such expenditures amount to 16 percent of GDP. Indeed, the public deficit at the States' level could reach 4.3 percent of GDP this year. In this context, the central authorities must adopt all necessary measures to ensure that restrictive actions taken on the union budget are not offset, and, for that matter, that they are supported by state budgets. We welcome, in particular, the intention to reduce the statutory liquidity ratio applied to commercial bank holdings of public bonds. This would also help reduce the monetary financing of the public sector which was still, during the last fiscal year, the major cause of the increases in monetary aggregates. Monetary measures have already been taken in order to reduce mounting inflationary pressures, and the staff mentions the authorities' intention to further tighten policy in case of renewed tensions on the reserves or the exchange rate.

Of crucial importance will be developments in interest rates. Steps have already been taken--some of them very recently--in terms of liberalizing and raising rates. However, interest rates on more than half the credits remain subject to controls. The aim must be to achieve positive real rates, at least by raising imposed ceilings, even for deposits and preferred sector credits. Decisive action in this field helps not only in the fight against inflation and in improving the allocation of resources; we agree with the staff that it also constitutes a clear and useful message to all economic agents, including potential foreign investors.

India must be especially commended for carrying out both rigorous macroeconomic adjustment and bold structural reforms. In spite of the difficulty of the endeavor, the authorities are aware that these are mutually reinforcing objectives. The radical departure from past industrial policies should substantially reduce some major hurdles to economic activity and growth. Since we broadly agree with the staff's comments on this topic, I will dwell only on four major aspects of structural policies, namely, the restructuring of the public sector, the tax reform, the new attitude toward foreign direct investment, and the liberalization of trade.

As a result of the package of measures announced in July, the public sector should come up against increasing competition. A first step will also be taken in the direction of privatization. Those preliminary measures should be completed as soon as possible, in particular, by the formulation of a legal as well as a social framework for the closure of chronically loss-making companies. I am quite encouraged by the reference in Mr. Arora's statement to his Finance Minister's statement on this point at Bangkok. It is also important, in this regard, that the restructuring effort include state government firms. Similarly, the publication of the precise conditions and timetable for asset sales would be most useful.

We also welcome the authorities' commitment to make the first steps toward a comprehensive tax reform part of the next budget. The staff rightly points to the need for, inter alia, reducing excessive reliance on import tariffs and broadening the tax base. We support the request for Fund technical assistance on these matters.

As far as foreign direct investment is concerned, the authorities are carrying out what could become a major reversal of past policies. Last July, clear principles were announced. It is important that no gap appears between the principles laid down and the modes of implementation of the reform. Indeed, an unequivocal move in the direction defined last July would go a long way toward alleviating what Mr. Arora has rightly called the "inhibitions" of financial markets in providing spontaneous capital inflows.

The foreign investment reform is closely linked to the modification of the overly restrictive trade system. In this regard, we very much welcome the announced measures of liberalization. In view of the weakened reserve position, we can understand the rationale for restrictive measures on imports, although their potentially negative impact on export capacity should be limited to the maximum extent and, as the staff states, such steps should be temporary and nondiscriminatory.

Progress in all these aspects of structural reform will be crucial for the coherence and the credibility of the program. It is welcome that there has been a special emphasis on structural reforms in defining the performance criteria and benchmarks for the first review.

Finally, let me reiterate our support for the policy of nominal exchange rate stability adopted by India since the devaluation of July 1991. We consider such a policy to be an indispensable anchor in India's current difficult situation and a strong means of containing inflationary pressures. However, and as stressed by the staff, the credibility of this stance hinges heavily on the continuation, on a long-term basis, of appropriate fiscal, monetary, and structural policies.

As far as the arrangement for the use of Fund resources is concerned, let me say that we can accept the proposed scheme. The level of access, namely, of 75 percent for the whole program and 45 percent on an annual basis, could have been somewhat higher but seems reasonable in view of the significant amounts already disbursed this year. The sequencing of reviews and disbursements is also appropriate.

May I add that this chair would give favorable consideration, when the time comes, to a request to transform the stand-by arrangement into an extended arrangement, especially in view of the strong content of structural reforms incorporated in the present program.

Current developments in India potentially amount to nothing less than an important shift of emphasis in the economic policy of a major economic power. The authorities' ambitious program for adjustment and reform, their readiness to adopt additional measures when needed, and their decision to respect debt service obligations in such difficult circumstances, all strongly merit the support of the international financial community. India's stance is all the more commendable in that, as Mr. Arora mentioned in his statement, it has chosen the road of adjustment and reform in a global environment that is not as favorable as it could be. Consequently, multilateral institutions and bilateral donors have been strongly and adequately supportive of India's efforts. We look forward to the successful conclusion of a structural adjustment loan with the World Bank. As for the Fund, it has a major role to play in this process in terms of financial assistance, guidance and monitoring. We thus agree with the proposed decisions and wish India every success in its endeavors.

Mr. Végh made the following statement:

First of all, we have to commend the stabilization effort and policy action implemented recently by the new Government in India. It is clear that the agenda of structural reform announced by the authorities represents a break from the interventionist policies of the past. The changes already introduced go a certain way toward gradual elimination of bureaucratic intervention, allowing free entry of firms to the market and opening up the economy to increased domestic and foreign competition.

At the same time that we welcome these movements toward structural reform, it is essential to accelerate the process of fiscal consolidation. Discipline in public finances has been a permanent characteristic of economic policy in India since independence, and it would be highly undesirable for the Government, at the same time that it takes the road of liberalization and market economics, to abandon its traditional principles of fiscal discipline. It is indispensable, therefore, in the area of fiscal consolidation, that the program for reducing the overall deficit maintain in the following years the speed projected for the 1991/92 budget in order to reach by 1994/95 a manageable level of 2.5 percent of GDP. In order to achieve this target, I believe that the burden of fiscal adjustment has to be more equally distributed between the Union Government, the States, and the public enterprises. In this sense, I was rather worried by the figures in Table 4 of the staff report. With respect to public enterprises, special attention should be given to the Electricity Boards run by the States by means of a complete overhaul of their present inefficient and unfair pricing system. As I have pointed out in the Board's discussion of other country cases, especially in the context of Eastern Europe, subsidizing the residential electric consumer by imposing an additional burden on the industrial consumer is not only inefficient from the point of view of the allocation of resources, but also unfair in terms of income distribution, since the bulk of the subsidy goes to high income families.

The lack of information on the quasifiscal deficit makes it difficult to obtain a full account of the real dimension of the fiscal problem the country is facing. In this connection, we would appreciate any comment the staff may have on this issue, and particularly on the existence of the remunerated reserve requirement and exchange rate guarantees as generating sources of that deficit.

In the external sector, we would postulate the prompt elimination of the import compression measures and multiple currency practices adopted in the face of the recent emergency situation. Quantitative restrictions on imports and discriminatory measures with respect to different goods and services are in conflict with the main objective of producer efficiency and consumer welfare. A comprehensive reading of the staff report leads to the conclusion that there is still in India a strong bias against imports and a lack of recognition of the basic economic fact that only a policy of import liberalization can lead to a strong export sector through the assured provision of inputs of high quality and low prices.

On the financial front, moreover, we welcome the recent introduction of a number of measures to tighten monetary policy further. However, we encourage the authorities to adopt timely and decisive action in the interest rate structure both to prevent the burden of monetary tightness from falling disproportionately on those sectors without access to preferential credit and to make the commitment to exchange rate stability more credible.

Finally, I would like to refer to the concern about the risk involved for the Fund in this and other likely arrangements with India in the future. External financing gaps are projected to extend through 1994-95 at least, and the adjustment efforts are likely to require additional support from the Fund beyond the present stand-by arrangement, as well as from other sources. In addition, debt service has become more rigid, with the shift from concessional sources to commercial financing, and the stock of external debt has been growing at a faster pace than the economy as a whole during the last three years, and is expected to continue doing so for the next few years. The ratio of total external debt to GDP is projected to increase from 24 percent in 1990/91 to almost 36 percent in 1992/93. The rate of increase is a matter of concern although it should be pointed out that the higher figure for the debt/GDP ratio is still far from the actual proportions already reached by some industrial and developing nations. If we look at the time distribution of repurchases, there seems to be a critical bunching of projected payments to the Fund in the three-year period from 1994 to 1996, which should be a matter of concern for the Government and for the Fund because it concentrates about two thirds of total debt service in the 1990s. All things considered, India's impeccable record of debt servicing to the Fund and other creditors, its record of cooperation, and the quality of the program being implemented are, in my opinion, strong arguments for the staff proposition that this credit risk is fully justified.

I fully support the proposed decision.

Mr. Kafka made the following statement:

During our last Article IV discussion on India in June 1990, the Board commended India's very strong growth during the 1980s--5 1/2 percent per annum, which was very much above the average of the previous decade, with impressive gains in both agricultural and industrial productivity, a very low rate of inflation, and a remarkable reduction in the country's structural rigidities. However, there was concern in the Board about the central government deficit financed largely by monetization. As can be seen from their impressive letter of intent, the authorities understand very clearly the danger of departing from an austere fiscal policy.

The target for reducing the fiscal deficit by 4 percent of GDP in only two years is ambitious but indispensable. It is commendable that the improvement in the fiscal position in 1991/92 is to be equally shared between revenue and expenditures. The staff shows some concern about the continued high level of subsidies, particularly in the case of fertilizers and food. Already there has been some reduction, but one must consider that an abrupt reduction of food subsidies could create social tensions which could jeopardize the economic program. What should be considered is a subsidy scheme, targeted more effectively on the poor.

The authorities' intention to hold the nominal exchange rate to strengthen confidence will be credible as long as it is supported by very tight financial policies and export liberalization. This makes India's need for commitment to these policies even stronger since it implies adopting the exchange rate as an anchor of the program.

The presentation of an alternative medium-term scenario, in addition to the baseline scenario, is very helpful. It is a practice that should be more frequently adopted. The alternative scenario shows clearly that even with lower savings, lower investment, and lower export growth, debt service--compared with the baseline scenario ratio--is still very low by any standard, for developing countries or otherwise, and it increases only from 24.7 percent of GDP to 26.6 percent in 1996/97.

The financing gaps that are expected to reappear in the last two years of the medium-term baseline scenario are small in 1995/96 and 1996/97 ($1.3 billion and $0.3 billion, respectively) and easily covered, if necessary, for example, by a small reduction in imports. India had, in the very recent past, one of the highest credit ratings among developing countries, and all indications are that it should easily recover that rating after this program is successfully implemented. As far as the Fund is concerned, India's unbroken, prompt payments record to international financial institutions fully justifies the extension of the Fund's financial assistance, which must be considered riskless.

What India has done in the recent past amounts to a fundamental shift of economic strategy. The reforms in industrial licensing, private and public sector competition, trade liberalization, and foreign investment show how much they have already done; the benchmarks for the first review are extensive and detailed and indicate that a radical economic transformation is already in process.

In sum, India's program is extraordinarily impressive and commendable. We thus strongly support India's stand-by request and ask Mr. Arora to convey to his authorities our sympathy regarding the recent earthquake and our best wishes for the success of their economic program. It goes without saying that we would look with favor on an appropriate request for an extended arrangement and concessional assistance.

Mr. Al-Tuwaijri made the following statement:

In response to a severe economic crisis, the new Government has acted with commendable swiftness to put in place a comprehensive and far-reaching adjustment program. Moreover, the commitment with which the authorities have embraced the task before them, as described in Mr. Arora's statement, augurs well for the success of the program.

Extensive government regulation and a decade of large fiscal deficits resulted in a deep-seated weakness in the Indian economy. The consequent vulnerability of the economy was brought to the fore by recent external shocks and domestic policy slippages, which led to an acute liquidity crisis. In trying to redress these problems, the proposed stand-by program strikes an appropriate balance between short-term stabilization and longer-term growth-oriented, supply-side measures. Indeed, the structural reform component of the program is geared to setting the foundation for a fundamental reorientation of the economy toward greater emphasis on open markets and market-based signals. Needless to say, success in stabilizing the economy in the short run will be essential to the longer-term success of these structural reforms.

On the whole, I support the staff's appraisal, but would like to emphasize a few points.

Strong fiscal action is essential to both India's stabilization and structural reform efforts. Fiscal consolidation is crucial for achieving an improvement in the external position and, at the same time, providing room for a revival of private sector investment. The authorities have already implemented some difficult measures, such as the reduction in subsidies, that demonstrate their commitment to fiscal consolidation. Nevertheless, it is important that the process of fiscal adjustment be reinforced to ensure sustained progress in this area. In this regard, I urge the authorities to expeditiously implement a comprehensive tax reform and a more effective expenditure control system. In the context of the tax reform, every effort should be made to minimize existing loopholes and distortions that would otherwise dilute the impact of the program's structural reform measures.

The Central Government is able to influence the fiscal performance of the States only indirectly. Therefore, it is prudent that the program does not rely on the States contributing to the overall fiscal adjustment. However, adjustment at the state level should be encouraged, and, therefore, I welcome the authorities' efforts to impose some indirect discipline on the states' spending, and I urge them to explore further channels to promote consolidation at the state level. In this regard, an early reduction in the statutory liquidity requirement could yield some benefit by hardening the States' borrowing constraint, in addition to liberalizing the portfolio management of the banking system. In fact, my understanding of the liquidity requirement indicates that the improvement in the Central Government's financial position would make more funds that are held captive under the liquidity requirement available to the State Governments. Clearly, this creates a risk that a reduction of the Central Government's budget deficit would be offset by a softening of the States' borrowing constraint.

On monetary policy, I fully support the staff's position that the authorities should be ready to make more active use of interest rate policy. This is particularly true in view of the authorities' desire to use the exchange rate as a nominal anchor and the need to revive private-sector capital inflows. Thus, I welcome the authorities' recent actions to raise interest rates, especially on deposits. However, a more aggressive stance on deposit rates, which are now only slightly positive in real terms, would help instill greater confidence in the authorities' inflation target. In addition, the scope of preferential lending should be cut back in order to promote the efficient allocation of savings as well as to spread the burden of monetary tightness more evenly. This also would increase the share of bank lending extended at market rates, which would help to improve the financial position of the banks and thereby facilitate the liberalization of interest rates on deposits.

The authorities have initiated an ambitious program of structural reform in the industrial sector. Key to the success of this program will be the ability of enterprises to take advantage of the reduction in government regulations. In this respect, as the authorities clearly recognize, the timely introduction of appropriate exit policies will be critical to ensure that the full efficiency gains of industrial restructuring will be realized. With the National Renewal Fund now in place, I urge the authorities to press ahead with implementing effective exit policies.

Before concluding, I would like to note that although the Indian authorities have already taken a number of significant policy steps, much remains to be spelled out by the time of the first review. Therefore, I fully support the phasing of purchases under the proposed stand-by arrangement. Moreover, many of the policy actions, upon which the review is conditioned, are essential to the durability and success of the adjustment program. Therefore, I would encourage the authorities to accelerate the implementation of the measures. With these remarks, I support the proposed decisions, and wish the authorities every success in their efforts.

Mr. Clark made the following statement:

The new Government, when it took office in late June, was faced with a very serious situation. Not only were foreign exchange reserves at a dangerously low level, requiring an immediate policy response, but it was very evident that there were deep-seated problems in the Indian economy that would require fundamental changes in policy. The measures adopted since June are clearly in the right direction and are a very welcome indication of the commitment of the authorities to significantly strengthened macro policies and radical structural reforms. However, while we are encouraged by these actions, it has to be stressed that this is only a beginning. The external situation remains difficult and a strong and continued adjustment effort will be needed to fully restore confidence, both domestically and externally, to ensure external viability, and to put the economy on a path of sustained growth.

In commenting on the program, I would like first to address macro policies and then the need for wide-ranging structural reforms. Strong fiscal action, together with a continued tight monetary policy, is critical to the success of the program. In our view, the planned reduction in the public sector deficit is probably the minimum that is necessary; indeed, it may well be that the authorities should be considering a more rapid fiscal consolidation. The targeted reduction in the deficit of the Central Government for 1991/92 is unchanged from the target set in late 1990, although the delayed presentation of the budget means that the planned reduction must be concentrated in the last eight to nine months of the year. Moreover, the targeted deficit reduction for 1992/93 is only one half percent of GDP greater than indicated in January when India requested a first credit tranche drawing. At that time, we had reservations about the pace of adjustment and felt that stronger measures might well be appropriate.

Developments since January, if anything, reinforce our concern. The external position is now more fragile, reserves having fallen further, and the estimated financing gap, both this year and over the medium term, has widened. Furthermore, the assumptions on the external side, particularly on the growth of exports, may well be on the optimistic side. Although the repercussions of the Middle East crisis are largely over, the external environment is not particularly favorable. Only a slow recovery appears to be under way in the industrial countries, while the deteriorating economic conditions in the Soviet Union, which accounted for 16 percent of India's exports in 1989-90, make prospects for exports to that market highly uncertain. There thus would seem to be an even more urgent need to address the imbalances in the Indian economy and reduce the reliance on external savings.

In the present circumstances, the reduction in the deficit of the Central Government targeted for this year may well be all that realistically can be achieved. However, as a signal of the seriousness of the authorities' intentions to reduce imbalances in the economy, it is essential that the target be met. Looking ahead, we would encourage the authorities to seriously consider more ambitious targets for reducing public sector deficits over the medium term than those now projected, which do not strike us as particularly ambitious. We are concerned that without greater fiscal consolidation, the prospects for sustained growth and a return to external viability may be at risk. Even on the basis of the relatively optimistic assumptions underlying the medium-term scenario, India's external position remains fragile, with only a gradual decline in the financing gap. Moreover, India will be having to adjust in a world environment in which demands on savings are likely to be strong.

Clearly, it will not be easy to achieve the planned reduction in the public sector deficit, let alone a more ambitious target. Although the planned tax reform, as well as measures to reduce tax evasion, will be important in strengthening revenue performance, expenditure restraint will have to play a major role. We welcome very much the steps taken recently by the authorities to reduce outlays on subsidies and the scaling back of defense expenditures. Nevertheless, such unproductive expenditures continue to form a large component of the Central Government's budget. As Table 14 in the background paper on recent economic developments shows, expenditures on defense accounted for 16 percent of the central government budget in 1990/91, more than double the amounts budgeted for education, health, and other community and social services.

The Managing Director, in his recent speech in New Delhi, commented on the recent easing of East-West tensions and the possibility of substantial cutbacks in defense spending by major powers. He suggested that, while the optimal level of defense spending depends on many factors and involves a complex value judgment for those responsible for a country's security, other countries should also reassess military spending, to see to what extent human and financial resources could be transferred to activities that would more directly contribute to growth and the reduction of poverty. I fully support this view. In India's case, it is difficult to see how the authorities can meet the goal of a substantial reduction in the public sector deficit over the medium term, and at the same time, improve India's poverty profile and provide some protection against the cost of adjustment for the poorest, without reassessing expenditures on defense and subsidies.

I have stressed the need for deficit cutting-measures, as I feel that fiscal policy, as with most Fund programs, is at the heart of the Indian program. However, continued monetary restraint is also critical to restoring confidence and ensuring the credibility of the authorities' exchange rate policy. We agree with the staff that India should move away from reliance on direct, selective measures of credit restraint and place much more emphasis on interest rates as a means both of allocating credit and signaling the determination of the authorities to defend the exchange rate.

The lengthy list of structural benchmarks for the first review of the program attests to the emphasis that is being placed on liberalizing the Indian economy and integrating it with the world economy. As Mr. Arora notes in his statement, these proposals and the actions already taken represent a significant break with the past. We welcome very much the recognition by the Indian authorities of the need to move away from the inward-looking policies of the past, and to reduce the excessive regulation that has characterized the Indian economy. The measures that have been taken and that are planned will provide a basis for a long overdue restructuring of the economy, and, over the longer term, an improved supply response, thereby contributing to stronger growth.

I do not propose to comment on the various structural reform measures, but simply refer to two areas that I regard as particularly important. The first concerns the need for concrete plans for the restructuring or closure of those public sector enterprises operating at a loss. I would urge the authorities not to delay, despite the political difficulties of such decisions. More often than not, a postponement only means that the problems get worse, increasing the cost of taking action. The second area that I feel should be on the Government's agenda for early action is reform of the banking sector. Action in both these areas is critical to the success of other reforms.

We can support India's request for a stand-by arrangement. The authorities clearly face a daunting challenge, but have made a promising start toward meeting them. In light of their strong commitment, we are extremely hopeful that the crucial first review of the program will take place as planned and show substantial further progress.

Mr. Kyriazidis made the following statement:

Let me join other Directors in expressing this chair's deepest sympathy to the Indian authorities on the tragic loss of lives in the recent earthquake.

As clearly depicted in the staff report, India is facing a deep economic crisis. The weaknesses and limitations of the development strategy pursued so far, based on a growing involvement of the state in the economic field, through the public ownership of industrial, manufacturing, and trading activities, have become evident. The large deficit in the Government's budget, the extremely weak balance of payments position, the sluggish growth of output, and the persistent conditions of poverty for a large part of the population are heavy inheritances of the past, although exacerbated by recent events--namely, the crisis in the Middle East.

This chair is pleased to ascertain that the new Indian Government has reacted to this situation with extreme vigor, embarking on a bold reform process which may radically improve the future prospects of economic development for the country. Mr. Arora's firm statement reassures me that the reform process set in motion is irreversible. The bold endeavors of the Indian Government merit, in my opinion, the concrete support of the international community, in particular when we take into account the undoubted positive effects to be derived by the other countries of the region from a stable and growing Indian economy. Therefore, this chair endorses the proposed decisions.

Notwithstanding my positive judgment on the new economic strategy of the Indian Government, I cannot but emphasize the crucial need to strengthen the stabilization program and to deepen the structural reform in order to firmly address the main structural weaknesses of the Indian economy that may be summarized in, first, a large overall public sector deficit, and second, the low efficiency of the productive structure.

Fiscal adjustment is the central pillar of the stabilization effort. The programmed measures on both the revenue and the expenditure side represent a significant first step of the adjustment strategy. However, as clearly emphasized by the staff, fiscal consolidation must be sustained by a comprehensive reform of the tax system in order to reduce India's dependence on tariff revenues. This chair welcomes the commitment of the Indian Government in this area; in addition, we encourage the Central Government to implement all possible measures in order to make State Governments' budgets consistent with the ongoing fiscal adjustment despite the political difficulties that might arise. In my view, this is crucial both to reverse the longstanding trends that have undermined India's external position and to increase the credibility of the Government's stabilization policy.

As far as economic efficiency is concerned, the policies to be pursued are two in number: first, to dismantle the net of regulations that stifle economic activity, and second, to open the economy to international competition.

Hence, this chair welcomes and supports the structural reforms announced last July. However, in the context of the industrial deregulation policy, I encourage the Indian authorities to strengthen their efforts to attract foreign investment by removing, promptly, the link between dividend remittances and firms' foreign exchange earnings.

Even if significant action is taken to reduce government intervention and enhance domestic competition, India's trade regime remains the most restrictive in Asia. This chair is aware that the present critical situation requires a strong response, and in this spirit I agree with the staff in approving the exchange restrictions represented by the advance import deposit and prior clearance requirements for import payments. From a more general point of view, this chair is pleased with the Indian authorities' intention to "substantively dismantle" the present system of high nominal tariffs and pervasive nontariff barriers but considers the programmed period of three to five years too long in the context of the trade liberalization policy. An acceleration of the process of India's integration into the world economy would provide the spark for a more rapid process of economic development. From theory, we know that trade should make faster growth possible. Whether faster growth indeed results depends on institutional and policy arrangements.

In this regard, I would like to make very short comments on two issues: exchange rate policy and wage dynamics. On the first issue, this chair welcomes the commitment of the Indian Government to stabilize the exchange rate and to maintain competitiveness by implementing tight financial policies. Further depreciations of the rupee could have negative repercussions on the economies of the other countries of the region, exacerbating the economic fragility that characterizes the whole area.

These considerations lead me to the second issue. Very few comments on wage policy can be found in either the background paper or the staff report, also because data became available only with a considerable lag. Therefore, this chair does hope that it is the intention of the Indian authorities to pursue a wage policy that will not undermine the efforts of stabilization. A coherent wage policy is necessary to avoid the risk that the implementation of tight financial policies would translate almost entirely into reduced employment with small, if any, effects on inflation. Such a situation would make any stabilization program short lived.

Let me briefly conclude by emphasizing the need for strengthening the structural reform process of the financial sector which plays a crucial role in the development process through the allocation of such a scarce resource as saving. Therefore, this chair encourages the Indian authorities to promptly address the problem of the weaker and undercapitalized banks and to free up bank deposit rates that could have significant positive effects on the external accounts.

With these comments, this chair supports the proposed decisions and wishes the authorities well in their challenging endeavor.

Mr. Goos made the following statement:

First of all, I should like to commend the new Government on its swift response to the deteriorating economic situation that it faced on taking office in late June this year. The measures already taken and envisaged under the authorities' adjustment strategy are indeed quite encouraging, and that strategy, inasmuch as structural reforms are concerned, would indeed represent "a clear break from the dirigiste policies of the past." However, much remains to be done to validate such an assessment. Actually, the authorities are faced with a largely unfinished agenda, which brings back unfortunate memories of the rather unsuccessful attempt under the extended arrangement of 1981 to embark on a comparable exercise of structural reforms and deregulation. But I must admit that I took some comfort from the report of the Managing Director on his visit to India where, as I understand, the authorities unanimously stressed the irreversibility of their reform intentions. Still, and without minimizing the importance of the measures already taken, I am concerned that a large and crucial part of the structural reforms is scheduled for implementation, or even just for preparation, only by the time of the next review. This approach has a flavor of undue gradualism, giving rise to the risk that the momentum of reform might be lost--once again, I might say--in the rather pervasive bureaucratic apparatus of the Indian administration.

While appreciating that the implementation of some of the remaining reforms requires time-consuming legislation, and acknowledging that the new Government had, within a short period of time, to concentrate on crisis management, there are a number of crucial reform measures which I would have thought should have been taken as prior actions. Such reforms include, inter alia, the abolition--and not just the relaxation, as mentioned in Table 7 of the staff report--of the prior approval requirement for capital goods imports; the elimination of quantitative restrictions on imported inputs and capital goods for export production; the lifting of the existing limitation on public enterprises to set prices according to market forces; and the hardening of the budget constraint facing state governments. Moreover, like Mr. Landau and others, I feel that the financial sector remains unduly constrained by pervasive regulations, including administered interest rates and selective credit controls. The very limited reform intentions in that area are one of the most serious shortcomings, I believe, of the proposed arrangement, in particular in view of the urgent need to mobilize national savings and thereby contain pressures on the external accounts and exchange rate developments. In this context, I should like to urge the authorities to secure without delay deposit rates that are sufficiently positive in real terms, although I am not quite clear to what extent the latest adjustments might have already reached or met this objective. I would also reiterate my concern about the Government's decision not to privatize public banks.

Other shortcomings of the agenda for reform include the following. First, the limited liberalization of the regime governing dividend remittances for foreign direct investment. These remittances are unnecessarily, and indeed in a counterproductive manner, restricted to the amount of actual foreign exchange earnings, a point made also by Mr. Wright. Second, the unduly gradual approach envisaged for tax reform. Given the importance of the reforms for macroeconomic stability, I would have thought that most of the measures should be ready for implementation already by the next review and not only as part of "a timetable for action in the medium term," as indicated in Table 7. Third, I was concerned to note that administered prices are being managed on the basis of distributional considerations. For well-known reasons, such considerations can be met in a more effective manner through direct income transfers.

That said, we also encourage the authorities to accelerate as much as possible the intended reforms of the public enterprise sector. Rapid progress in that area seems to be of critical importance because the public enterprises account for about one third of fixed investment but only one quarter of nonagricultural GDP. To conclude on the issues of structural reform and deregulation, I think Mr. Wright had it perfectly right when he stressed that the program so far is quite long on promises and intentions but rather short on specific actions.

On macroeconomic policies, while appreciating the progress intended for 1991/92 in fiscal consolidation, like Mr. Dawson, Mr. Clark, and others, I should like to encourage the authorities to aim at more ambitious adjustment for 1992/93 than envisaged under the program. The overall deficit of 8.5 percent in terms of GDP projected for the next fiscal year appears to remain excessively high; what is more, it would imply a considerable slowing in the pace of adjustment, in particular no further consolidation in the fiscal accounts of the States and Union territories, and only marginal progress in regard to essential public enterprises. Such a slowing of the pace of fiscal adjustment would be difficult to reconcile with the continued precarious external situation projected by the staff.

The same point applies in a sort of mirror fashion to the very limited progress expected in the external current account for 1992/93. That concern assumes additional weight considering that export projections appear to be based on rather optimistic assumptions, and here I fully share the views expressed by Mr. Clark. As I understand it, the Soviet Union has been the second most important export market for India, accounting not just for 16 percent, as Mr. Clark mentioned, but for 20 percent of India's export earnings. Considering the economic disruptions in the Soviet Union, I find it difficult to see how the likely decline in export shipments to that country could be offset in the short run by higher exports to other markets. This appears all the more questionable in view of the relatively low sensitivity of the Soviet market to product quality, the fierce competition on Western markets to be expected for India's traditional manufacturing exports, and also the rather subdued growth performance in industrial countries. Maybe the staff would care to comment on this point and the export projections.

With these observations, I can support the staff appraisal and the proposed decisions.

Mr. Torres made the following statement:

We welcome today's discussion on India. As Mr. Arora has so well pointed out in his statement, it gives us the opportunity to review a comprehensive economic program that contemplates the stabilization measures, as well as the radical structural changes greatly needed by the Indian economy. In general, the economic program for 1991-1993 represents a welcome step in the process of stabilization and structural reform. However, there is still much to cover in this process, and we have some concerns with respect to the size and nature of the adjustment measures, as well as with the pace and extent of the structural reforms.

The reduction of the fiscal deficit is a key element in the stabilization program. We welcome the authorities' efforts to reduce the overall fiscal deficit in 1991. However, the results may not be as projected given the short period of time remaining for the implementation of the measures. Therefore, the authorities must be prepared to adopt tighter monetary measures in order to control inflation and sustain the external position. We are pleased to know from the staff's supplement that some actions along these lines have been taken. Nevertheless, the burden of the adjustment should not rely so heavily on monetary policy. Evidence shows that such a policy mix may be costly in terms of economic activity and income distribution. Therefore, stronger actions are required in the fiscal area for the following years, especially given the already heavy debt burden. I agree with other Directors that the reduction of the public deficit from 10 percent of GDP in 1991/92 to 8.5 percent of GDP in 1992/93 is a moderate step and still imposes strong pressures on monetary policy. It would be advisable to further review the fiscal accounts in order to determine whether there is more room for additional measures. The strengthening of the financial position of the public sector also requires the adoption of administrative procedures aimed at increasing the authorities' control over fiscal activity. We welcome the actions taken in this area, in particular those related to central public and state government enterprises.

The important role that monetary policy has to play in defending the external reserve position and controlling inflationary pressures requires the utilization of more market-based instruments. The actual combination of indirect and direct intervention has negative effects on the efficient allocation of financial resources, in particular when the discretionary protection of some sectors and selective credit controls are reinforced. We understand the difficulties of developing a more transparent mechanism of monetary management. However, policy measures should be gradually oriented to this end. Notwithstanding the actual need for tightening monetary policy, the recent actions taken by the Reserve Bank of India still rely heavily on direct controls. Further steps should be taken to liberalize interest rates in order to allow market forces to play a more significant role. The implementation of a monetary program based on targets for reserve money and net domestic assets could represent a very difficult task for the monetary authorities under the present conditions that combine both quantity restrictions and price controls in the financial sector.

The adjustment measures need the support of structural reforms in order to achieve lasting positive results. We welcome the initiatives taken by India's authorities in this regard. However, further efforts are required to accelerate the process of transforming India's economy into a more market-oriented system. Particular attention should be given to the liberalization of trade and exchange restrictions. The reduction of quantitative restrictions and tariffs pursued under a program financed by the World Bank is a positive step. However, we agree with the concerns and recommendations made by the staff. The financial sector and tax reforms are other areas of concern. We hope that the committees appointed to work on these issues will be able to submit their recommendations very soon. Fiscal consolidation requires the reduction and rationalization of the public sector. Strong efforts are needed to achieve this objective. The significant technical and financial resources needed to develop and implement the structural reforms require the support of the multilateral institutions, which should be strengthened.

India's external position remains highly vulnerable, and, as the staff comments, significant risks are still present, even under relatively optimistic assumptions. The medium-term scenario prepared by the staff presents significant financing gaps for the next four years, considering that the reserve position relative to imports and debt service payments will remain weak. In order to cover the projected gaps, additional assistance from multilateral, official, bilateral, and commercial sources will be needed. For this, a sustained implementation of a strengthened and well-defined program, particularly on the structural front, is a necessary condition. In this context also, this chair is ready to consider an early move from the present stand-by to an extended arrangement.

The set of measures taken by the Indian authorities, their intention and commitment to stabilize and transform India's economy, and India's excellent track record in servicing its debt, compensate for the risks involved in the Fund's exposure. Therefore, we support the proposed decisions related to the stand-by arrangement, as well as the decisions regarding the Article IV consultation. We urge the authorities to accelerate the structural reforms, and the multilateral institutions to intensify technical assistance in this area. We wish the authorities success in their important task.

The Director of the Central Asia Department said that the staff expected to be able to present more specific plans in several important policy areas at the time of the first program review, in particular with respect to financial sector reform, tax reform, tariff reform, and the rehabilitation of public sector enterprises including exit, or closure, policies. The new Government had been in office for only four months and had directed its attention, first, to formulating emergency measures to prevent a more serious balance of payments crisis. The Government had started to formulate medium-term plans, which had to be well thought through, and which took time. Together with the World Bank, the Government was working on tariff reform, under a structural adjustment loan. In November, two important committee reports would be submitted to the Government--one on financial sector reform by the Narasimham Committee and one on fiscal reform by the Chelliah Committee.

Defense spending in the 1991/92 budget was to fall in relative terms from about 3 1/2 percent of GDP--the average of the preceding three fiscal years--to 2.8 percent of GDP, the Director noted. In nominal terms, in rupees, there was a slight increase in defense spending in the current budget, but because of the exchange rate depreciation, defense imports had declined in volume terms. Whether that decline would continue remained to be seen, but the staff expected that that would be the case.

The staff would agree with Mr. Mirakhor that in order to create conditions for sustainable export growth in India, a flexible exchange rate policy in combination with a dismantling of import protection was needed, the Director continued. That process would begin with the 1992/93 budget. For the time being, the Indian balance of payments was still in the phase of slowly returning confidence and the gradual unwinding of speculation. Under those conditions, the authorities' policies of a stable exchange rate and high interest rates were most conducive to support that process. Although some appreciation in the real exchange rate was involved, given the large decline in the real exchange rate over the past year, a slight and temporary appreciation would not present an obstacle to the export recovery that was implicit in the projections.

It would be important, as Mr. Al-Tuwaijri had mentioned, to reduce the statutory liquidity ratio of banks in line with the reduction of the central government budget deficit in order to withhold those funds from the financing of state government budget deficits, the Director said. Such a reduction would almost certainly be part of the financial sector reform which was being worked out by the Narasimham Committee.

Several Directors had stressed the need for a larger fiscal adjustment than was contained in the present program, in particular in the outer years, the Director noted. That possibility, which was desirable, and its feasibility would be discussed by the mission that would review the stand-by program and start discussions on a program to be supported by an extended arrangement. On the expenditure side, whatever cuts were feasible would be discussed, bearing in mind the difficult balance to be struck between cutting expenditure on subsidies, defense, transfers to the States and public enterprises, and possible increases in social expenditures, in particular for primary education, basic health care, and the social safety net. On the revenue side, consideration had to be given to an equal balance between the speed of the tariff reduction--and the higher the speed, the better--and the resulting revenue loss and the extent to which it could be offset by the effect of tax reform on domestic revenue. The process would not be easy.

For the public sector as a whole, the speed of adjustment would depend crucially on the effectiveness of public sector enterprise reform, the Director concluded. The structural adjustment loan that was being discussed with the World Bank would also include measures to support public sector enterprise reform.

The staff representative from the Central Asian Department noted that there were four elements to the public enterprise reform, some of which were under way, and some of which were still to come. First, greater competition was being promoted by giving the private sector access to areas that had previously been reserved for the public sector. That reform had already been largely implemented under the new industrial policy announced in July. Second, greater autonomy would be given to the efficient public enterprises that would remain in the public sector. Again, considerable progress had been made through the mechanism of the memorandum of understanding, which was a broad contract between the Government and public enterprise management.

The third element of the public enterprise reform would be the closure of chronic loss makers, or the exit policy, the staff representative commented. Little had been accomplished in that area so far. Of the 250 central government public enterprises, probably 50 were chronic loss makers with negative net worth and with little prospect for a turnaround. Attention would have to be paid to them first, and in fact, one of the structural benchmarks for the first review was the formulation of a program of action in that area; such a plan of action was also among the areas covered by the World Bank structural adjustment loan.

Cost recovery, or appropriate pricing policies, was the fourth element of the reform, particularly in the area of state electricity enterprises, the staff representative noted. The problem in that respect was largely one of pricing electricity to the agricultural sector, which currently paid only a small fraction of the actual cost of electricity generation. The Minister of Finance had taken the initiative of proposing a minimum uniform tariff throughout India for all state enterprise electricity boards, and if that proposal was adopted, it would be a major step forward.

It was not so much the increase of the equity limit for foreign direct investment from 40 percent to 51 percent that was such an important incentive as the fact that many approvals of foreign direct investment would be automatic in the future, the staff representative observed. The shift from a case-by-case approach, under which most investment proposals had been rejected, to automatic approval of foreign direct investment up to 51 percent in large areas of industry was a major reversal of past policies. Whether under the present circumstances the result would a substantial inflow of foreign investment remained to be seen, but there had already been some important positive indications. For example, Ford, General Motors, and IBM had made announcements of significant new foreign direct investment since the new policy was introduced.

As to the possibility of the Reserve Bank of India incurring potential deficits as a result of foreign exchange guarantees linked to nonresident deposits, the staff representative noted that the Reserve Bank of India was profitable overall. The Bank did incur some losses on the exchange rate guarantees, and they were recognized in its accounts. The recent exchange rate change would have some implications for the Reserve Bank's balance sheet over time, but the staff did not anticipate a problem of anything like the magnitude of that of a number of other countries. The larger issue concerned the commercial banks and their undercapitalization.

On India's trade with the Soviet Union and its implications for broader export growth, the staff representative observed that 16 percent of India's exports were to the Soviet Union. The projections assumed neither a growth nor a decline of those exports over the medium term. Some exports--for instance, agricultural commodities, and basic chemicals--probably could be easily redirected to other markets, whereas other commodities probably would encounter difficulties. Overall, the problem was not of the same magnitude as in Eastern Europe.

On the broader issue of whether the export projections were too ambitious, given the problems in the Soviet Union and given the overall growth in world markets, the staff representative from the Central Asian Department added, it should be noted that the projections were not based on the continuation of present policies; they assumed a major trade liberalization that would dramatically increase the integration of India's economy with the world economy. Without such a reform, the projected export growth numbers would not be achieved, as indicated in the alternative scenario in the staff report. Thus, the projection was contingent on a major policy reform that still had to be implemented. Furthermore, increased integration with the world economy would require, in the first instance, a recovery in imports. The recovery of exports would depend on an increase in imported inputs. That was why the decline in the external current account would be quite moderate in 1992/93.

Mr. Prader submitted the following full statement:

> Changes in the international environment have underscored the need for new initiatives to overcome the bottlenecks which have long affected the Indian economy. The adjustment policy measures announced in late June should combine a comprehensive program of economic stabilization and return to fiscal prudence with a basic reorientation of economic policy away from detailed government regulation and control and toward greater reliance on market forces, foreign competition, and foreign investment as the means of promoting efficiency, improving resource allocation, and achieving sustainable economic growth over the medium term.

The stabilization program should focus on the priority goals of bringing down the unsustainable current account deficit and reducing the overall public sector deficit in a lasting way. The interconnections between these twin deficits make it difficult to distinguish external from internal causes. In any case, external shocks are to be countered by internal adjustment measures aimed at absorbing them, easing the payment situation, and releasing resources for the private sector. The severity of external influences thus depends greatly on the adaptability of a country's economic policy. The only two clearly exogenous factors in the Indian situation are the Middle East crisis, with its concomitant higher oil prices and loss of worker remittances, and the change in the pattern of financing India's external deficits.

India's borrowing possibilities have narrowed and its current account has deteriorated substantially since August 1990, and these problems have carried over into 1991. Thus, the ingredients of the current constraints were mostly inherited from the previous year. The worsening of the balance of payments and increasing pressures from the fiscal deficit not only restrict the Government's room for maneuver against inflationary pressures but also place limits on economic growth.

The monetary and fiscal measures taken in late June 1991 to stabilize and improve the efficiency of the domestic economy were accompanied by a package of external measures which the Indian Government and the Bretton Woods institutions hope will help India regain internal and external confidence consistent with its level of development and its progress in dealing with its structural problems. Despite expectations that external financing gaps will persist for several more years, creating some risk for the proposed stand-by arrangement, we support India's request for the stand-by as the request of a member which has displayed an exemplary spirit of cooperation during its implementation of a strong underlying adjustment program.

I have two additional comments. The first concerns fiscal policy and debt, while the second concerns the structural reform. Among expenditures, subsidies, defense spending, and transfers to public enterprises have all been rising much faster than the average and should be curbed as a matter of priority. An overall expenditure reduction was derailed by the rapid rise in interest payments, which are borne by the budget. Government debt accounts for a large share of India's total external debt, which has risen from 18.0 percent of GDP in 1984 to 24.0 percent in 1991. Another alarming feature of the same period was a steep increase in the stock of nonresident deposits. These began to be withdrawn in September 1990 and have led to net outflows of short-term capital as commercial banks failed to renew credit lines. It is now time to focus attention on the medium-term pattern of debt growth and the relationship between deficits and debt. In a Fund Working

Paper entitled "The Growth of Indian Public Debt--Dimensions of the Problem and Corrective Measures," Raja J. Chelliah notes that "on the basis of a number of conservative assumptions...the analysis demonstrates that maintaining the primary deficit even at a level of 3.5 percent of GDP is unsustainable because this would raise the debt-to-GDP ratio to 77.4 percent of GDP in 2000/01 from 60.2 percent of GDP in 1989/90, and the deficit-to-GDP ratio to nearly 10 percent." Does the staff agree with these forecasts of the size and rate of growth of India's debt?

Narrowing the scope of government activities, eliminating unjustifiable subsidies, and cutting defense spending is the key to stabilization. The goal of price adjustment will require a recovery of private savings and investment to correct the damage inflicted on India's current account by the large public sector deficit during the 1980s. The staff stresses expenditure restraint as a means of cutting the fiscal deficit, but while agreeing that subsidies and defense spending are ideal targets for significant cuts, I must insist that equal attention go to measures for enhancing revenue. Partly because of the large degree of fiscal autonomy of the States vis-à-vis the Union, total central government revenues and grants are low, at about 11.4 percent of GDP, and very low, considering that total tax revenues amounted to only 8.4 percent of GDP in 1991. It is clear that unlike the stabilization, the fiscal adjustment has to be based on tax reform in addition to the restructuring of public expenditures. Since it is reasonable to assume that certain expenditures, such as investment, cannot be compressed any further, at least five points must be added to the existing government revenues of 11.4 percent to bring the total closer to the developing country average of approximately 20 percent of GDP. This will form a basis for a stable public savings rate sufficient to fund infrastructure rehabilitation and domestic debt service. Could the staff make a comment on that?

The structural adjustment program should aim at creating a fully competitive market providing constructive and flexible mechanisms capable of mediating the economy's responses to social, economic, and technological changes without excessive cost. In general terms, governments make an important contribution by maintaining an adequate political and social environment and by establishing ground rules for market operations, and also by intervening in the economic process whenever intervention is certain to have positive results. An important government contribution to the process of structural adjustment is to preserve macroeconomic stability while maintaining the momentum of far-reaching reforms.

I welcome the Government's four major initiatives: abolition of the complex system of industrial licensing, the liberalization of trade, the elimination of special treatment for certain public sector industries, and the liberalization of foreign direct investment. To maintain the momentum of foreign capital inflows to support faster capacity growth and somewhat higher output growth, the liberalization of foreign investment policies should be continued. To prepare the private sector for the essential role it is expected to play in the medium term, more capital must be mobilized for achieving present investment targets. The disinvestment program for loss-making public enterprises should be accelerated. The public enterprise sector plays a central role in the Indian economy, and is frequently responsible for producing essential inputs. However, the failure of public sector suppliers of these inputs to respond to market signals results in frequent shortages. This unreliability in the supply of such key inputs as electricity and rail services has very destructive effects on capacity utilization rates. One way out of this situation is to find ways of increasing domestic saving and capital accumulation. Given India's debt service obligations, the constraints on distributional dynamics, and the level of transfers abroad, a sufficient rate of capital accumulation can only be achieved at the expense of nonproductive uses of resources derived from nonlabor income. Tax reform would be a major policy tool toward meeting this objective.

Mr. Trbojevic submitted the following statement:

We have been impressed by the Indian Government's positive approach to reform. Our chair supported India's efforts to implement such a program, and we encourage the Indian authorities to continue and to further intensify such efforts, because we think that the Indian program is the right answer to the present economic, financial, and social situation of that country.

We are in general agreement with the staff appraisal, but before I make any specific remarks, I would like to say that the most crucial problem for India at the present stage is the restoration of confidence, both on the domestic and external side. Restoration of India's economic creditworthiness demands firm action by the authorities to deal with fiscal imbalances in order to increase savings and investment, both in the public sector and the private sector. It is essential that structural reforms to promote economic growth, and trade policy liberalization as a part of those reforms, are implemented as planned and even strengthened in order to regain that confidence.

It seems clear enough that the correction of accumulated fiscal imbalances should be the first priority. We fully endorse the Indian efforts to reduce the fiscal deficit of the Union Government to 6.5 percent of GDP in the current fiscal year, but we still have a problem with the high level of subsidies, at 1.9 percent of GDP. Their reduction should be expedited. A full price liberalization, a speeded-up process of privatization, and increased competition between public and private sectors should be considered by the Indian authorities as complementary measures to a cut in subsidies. In the same context, I would raise the problem of transfers to loss-making enterprises. We fully agree and support the authorities' decision to close or restructure some of the nonviable public enterprises, but the simple fact that the Indian authorities have set end-March 1992 as a deadline to formulate specific policy proposals gave me the impression that the process might be delayed. Staff comment on this possibility would be welcome, as well as on the level of defense expenditures, which seems to be rather high under the present economic circumstances.

On the revenue side, I would restrain myself to the observation that the ratio of tax revenue to GDP has been declining, and I would reiterate a previous recommendation for an enlargement of the VAT base.

On the monetary side, we were pleased with the tightening of the policy that took place on October 8, including increases in both lending and deposit rates. We agree with the staff that the authorities should be ready to raise deposit interest rates further, should the need arise.

On the external front, I would note that India's external equilibrium is currently very fragile. The ratio of India's external debt to its GDP has increased sharply in recent years. The level of gross international reserves is still very low. Thus, in our view, one of the most important macroeconomic objectives of the program in the period ahead must be rebuilding those reserves in accordance with the staff's projection, which we fully support.

At the same time, however, I would prefer to stress the cautiousness of this chair regarding the larger involvement of the Fund in financing India's external gap. I would like to reiterate the position expressed by this chair on July 22, 1991, that for India, and for other member countries as well, the Fund should remain the lender of last resort and that its resources should be available in times of need as additional reserves, rather than become a part of regular financing. We agree with the staff that the proposed stand-by arrangement "does entail a degree of risk for the Fund". However, taking into account India's great economic potential and its past excellent record with the Fund and other creditors, we support India's request for a stand-by arrangement and the proposed decision.

Mr. A. R. Ismael made the following statement:

We welcome the comprehensive program of economic and financial adjustment that the Indian authorities are implementing in support of their request for a stand-by arrangement. Indeed, they should be commended for the bold actions they have already taken and which should help to reduce significantly the prevailing imbalances.

As has been noted by previous speakers, over the years, the Indian economy has become overregulated and thus inefficient. It is therefore encouraging to note that the authorities are giving full attention to structural reforms in order to improve the efficiency of the economy. We especially welcome the measures being implemented in the area of trade liberalization and the general deregulation of private sector activity. The strong commitment of the Indian authorities to a program of liberalization, as indicated in the letter of intent, is therefore appropriate. These reforms should go a long way in helping the authorities to achieve the objective of "exploiting the potential for robust growth inherent in the economy", as indicated by Mr. Arora in his helpful statement.

We note also that the public enterprise sector is quite extensive and has become inefficient. While welcoming the several initiatives being taken to improve its performance, we are, however, of the view that much more could be done in this sector. In addition to the envisaged closure of unviable enterprises, as mentioned in Mr. Arora's statement, could the staff comment on whether a comprehensive program of reform and privatization is being envisaged? Such a program could contribute significantly to a reduction in the public sector deficit as well as improve economic efficiency.

As regards the financial system, we welcome the liberalization process that has taken place. Nevertheless, the system still hampers economic development and a more comprehensive reform is required. The setting up of a committee to study the financial system and to make recommendations for its improvement is an important step, and we would encourage the authorities to persevere in their efforts at reforming this sector.

Overall, we are in general agreement with the thrust of the authorities' program and with the staff appraisal. While noting the staff's view that there will be a certain degree of risk for the Fund, owing to the continued existence of external financial gaps, we do not think that this is a major problem in view of the strength of the program and India's excellent past performance in meeting its obligations. The firm intention of the authorities to enhance the adjustment process, and their commitment to taking additional measures to liberalize and improve the efficiency of the Indian economy, are all important factors that augur well for the future financial position of India. We are confident that the remaining financing gaps will be closed. We can, therefore, support India's request for a stand-by arrangement.

Mr. Fridriksson made the following statement:

The new Indian Government's policy declarations, and its swift action to address the deteriorating economic situation, signal that it wishes to make a clean break with past policies and embark upon a radical reform program that will transform the economy into a modern market economy. The staff report before us describes several major initiatives that have been announced by the authorities. A picture is drawn of a promising beginning in tackling both the underlying problems and the immediate difficulties facing the economy. The stabilization package has been favorably responded to by the international community in the form of financial support for the initial efforts of the Indian authorities. Consequently, residual financing gaps under the program have been eliminated.

This is the setting for today's consideration of India's request for a stand-by arrangement involving a substantial amount of Fund resources. In assessing the program, we have, on the one hand, India's impeccable record of cooperation with the Fund and the authorities' reaffirmation of their commitment to maintain an unblemished payments record; and on the other hand, we note from the staff appraisal that the stand-by arrangement does entail a degree of risk for the Fund.

The fundamental elements of the required strategy are clear. The authorities need to bring about a major reduction in the fiscal deficit and radical structural reform. Only fiscal consolidation can change the current situation in which a large share of domestic financial savings is pre-empted by the public sector. Monetary policy must, of course, remain tight and the rationalization of the public enterprise sector be given high priority.

I note with some concern the staff's medium-term scenario, which states, among other things, that viability of the package will be strongly influenced by the strength of the adjustment program. India's continuing adjustment efforts will require additional support from the Fund as well as from other sources beyond the present stand-by arrangement. The attainment of medium-term viability is far from being assured. Should India, for any reason, fail to maintain momentum in the reform process or encounter unforeseen difficulties, Fund resources will be at risk. The process of adjustment has just begun, with many of the policies still to be formulated. The economic situation calls for prompt and decisive action, and, despite declared intentions to move away from past practices, elements characteristic of previous policies have been maintained and resorted to once more. Moreover, the envisaged fiscal improvement, particularly in the outer years, appears to be rather modest. This is a cause for concern because only decisive and decisively implemented policies will ensure medium-term viability.

Despite the apparent success of the immediate policy measures to contain the external liquidity position, there is scant evidence that confidence in macroeconomic policies has been established. Consequently, there is no room for complacency. Should the authorities' current policy fail to convince the market, then additional measures will be needed. Incidentally, I support the authorities' intention to pursue a fixed exchange rate policy following the recent devaluation. This policy reinforces the demands placed on fiscal policy.

In light of these concerns and the projected financing gaps in the next few years, it is all the more important that India quickly and decisively consolidate the public sector and continue to support the exchange rate policy with appropriate monetary and credit policies. Of equal importance is that there be no delay in the implementation of fundamental structural reforms. In this respect, we fully agree with the tone of the staff appraisal. I also note Mr. Arora's remark in his statement that there is growing political awareness of what needs to be done.

In our view, it is appropriate that agreement on a comprehensive tax reform in 1992/93 be a condition for completion of the first program review, and that corrective measures be taken, should expenditures not be contained as envisaged.

On the structural side, I am concerned that many of the benchmarks for the first review of the stand-by arrangement, while signifying impressive and needed action, simply comprise suggested timetables and not concrete plans for action. Formulation of an appropriate budget for 1992/93 and the further specification of structural reforms at the time of the first review are crucial to the success of the program.

My remarks may have been rather critical, but I would in closing like to commend the authorities for their record of cooperation with the Fund. We fully support the profound changes that are planned for the Indian economy. We, therefore, endorse India's request for a stand-by arrangement. We regret that India has taken recourse to measures that, given today's economic setting, should be avoided, and we urge the authorities to dismantle them as soon as possible. We agree with the staff's recommendations concerning the approval and nonapproval of the various exchange restrictions in force.

The Fund has been very forthcoming in its relations with India. Now it is up to the Indian authorities to live up to our high expectations.

Mr. Spencer made the following statement:

At this stage of the discussion, I do not have much to add. However, I would like to reinforce some of the earlier comments about the need for an acceleration of the adjustment process in India.

The medium-term outlook portrayed in Table 11 of the staff report shows quite starkly the extent of adjustment needed, with large financing gaps extending out to 1996, even though the projections already assume a significant intensification of the reform effort. This points very clearly to the need first, for a more aggressive and comprehensive approach to structural reform; and second, for handling India's adjustment program in the future under some form of extended Fund arrangement.

There is no doubt that the new Government has made a good start in some policy areas, but there are two aspects of the program that give me cause for concern. The first is that notwithstanding the recommended phasing of purchases, a long agenda of reforms is not due to be completed until after the initial purchases under the stand-by arrangement have been made. In other words, as noted by Mr. Wright and others, the program is long on promises but relatively short on actions.

My second concern is that many of the reforms to date continue to be of an incremental and/or patchwork nature. In too many cases, we see direct controls being eased rather than abolished; and we see new special schemes being introduced to offset distortions arising from the partial liberalization of markets. I might just mention two examples here. The first is the tradable import entitlement scheme, which appears to have been introduced to counter the effects of a reduction in export subsidies without any accompanying reduction in import protection. A second example is the special scheme aimed at attracting capital back into the country that has apparently been needed in the absence of a flexible monetary policy mechanism that would normally be expected to generate the positive real interest rates necessary to support the capital account and hence the exchange rate. The reluctance of the authorities to liberalize interest rates ahead of financial sector reform is perhaps understandable, but this example helps to highlight the difficulty of implementing a gradualist reform strategy in the face of an apparently seamless web of interacting rules and regulations.

A more rapid and aggressive approach to reform would have the advantage of avoiding the need for temporary stop-gap measures--and also has a potentially important political advantage. As the staff points out in its appraisal, the need to build a political consensus for reform has become urgent. And to achieve this, the experience in Eastern Europe and elsewhere suggests that some critical mass of reforms might be needed to get the political ball rolling, so to speak. The important thing is to achieve a sufficient momentum in the reform process such that newly affected interest groups begin to call for a spreading of adjustment costs to all groups, rather than calling for insulation from those adjustment costs.

I am encouraged by the Chairman's earlier comments regarding the emerging mood of irreversibility. And I hope that India can develop this consensus further, as I am sure it will be essential for the ultimate success of this and any subsequent programs.

Mr. Fayyad said that his chair was in broad agreement with the staff appraisal, and supported India's request for the stand-by arrangement. As emphasized by the staff and previous speakers, sustained action on the fiscal front was of critical importance, particularly if further tightening of monetary policy, which was already quite tight, was to be avoided. That was all the more so, considering the need to impart credibility to the authorities' announced intention to hold the nominal value of the rupee stable.

He had two specific comments, Mr. Fayyad continued. First, in principle, his chair could understand the rationale for not treating proceeds from asset sales on an equal footing with those resulting from structural-type deficit reducing measures, but only to the extent that such sales could not be expected to yield a durable improvement in the deficit or conditions that were at least conducive to further fiscal consolidation in subsequent years. In the light of that qualification, he would appreciate some elaboration by the staff on the justification for treating proceeds from asset sales in fiscal 1991/92 in excess of Rs 25 billion as a financing item.

His second point was a presentational one, Mr. Fayyad noted, related to the treatment of grants in the budgetary accounts. He said presentational because his chair believed that regardless of whether grants were included above the line--as, for example, in the case under discussion--or as a financing item, the determination as to the magnitude of the needed domestic fiscal effort was made in individual cases depending on the specific circumstances. Nevertheless, a case could be made for presentational uniformity across countries in that respect, by including grants above the line or as a financing item in all cases, as that would improve the transparency of the budgetary accounts and facilitate intercountry comparisons.

Mr. Mwananshiku made the following statement:

The financial assistance requested by the Indian authorities that is being considered by the Board, together with the financing provided by other sources, is no doubt of critical importance for the successful implementation of the adjustment strategy envisaged by the authorities to address the internal and external macroeconomic imbalances currently affecting the Indian economy. The staff report provides a clear and concise analysis of these problems and advances policy recommendations with which we are in broad agreement. The readiness with which the authorities decided to tackle the deteriorating economic situation, despite the current difficult political environment, is a reflection of the authorities' commitment to pursue prudent economic management and deserves the full support of this institution.

Despite the progress achieved in the recent past on many fronts, the Indian economy continued to be confronted in 1991/92 with large fiscal deficits, weakening of the external position, and the building-up of inflationary pressures. It is encouraging to note that the authorities, realizing the seriousness of the wide fiscal deficit and its effect on growth and inflation, undertook to implement a large set of measures that hopefully will reduce the overall public sector deficit by 2.5 percentage points at the end of the current fiscal year. In particular, the comprehensiveness of the measures with which the authorities intend to enhance the revenue performance and reduce significantly current expenditures, essentially by restraining military expenditures and reducing subsidies, are noteworthy. Given the burden of the public enterprise sector on the public finances, it seems that a thorough reform of this sector is warranted, essentially through early implementation of a divestiture and/or privatization program whilst improving the economic efficiency of the enterprises that remain under state control. In this regard, it is to be noted that not only are the transfers to public enterprises to be significantly reduced under the current budget, but actions are also being envisaged by the authorities to rationalize this sector. The other commendable signal is the creation of an incentive to private investment, particularly foreign direct investment, which was significantly liberalized and procedures for its approval simplified. These steps will certainly contribute to easing the burden on government finances stemming from the low productivity of many of the public enterprises, and more directly, have a positive impact on the external accounts.

In this area, significant efforts are being made by the authorities to improve the external current account position, through a better monitoring of import growth and in particular through export promotion measures that will be critically important to sustain medium-term balance of payments viability.

However, for those external policy efforts to succeed, it is crucial that India's export markets be expanded through easy access to industrial countries' markets. Considering that a significant part of the export market was directed to the Eastern European countries, including the U.S.S.R., it becomes even more important that access to alternative markets be provided in view of the developments taking place in those countries which may eventually have a negative effect on the Indian trade balance. As for the projections for the medium-term outlook, despite the strong policy measures that have been undertaken by the authorities, large financing gaps are expected to persist for years to come. We believe, however, that the strong commitment shown by the authorities, and expressed in Mr. Arora's statement, to adhere to the strong adjustment program lays the basis for continued and much needed financial assistance from the donor community. This will help to bring the Indian economy onto the path of sustainable growth with an undoubtedly positive impact on the alleviation of the widespread poverty.

Mr. Deng made the following statement:

Since the decade began, India's economic performance has been seriously disrupted by large internal and external imbalances. The economic difficulties during this period were intensified by domestic political tensions as well as external shocks, which, to a large extent, contributed to policy slippages and disruption of the adjustment process. Faced with a deteriorating economic situation, the authorities responded promptly with stabilization measures to overcome the immediate difficulties. In particular, the recent initiation by the new Government of a comprehensive economic program aimed at addressing long existing, fundamental economic problems is especially encouraging.

From the staff report and Mr. Arora's helpful statement, there is clear evidence that, despite the seriousness of the current economic situation, the authorities remain firmly committed to the adjustment effort. The policy measures contained in the program are correctly focused on the key areas, particularly on the fiscal imbalances, which have been the fundamental cause of external difficulties facing the economy. The strength of the adjustment program has begun to show its effects, with inflation dropping and gross official reserves rising significantly. In this context, it is crucial that the authorities move forward with strong and decisive action to ensure that the economic reforms not be diverted from this course.

On policy aspects, we fully endorse the staff proposals. The key to the success of the adjustment is the correction of the large fiscal imbalances. The target for the reduction of the fiscal deficit demonstrates the authorities' determination, but it also poses a great challenge; extraordinary efforts will be required in order to achieve this objective. We certainly support the various policy measures the authorities intend to implement during the period ahead. However, we would like to emphasize that, given the underlying problems, which apparently are difficult to correct in the short run, policy action should be oriented more in a medium-term or long-term perspective in order to achieve a sustainable improvement in fiscal performance.

Structural reform is important in order to ensure the steady progress of the adjustment program and a general improvement in economic performance. In this regard, the liberalization measures undertaken by the authorities thus far are encouraging steps toward the transformation of an overprotected and overregulated economy into a market-based economy. We would like to encourage the authorities to continue implementing structural measures, with priority being given to tax and public enterprise reforms as well as trade reform, so that deep-rooted structural rigidities can gradually be eliminated and the objective of sustained economic growth achieved.

Finally, we believe that the Indian authorities' firm commitment to the underlying adjustment program deserves further financial aid, and, therefore, we support the authorities' request for a stand-by arrangement. We can support the proposed decision, and wish the authorities success in their adjustment endeavors.

The Director of the Central Asian Department said that as he had already mentioned, the fact that more concrete measures of policy reform would be in place only at the first review was partly a matter of necessity, because of the time it would take the new Government to formulate a medium-term plan of action. That timing aspect had been taken into account in the phasing of purchases; as shown in Table 1 of EBS/91/176, the normal quarterly purchase would be SDR 185 million, whereas the amount available following the first review would be SDR 461 million.

The amount of asset sales that would be counted as revenue had been limited to the predetermined estimate, simply to preserve the planned fiscal effort in other areas, namely, expenditure cuts and increases in domestic tax revenue, the Director explained. If additional unplanned asset sales had been counted as revenues, the fiscal target could have been met without reducing expenditure cuts or by reducing the domestic revenue effort. By agreeing on a predetermined value of asset sales, that potential problem was eliminated.

Finally, the Director of the Central Asian Department noted that the working paper to which Mr. Prader had referred had been written for the Fiscal Affairs Department by Mr. Raja J. Chelliah, who was heading the committee on fiscal reform. Mr. Chelliah had made his estimates and extrapolations precisely to show that past fiscal policy was unsustainable.

and would eventually lead to an explosion of government debt. The fiscal adjustment that was implicit in the program kept the revenue deficit below Chelliah's threshold, and the adjustment should therefore be sustainable.

Mr. Fayyad commented that he understood the rationale for not treating the proceeds from asset sales on an equal footing with expenditure reducing/revenue enhancing measures of a structural type. His more specific question was whether proceeds in excess of the specified amount would not create conditions conducive to further fiscal consolidation. In other words, was it the staff's determination that amounts in excess of Rs 25 billion would not, in fact, be so conducive, and how had that precise figure been arrived at?

The Director of the Central Asian Department replied that any excess would certainly be desirable, but at the time the fiscal program was formulated, it had been very uncertain that such an excess would, in fact, occur. If it should occur, it should not be allowed to influence the measurement of the fiscal adjustment that had been agreed with the Government. If the staff had known with certainty that there would be an excess, it would have built it into the program and probably would have agreed on a somewhat tighter fiscal target. The authorities themselves had decided on the amount they actually planned to sell, based on their ability to do so with certainty, but without setting a limit. If there was enough absorptive capacity, they might sell more, and they should.

Mr. Arora thanked Directors for their expressions of sympathy for victims of the earthquake in India and for their strong support of the program.

Some Directors had suggested that the pace of specific policy actions was falling short of expressed intentions, Mr. Arora observed. He wished to remind the Board that the Fund, the World Bank, and the members of the India consortium had come to the country's assistance during a period when one Government had left office, in the middle of November 1990, and another had taken office, following the June elections. Ways and means had had to be found, with that assistance, to create an environment in which later policy action would be possible. The civil service, in the absence of an effective government, had been unable to do more than formulate views derived from past experience. Those views, which had been presented to the India consortium in April, had not, as a matter of fact, addressed the problems. The new Government was inclined to take a much bolder view of what needed to be done, requiring a reorientation of the entire process of thinking.

Once the new Government came to power, the basic question had been whether it would or would not default on its debt, Mr. Arora noted. Many people in India had suggested that default would in a certain sense protect the people's living standards, and that eventually the problems would solve themselves. The Government, of course, had decided that that was a dangerous, risky, and wholly suicidal view to take. With the cooperation of the Fund and other partners, the Government had decided upon a stabilization program, which had claimed its entire energy. It was fortunate that the devaluation had not led to the catastrophic consequences forecast by some, especially as it had been decided upon when the monsoon in the north seemed likely to fail; it had not rained for about four weeks, and the specter of rising food prices would have overwhelmed any stabilization program. The strong, tangible support given to India had reinforced the Government's confidence to take measures which would have a more durable value. But in July, it had been quite clearly impossible for the Government to do much more than shore up confidence in India's prospects. It would not be correct to say that no action had been taken, but in India, even liberal minds proceeded cautiously. Unlike earlier reforms, which had nevertheless contributed to India's growth, the reform undertaken in July at the height of tackling an emergency went quite a long way in indicating the direction in which India was headed.

It must also be said that there had been doubts and fears about the Government's ability to carry its policy in parliament, in which it did not have a majority, Mr. Arora added. To the credit of India's leadership, the resistance had gradually been worn down. As the Managing Director had been told by the Prime Minister and the Finance Minister, there was a virtual consensus on what needed to be done to address India's problems. The suggestion that India was somehow trying to drag its feet on essential policy actions should be evaluated in the light of the actual situation that the country had faced at the end of June 1991. True, much remained to be done, and he was grateful to those who had made suggestions, which would be communicated to the Government. He took it that Directors' comments had been made essentially from the point of view of injecting a sense of urgency into the reform process. But he wished to submit to the Board's attention the complexity and size of India and its economy, with its multilayered society of people, some of whom were living in the sixteenth and seventeenth centuries, alongside others living in the twentieth century both in India and abroad.

In addition, the reforms in all sectors were mutually interlocking, Mr. Arora noted. Simultaneous action had to be taken in many areas, and in others, it was necessary to determine what steps would take the reform process forward most effectively. For example, with respect to banking reform, it was important to strengthen the capital base of the banks before moving to interest rate liberalization, which would create problems for the banks in meeting the competition for deposits. Similarly, trade reform was a complex issue. As the Managing Director would recall, the Minister of Trade had initially thought that liberalization of the trade regime in two to three years was quite a bold objective. After four or five months, the Minister could envisage completing in two years what he had thought would take three to five years. It was a process of learning how fast action in different areas could be taken, and the first review should provide the occasion to help move that process forward. Certainly, political opinion in India seemed to support a faster move forward than had been thought possible in July 1991.

Therefore, the suggestion that India was not into a fast enough mode of action warranted reassessment, Mr. Arora considered. Of course, he would communicate to the Government the feeling that as much as possible should be done to stabilize the situation and then to move forward. Signs of stabilization were beginning to be evident, as he had mentioned in his statement, but fiscal adjustment and the implementation of the budget were of paramount importance. Some Directors had suggested that the process of fiscal adjustment was perhaps too slow, and that a reduction in the deficit of 4 percent over a two-year period might need reconsideration. But based on the experience of the past ten years, fiscal adjustment of that order of magnitude appeared to be quite strong. It was very difficult to change expenditure patterns in a short time frame without creating the risk of very serious problems. Some economists in India suggested that a reduction in the deficit of from 1.5 percent to 2.5 percent in one year could depress economic activity to the point of disrupting the adjustment process. The creation of a serious unemployment problem because of much stronger fiscal adjustment and depressed economic activity might sound good in theory, but in practice, it would lead to serious problems of adjustment in a country where unemployment was already quite high.

To conclude, Mr. Arora said that he welcomed the suggestion made by Mr. Wright and by other Directors on converting the program under the stand-by arrangement into a medium-term program, perhaps with an added element of an ESAF arrangement. That was indeed the intention of his authorities.

The Chairman made the following summing up:

Executive Directors welcomed the measures taken by the authorities to correct an exceptionally difficult external payments situation. A series of stabilization measures had been implemented to cope with the immediate crisis; soon thereafter, a comprehensive adjustment program had been initiated to reverse the basic forces underlying the crisis, namely, excessive fiscal deficits and deep-rooted structural rigidities. Directors noted that these steps had already received large financial support from bilateral and multilateral sources, including the Fund, and that there were now some signs--particularly after the recent tightening of monetary policy--of a welcome easing in the tight external reserve position.

Directors welcomed the view of the authorities that initial progress of the program had made its continuation irreversible because the remaining agenda of macroeconomic adjustment and structural reform was large. Inflation was still high, significant external financing gaps were projected for the medium term, and concrete and detailed proposals still had to be formulated to address some of the most intractable structural problems. In these circumstances, there was clearly no room for policy slippages; if anything, the macroeconomic adjustments and structural reforms should be accelerated in order for India to reap the benefits more quickly. Several Directors suggested that, at an appropriate time, the authorities might wish to consider a program that could be supported by an arrangement under the extended Fund facility, or under the enhanced structural adjustment facility, in place of the stand-by arrangement.

Directors generally agreed that the targeted reduction in the Union Government fiscal deficit to 6.5 percent in 1991/92 was appropriate and, indeed, even ambitious given that the reduction was largely to be implemented in the last eight months of the fiscal year. Most important from the point of view of restoring public confidence, key measures to bring about this fiscal adjustment had been taken up front, including welcome cuts in export and fertilizer subsidies, and an increase in oil prices. Directors also welcomed the lower budgetary provision for transfers to public enterprises, and fully supported lower real military spending. Directors stressed the importance of careful monitoring and tight expenditure control to ensure that the targeted fiscal consolidation was achieved. A further sharp reduction in the fiscal deficit was clearly needed in 1992/93 to alleviate excess demand pressures and improve the external position.

Many Directors stressed the importance of an early implementation of comprehensive tax reform. Further cuts in subsidies and transfers to public enterprises should also be sought. Several Directors noted that there was scope for further savings in military expenditure, and for cuts in the public sector wage bill. Directors also emphasized that the process of fiscal consolidation had to be extended to all levels of government. In particular, the States and the public enterprises should bear a share of the adjustment burden.

Directors were in broad agreement with the authorities' intention to keep the nominal exchange rate stable following the recent devaluation. However, they emphasized that the desired restoration of confidence could be realized only if financial policies were sufficiently tight to make such an exchange rate policy credible. Accordingly, Directors emphasized the importance of the authorities' commitment to tight money and credit policies. In this context, they welcomed the recent monetary measures, especially the increases in interest rates, and considered that a further increase in deposit interest rates and in lending rates to priority sectors, which were still negative in real terms, would be warranted.

Directors commended the authorities for the impressive structural reforms aimed at breaking away from the legacy of extensive state intervention in the economy. The de-licensing of most industries, the scaling back of areas reserved exclusively for the public sector, and the liberalization of foreign direct investment were clearly of far-reaching importance to reinvigorate the economy. Directors urged the authorities to maintain the momentum of reforms through a timely formulation of action programs in all other key areas.

In particular, a clear policy allowing for the exit of unviable firms was needed, and Directors urged the authorities to accord the highest priority to the early formulation of an exit policy that was socially and politically feasible. They noted that the closure of unprofitable firms was essential if the other structural reforms were to generate their full efficiency gains. A number of Directors also urged the authorities to enlarge the program of partial disinvestment in selected public enterprises.

Tax reform, including a broadening of the tax base, was essential to support the ongoing process of fiscal consolidation and to allow for a much-needed reduction in import tariffs. Trade and payments liberalization was essential to increase efficiency, promote greater competition, and encourage India's fuller integration into the world economy. In this context, Directors welcomed the trade liberalization proposals that were being formulated in the context of a proposed World Bank structural adjustment loan, and stressed that the proposed tariff reductions would have to be closely integrated with the broader tax reform in order to safeguard the fiscal objectives of the program. A number of Directors also urged that the special import compression measures be phased out as soon as possible.

It is expected that the next Article IV consultation with India will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to India's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1991 Article XIV consultation with India, in the light of the 1991 Article IV consultation with India conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions described in SM/91/207 are maintained by India in accordance with Article XIV, except that the restrictions arising under the remaining bilateral payments agreements with two Fund members, the cash margin requirements for the payment for most imports other than capital goods, the undue delays created by the prior clearance requirements for the payment for current international transactions above specified amounts, and the restrictions on the sale of foreign exchange for the

import of capital goods, are all subject to approval under Article VIII, Section 2(a); and the multiple currency practices arising from the 15 percent tax on foreign exchange provided for travel abroad and the exchange rate guarantee on principal and interest payments on foreign currency nonresident accounts are subject to approval under Article VIII, Sections 2(a) and 3. The Fund welcomes the recent actions of the authorities to lower the cash margin requirements for the payment for imports and to relax a number of the prior approval requirements for the payment for certain current international transactions, and grants approval of these two restrictions until March 31, 1992 or the completion of the first review under the stand-by arrangement, whichever is earlier. The Fund urges the authorities to remove the restrictive features of the bilateral payments agreements with two Fund members and the restriction on the sale of foreign exchange for imports of capital goods and to eliminate the multiple currency practices. The Fund also encourages the authorities to further simplify the exchange system, which remains complex.

Decision No. 9849-(91/145), adopted
October 31, 1991

Stand-by Arrangement

1. The Government of India has requested a stand-by arrangement for a period of 20 months from October 31, 1991, in an amount equivalent to SDR 1,656 million.

2. The Fund approves the stand-by arrangement set forth in EBS/91/176, Supplement 3.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 9850-(91/145), adopted
October 31, 1991

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/91/144 (10/30/91) and EBM/91/145 (10/31/91).

4. ISRAEL - RELEASE OF INFORMATION

The Executive Board approves transmittal of the background paper on recent economic developments to the CONTRACTING PARTIES to the GATT, as set forth in SM/91/199, Supplement 1 (10/25/91).

Adopted October 30, 1991

5. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/91/254 (10/29/91) and Correction 1 (10/30/91) is approved.

APPROVED: April 16, 1992

LEO VAN HOUTVEN
Secretary