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04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/27

10:00 a.m., February 22, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
C. H. Dallara	
J. de Groote	
B. de Maulde	
M. Finaish	T. Alhaimus
H. Fujino	
	B. Goos
J. E. Ismael	Jaafar A.
	L. Leonard
A. Kafka	H. A. Arias, Temporary
H. Lundstrom	
E. I. M. Mtei	A. Abdallah
	B. Jensen
	J. E. Suraisry
P. Pérez	
	J. de Beaufort Wijnholds
C. R. Rye	
G. Salehkhou	
A. K. Sengupta	
N. Wicks	
	L. Tornetta, Temporary
Zhang Z.	

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

Also Present

C. L. Robless, South Asian Regional Office, IBRD. Asian Department: Tun Thin, Director; C. M. Browne, N. N. Choudhry, R. J. Hides, D. M. Ripley, A. Salehizadeh, D. A. Scott. Exchange and Trade Relations Department: M. Guitián, Deputy Director; S. J. Anjaria, S. Kanesa-Thasan, A. B. Petersen. Legal Department: S. A. Silard. Middle Eastern Department: S. H. Hitti. Treasurer's Department: A. G. Chandavarkar. Bureau of Statistics: P. J. Winglee. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: D. Hammann, K. A. Hansen, S. M. Hassan, H.-S. Lee, G. E. L. Nguyen, P. Péterfalvy, T. Sirivedhin, D. C. Templeman, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: J. Bulloch, M. B. Chatah, J. J. Dreizzen, G. Ercel, V. Govindarajan, N. Haque, G. D. Hodgson, Z. b. Ismail, H. Kobayashi, S. Kolb, R. Msadek, M. Rasyid, A. H. van Ee, Wang C. Y.

1. HUNGARY - 1984 ARTICLE IV CONSULTATION - POSTPONEMENT

Mr. de Groote requested an extension of the period within which the Article IV consultation with Hungary should be completed, owing to the absence on emergency leave of the staff member who had headed the mission. The staff report had previously been scheduled for discussion on February 22; he suggested that it be placed on the agenda for March 8.

The Executive Directors agreed to the request.

The decision was:

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1984 Article IV consultation with Hungary to not later than March 8, 1985.

Decision No. 7910-(85/27), adopted
February 22, 1985

2. INDIA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with India, together with a proposed decision (SM/85/27, 1/25/85). They also had before them a report on recent economic developments in India (SM/85/41, 2/8/85).

The staff representative from the Asian Department noted that the burden of external debt service by the end of 1983/84 had risen above the program forecast of 10 percent of current account receipts, rather than the 14 percent mentioned in the staff appraisal (see SM/85/27, Cor. 1, 3/1/85).

Mr. Sengupta made the following statement:

At the time of the 1984 Article IV consultation, the Board commended our authorities on the progress achieved under the adjustment program despite an unfavorable external environment. As has been noted in the staff report, all performance criteria were observed throughout the program period. The important objectives relating to economic growth, reducing inflation and, avoiding a deterioration in the balance of payments had been achieved. The data available clearly show that the successes in 1983/84 were, in fact, greater than expected at that time. Real GDP rose by 8 percent during that year as against the projected 6-6.5 percent, mainly because of a record growth in foodgrains production, which reached 152 million tons, a 14 percent increase over the previous peak harvest of 133 million tons achieved in

1981/82. Growth in the industrial sector was 5.5 percent in 1983/84, as projected. Taking the period as a whole, the GDP growth rate on the average was about 5 percent, above the rate of 4.8 percent targeted in the program. This is significant, especially as during the implementation of Fund programs, countries often experienced loss of growth and as India faced a severe drought in one of the three program years, 1982/83.

Controlling inflation was an important element of the program. The rise in wholesale prices was brought down from 18 percent in 1980/81 to 9.5 percent in 1983/84 and is expected to decline further during the current year; by present indications, it would be below the program objective of 8 percent. This was achieved in spite of substantial increases in the administered prices of a broad range of goods and services such as petroleum, steel, cement, coal, railway fares and freight charges, and postal tariffs, which had a cost-push effect.

On the external side, deterioration in the current account balance was avoided during the program period. In fact, foreign exchange reserves improved during the program period. There was a faster turnaround than expected, largely owing to successful implementation of the oil production program and more buoyant private transfers than originally envisaged. My authorities recognize the crucial role of export performance in achieving medium-term viability of balance of payments. They also note that even though India's exports registered a growth rate of 10 percent in SDR value terms from 1980/81 to 1983/84--when world trade in value terms remained stagnant--the growth in volume terms was less than the programmed target. However, this has to be viewed against the background of recessionary conditions in the world economy during that period and also the supply constraints that India faced in 1982/83, a year of drought.

The slow growth of exports in recent years has been receiving serious attention from the Government. It is recognized that in addition to the stimulus that would be received by Indian exports from the possible transmission of recovery in industrial countries, some new and positive initiatives would be needed, not only in the classic form of export incentives but also in the broad area of industrial capacity creation capable of responding to export incentives. A high-power committee set up by the Government to review the gamut of external trade policies has recently submitted its report, which is being examined by the Government.

India followed a cautious, prudent policy on commercial borrowing to ensure that the debt service burden remained within manageable limits. However, India's ability to continue this policy will depend crucially on the volume of concessional assistance that it receives in the medium term.

In the current year, GDP is expected to grow in real terms by 4-5 percent, over and above the substantial increase of 8 percent last year. Agricultural production is expected to show further growth of 2 percent over the all-time record production of 1983/84. The expected increase in industrial output of 8 percent will be made possible by strong growth in demand arising from the rise in agricultural incomes and continued efforts to remove infrastructural bottlenecks.

Price developments during the year have been encouraging, especially during the past few months. The wholesale price index, which increased by 7.5 percent from March 31 of the current fiscal year to August 11, 1984, has slowed appreciably in the later part of the year. The rate of inflation during the current year till February 2, 1985 was only 4.9 percent, against 8.8 percent in the corresponding period last year. The annual rate of inflation on a point-to-point basis as on February 2, 1985, was in fact 4.5 percent compared with 11.1 percent during the corresponding period in the previous year. My authorities will continue to be vigilant and will take appropriate measures to control the rate of inflation.

My authorities are anxious to control budgetary deficits as a matter of policy. In the budget estimate for 1984/85, the deficit of the Central Government is expected to decline, as noted in the staff report. However, the authorities recognize that pressures are developing on the budget in the current year and have therefore taken measures to control expenditures by various means such as a ban on new recruitment and deferring expenditures wherever possible.

Monetary policy in the current year is aimed at a deceleration in the expansion of overall liquidity (M-3) and of reserve money. The growth in the money supply (M-3) in the current year up to January 25, 1985, however, was 15.8 percent, which is almost equal to the increase of 15.4 percent in the corresponding period of the previous year. Credit policy took into account the high rate of industrial growth in the current year, requiring larger working capital and the significant increase in foodgrain stocks consequent on larger than expected procurement. Adequate credit expansion, therefore, had to be allowed to meet the requirements of productive sectors. The overall emphasis of monetary policy, however, has continued to be on moderating the rate of growth of liquidity and curbing inflationary expectations.

My authorities are in general agreement with the staff's medium-term scenarios and consider the projections in Scenario A to be consistent with their own projections. They are aware that the scenario would require a substantial increase in the volume growth of exports, which would depend very much on the international environment. Several measures are being contemplated to accelerate exports.

Even under Scenario A, India's debt service ratio would reach 20 percent by 1988/89. However, the base year (1983/84) figure, according to the authorities' estimates, is about 12 percent, while the staff's figure is 14 percent of current receipts. The debt profile of India has been undergoing a change since the beginning of the 1980s owing to greater recourse to commercial borrowing and a harder mix of IDA and IBRD resources. My authorities will continue to follow prudent policies regarding external commercial borrowing.

My authorities regard the promotion of efficiency as being of vital importance. One of the guiding principles outlined in the Seventh Plan is "improved efficiency and productivity." There has been a noticeable improvement in capacity utilization in some important industries in the past few years. My authorities are determined to continue their efforts to modernize industry, upgrade technology, and improve productivity. The Government had set up a number of high-powered committees to look into all these aspects. A committee on trade policies had already submitted its report. Another committee is examining the principles of a shift in our economic policy from physical controls to financial controls and other related issues. Yet another committee reviewing policies regarding public enterprises for improving their functioning and viability has also formulated major proposals for reform. When all these policy changes are effected, they will give a new thrust to our strategy of economic development, as epitomized in a recent speech by our new Prime Minister: "Improvement in productivity, absorption of modern technology, and fuller utilization of capacity must acquire the status of a national campaign."

Extending his remarks, Mr. Sengupta noted that because elections were being held for most of India's State Assemblies, policy announcements were not being made at present. However, he would make a few remarks about the framework of the Indian Government's policy, bearing in mind that 1984 to 1985 had been an eventful and turbulent period. At the end of 1984, a new Government had been elected by a massive majority that endorsed its platform of maintaining the country's unity and continuing the national policies of the late Prime Minister, Mrs. Indira Gandhi.

In the 1980s, Mr. Sengupta said, India's policies had been directed toward the rationalization of economic activities, with the emphasis on productivity, efficiency, and modernization, as well as on a move away from administrative planning to market-related signals, based on financial and fiscal policies. Yet the authorities had followed that approach without deviating from the main national objectives of growth, industrialization, the transformation of agriculture, the expansion of employment, and, most important, special measures for the elimination of poverty. It was Mrs. Gandhi who had first clearly formulated the idea that economic growth and development by themselves were not enough to achieve the redistributive impact necessary in a low per capita income country like India, and specific measures had been introduced directed toward the poorer sections of the country.

In the mid-1970s, especially after the oil crisis, when the inflation rate had shot up and the balance of payments had come under severe strain, a major adjustment program had been adopted, Mr. Sengupta recalled. The rate of inflation had been brought down to zero--in fact, it had been negative one year--reserves had increased significantly, and there had been a balance of trade surplus. That achievement had come at the cost of growth and investment, turning back to some extent the hands on the clock of development, investment, and modernization. India could not afford to continue such a policy because development was the only sure way to achieve distributive justice and eliminate poverty, which in turn were the only certain bases for sustaining democratic government.

Thus, in the 1980s, when the new Government had restarted the policy of modernization, it had sought to anchor its adjustment policy of rationalization and modernization of the economy on growth and sustained investment, Mr. Sengupta observed. For that reason, his authorities had requested an extended arrangement with the Fund in support of an adjustment program fully consistent with the framework of the Sixth Plan. The authorities had lauched that Plan before entering into the arrangement with the Fund, which had thus been sought in support of advance planning and not as a matter of crisis management.

The present Government remained committed to that adjustment policy, Mr. Sengupta concluded. In the latter half of 1984, while Mrs. Gandhi had been alive, a number of high-powered committees had been formed to examine all aspects of that policy in detail. The recommendations made by those committees had provided a framework within which all crucial aspects of policy had been examined; it remained to be seen, in a democracy, whether all their recommendations could meet with acceptance. However, the new Prime Minister had made it clear in several statements that his primary objective was to move in the direction of improving productivity, modernizing economic activities, and making fuller use of capacity.

Mr. Zhang noted that a major development for the Fund in 1984 had been the Indian Government's decision to give up its right to purchase SDR 1.1 billion from the Fund during the third year of the extended arrangement. The decision had been all the more important as it had come at a time when the Fund had been hard pressed, as a result of increasing demand for its resources on the part of developing countries. The overall aim of the program under the extended arrangement had been to strengthen the implementation of the five-year plan and thus the process of growth and development, enabling India to attain a position of economic strength so that it could stand firmly on its own, reducing its reliance on external assistance. As the staff report showed, the main objectives of the extended arrangement had been realized: growth of real GNP had increased, inflation had been reduced, and a deterioration in the external balance on current account had been avoided. Those had been the achievements enabling the Indian Government to relinquish further use of Fund resources.

Striking achievements in the real sector included strong growth in the output of foodgrains to the point of self-sufficiency; a marked expansion of oil production; and continued diversification of the industrial base, with encouraging signs that output would pick up after the weak growth of the past few years, Mr. Zhang continued. Those were among the objectives that most developing countries found it extremely difficult to attain. There were however a few areas of immediate concern. First, prices needed watching. The staff considered that the upward movement in wholesale prices had to be attributed more to the strong monetary expansion than to the special short-term factors having operated in previous years. Second, the budget for the current year might be too expansionary. The staff report indicated that bank financing of the Central Government and state governments during the first half of 1984/85 suggested that the increase in the consolidated deficit could turn out to be substantially larger than initially projected. The report also noted that the rising trend in the public sector deficit in relation to GDP was absorbing a larger amount of the savings available to the economy.

From a longer-term perspective, developments in India during the past several years had clearly signaled the growing underlying strength of the economy and its success in recording growth under the successive five-year plans, Mr. Zhang noted. Like China, India was still a low-income, densely populated country, confronted with many structural imbalances and maladjustments associated with continued rapid industrialization over several decades. Therefore, new policies were needed to foster the achievement of longer-term objectives. In order to maintain a viable external equilibrium, the Government would have to pay more attention to strengthening export performance, which to date had been less satisfactory than originally expected, and to controlling the growth of external debt service, which had been increasing steadily in relation to external receipts. To meet those objectives and promote the fundamental goal of improving the standard of living of its large population, India would have to adopt new policies to improve the efficiency of investment and the competitiveness of the economy--inter alia, by reducing some excessive regulatory measures--and to ensure cautious external commercial borrowing. The Indian economy had reached a new maturity, and new policies, based on experience and past success, would enable India to make further progress.

On exchange rate policy, Mr. Zhang asked the staff to elaborate on its comments on pages 25 and 26 of the staff report; the authorities foresaw a limited role for exchange rate policy, whereas the staff felt it should play a more central role. Was a compromise in sight, and had the staff undertaken any statistical estimates in assessing the effectiveness of exchange rate policy?

Mr. de Groote remarked that the Indian authorities had made satisfactory progress with their economic program over the past two years. The results, especially in economic growth, control of inflation, a better balance between savings and investment, and a much improved balance of payments, were most encouraging and were not inconsistent with a favorable medium-term and long-term outlook. The structural restoration of economic activity, supported by the implementation of sound domestic economic policies within the framework of the previous extended arrangement, had contributed to the improvement of the Indian people's living conditions. However, the large budget deficit, the feeble export performance, and the remaining structural weaknesses in the economy were still matters for concern. In the present political and economic environment, the time seemed ripe for bearing down on those issues on which the staff papers focused.

He understood from the staff report that the authorities' main arguments in support of a more gradual approach to the solution of those problems concerned inflationary pressures, Mr. de Groote continued. It was true that adjusting administered prices, preventing industrial licensing from being made more restrictive, and strengthening export incentives would all help to improve the efficiency of resource allocation and diminish structural weaknesses. But it was equally true that the pressures exerted by such policies on inflationary expectations might threaten the authorities' ability to hold inflation to the projected rates, at least over the short run. A judgment therefore had to be made as to which of those two considerations was more important. The promotion of efficiency and improved international competitiveness had been singled out by the staff as essential to higher economic growth and a sustainable balance of payments; in his view, those two main considerations were more important than the issue of inflationary pressures. With the inflation rate below 5 percent and with market forces playing a larger role in the production process, it was not certain that anti-inflationary policies should take priority over structural change. He had been happy to learn from the media that the new Prime Minister intended to take bold steps to modernize the economy; he hoped that those steps would be taken soon and that both the domestic and the external sectors of the economy would become more efficient.

With respect to fiscal policy, the consolidated deficit of the Central Government and state governments remained high, despite a strong increase in public savings, Mr. de Groote observed. A shortfall in tax revenues and unplanned increases in budgetary expenditures had caused the deficit to remain at about 7 percent of GDP for the past two years. It was self-evident that an improvement in public sector finances and higher rates of both public and private savings were needed to generate the larger share of domestic savings that would be required to offset foreign borrowing and contribute to financing India's sizable investment projects. At the same time, as the staff had pointed out, the large public sector deficit had absorbed a great share of available savings. An increase in the financial returns to public enterprises, closer scrutiny of subsidy policies, and better control of expenditures would constitute the ideal policy mix for reducing the consolidated budget deficit over the medium term.

Despite the authorities' efforts to provide specific incentives, the export performance of the Indian economy remained inadequate, Mr. de Groote remarked. It was stated in the report on recent economic developments that, acording to an unpublished study commissioned by the Industrial Credit and Investment Corporation of India (ICICI), the profitability of production for export compared unfavorably with that of production for the domestic market. The attractiveness of export markets to Indian manufacturers appeared to have declined still further during the 1980s. Under those circumstances, increasing India's export earnings, which had amounted to SDR 7.9 billion or less than 5 percent of GDP in 1983/84, would require a flexible exchange rate policy and further import liberalization. Medium-term projections for the balance of payments under Scenarios A and B indicated that total commercial borrowing between 1985 and 1990 would be in the range of $15-22 billion. Clearly, the authorities would have to place greater emphasis on increasing export earnings by adopting a more flexible exchange rate policy in place of the present one that merely maintained the exchange rate at a constant real level, by paying careful attention to the trend of public finances, and by increasing the direct contribution of the public sector to the external accounts.

Great difficulties surrounded the measurement of markets such as the underground economy in India, Mr. de Groote observed. News reports referring to statements by "some economists at the World Bank" suggested that India's underground economy could account for half the national product. If so, prices, including the relative price structure, and national account data would be somewhat different from those presented in the staff report.

In conclusion, Mr. de Groote remarked, the reorientation of economic activities toward an enhanced role for the market and the promotion of export activities seemed to be priorities of the moment in the fight against poverty in the longer term.

Mr. Wicks said that it was always appropriate to note the high quality of Indian economic management, which had succeeded in bringing the complex country safely through the economic storms of the 1970s and early 1980s. As Mr. Sengupta had made clear, there had been real economic progress in 1983 and 1984, particularly in foodgrain production, helped of course by the weather but also by the rapidity with which oil production had been brought on stream. Nevertheless, reading the staff report, he had had to conclude that the full potential of the economy could be realized more quickly if new policy thrusts were made.

In highlighting various aspects of the need for structural change in the Indian economy, Mr. Wicks referred first to the adjustment effort of the past three years, which had been successful in many respects, notably in terms of real GDP growth and the maintenance of a sustainable external position. At the same time, progress toward structural adjustment had been relatively slow. Second, the authorities must give priority to improving export performance if India were to avoid potentially severe external debt problems by the end of the decade. Crucial to the achievement of that goal was the ability to press ahead with the removal of structural constraints on economic performance. Third, as he had mentioned during the Executive Board's recent discussion of upper credit tranche arrangements and conditionality (EBM/84/174 and EBM/84/175, 12/5/84), effective adjustment required early and decisive action to deal with structural problems. Fourth and last, he welcomed the maintenance of a close working relationship between the Fund and the World Bank. In an economy where the World Bank group was so heavily involved, and might become more involved, it was essential for Bank supply-side projects and supply-side advice to be carefully meshed with the macroeconomic policy advice of the Fund. In that connection, he noted that the Bank staff had concurred in the appraisal in the staff report. In 1984, the World Bank itself had produced a useful document giving a medium-term view of the economy.

It was difficult to reach firm conclusions on fiscal policy without knowing the outcome of the budgetary review in which the authorities were engaged, Mr. Wicks continued. It would be interesting to know, from a procedural point of view, whether it might not be helpful to schedule the Article IV consultation after the annual budget was drawn up. On points of substance, the central government budget deficit for 1983/84 would be somewhat higher than the authorities intended. Among the causes that they had identified were the shortfall in income tax receipts and higher than expected fertilizer subsidy payments owing to higher import prices. He asked whether it might not be possible to reduce the impact of those items on the budget in future. With respect to revenue, there might be further scope for increasing indirect taxes, such as the petroleum excise tax. There were complex agricultural arguments in favor of some subsidy on fertilizer, and he would be interested in knowing the World Bank's views on the matter; however, he believed that the authorities hoped to reduce the burden of those subsidies under the Seventh Plan by improving the output and distribution of fertilizers. At a minimum, it would be important to keep that budget item under closer control.

He welcomed the authorities' intention to pay greater attention in the next plan to the financial position of the public enterprises, Mr. Wicks continued. Nevertheless, real improvement in the efficiency of those industries seemed unlikely, with so many of them subject to intra-public sector decision making, which was bound to inhibit the entrepreneurial talent required in the Indian economy.

The need for improved fiscal performance by the state governments was a well-worn theme of discussions on the Indian economy, Mr. Wicks noted. The heart of the problem was the freedom of the states and the Central Government to pursue inconsistent fiscal policies. The question was whether greater centralization of macroeconomic decisions was possible, with the responsibility for the allocation of funds being reserved to the states. He recognized the sensitivity of the issue in a federal state but nevertheless encouraged the authorities not to rule out such a course.

On monetary policy, Mr. Wicks agreed with the staff that inflationary pressures posed particular problems in the Indian economy. It would therefore be important to control those pressures, both by dampening inflationary expectations and by containing the credit demands of the public sector. Unfortunately, statistical inadequacies clouded the analysis in that area, but he agreed with the staff that a restrictive monetary stance remained appropriate in view of the recent growth in the monetary aggregates. The authorities ought to consider a more active interest rate policy, which might help to sustain the already high savings ratio and also stimulate the efficiency of the banking system, which was at present weighed down by a battery of administrative controls on lending.

On external policy, Mr. Wicks remarked, although a large improvement in exports was expected for 1984/85, he shared the staff's concern over India's inability to maintain its market share. To some extent, that inability reflected infrastructural constraints, but with exports accounting for less than 6 percent of GDP, it was hard to avoid the suspicion that exporting was regarded as a residual activity. Attitudes seemed to be changing, but the authorities could speed up the change by creating a policy environment conducive to cost-competitive export promotion. In doing so, they would, he hoped, make greater use of the exchange rate as a policy instrument as well as pressing ahead with import liberalization. He had been heartened by Mr. Sengupta's remarks, which gave further evidence that an improvement in export performance was taken as a national priority.

The authorities' cautious approach to the use of nonconcessional external financing and their objective of keeping the debt service ratio below 20 percent were commendable, Mr. Wicks said. It was essential that they should continue the prudent financial policies that had served them so well. He had been disappointed to learn that foreign direct investment was not regarded as an important source of financing the current account deficit. Recent tragic events in India made that subject especially sensitive, but he urged the authorities to reconsider the scope for such investment.

To sum up, Mr. Wicks considered, it was always presumptuous for someone from a developed country to offer categorical judgments about a totally different economy. He had therefore listened with interest to Mr. Zhang's comments, and agreed generally with his views on the need for structural change. His authorities' knowledge of India convinced them of the enormous long-term potential of the economy in terms of natural resources, a huge domestic market, a good geographical location, and a large and industrious work force. That potential would not be realized unless the authorities could relieve the balance of payments constraints that would begin to be felt by the end of the decade. For that purpose, exports would have to increase significantly, something much more likely to happen in an economy where the state had the role more of an umpire than of a player and where entrepreneurs were given rather greater incentive to leave the crease and swing their bat a little.

Mr. Goos noted that India's satisfactory maintenance of the positive economic performance of recent years, and its continued favorable economic prospects, had taken place in a less than ideal environment. The country had been faced with the second oil price increase, a prolonged world recession, and a temporary drought. The inevitable conclusion was that the improvement in economic performance had been largely due to the reorientation of economic policy toward structural reform and export promotion under the Sixth Plan, which had also been supported by an adjustment program under an extended arrangement with the Fund. Concrete examples of the beneficial effects of that policy reorientation were to be found in the report on recent economic developments, including the increased utilization of industrial capacity since 1981/82 in response to the easing of regulatory constraints and a more flexible pricing policy. Production in the motor industry had also grown rapidly following the liberalization of industrial policy, and cement production had picked up in response to more realistic producer prices.

Those immediate beneficial effects of recent reform measures could hardly be overlooked, and he therefore found it difficult to understand why the authorities had refrained for so long from taking speedier, more forceful reform measures, Mr. Goos went on. He was all the more astonished because there had apparently been general agreement between the authorities and the staff in recent years on the pressing need to strengthen the efficiency and international competitiveness of the Indian economy. Even though that agreement had been re-emphasized in the staff report, the authorities apparently still had reservations based on their view, reported on page 19 of SM/85/27, that in designing export promotion policies, "the small share of exports in GDP had to be taken into account." The precise meaning of that statement was unclear to him, but ample evidence existed that countries in general, regardless of their size, had fared much better with outward-looking policies than with inward-looking ones, a theme that recurred in the World Bank's World Development Report.

Against that background, it was disappointing that the structural weaknesses in India's economic system, which had been widely criticized at the 1984 Article IV consultation, remained largely untackled, Mr. Goos observed. Higher economic growth continued to be hampered by widespread administrative controls, centralized decision making, and bureaucratic attitudes that encouraged inefficiency. Therefore, he underlined the staff view on page 30 of SM/85/27 that "further liberalization of import and industrial policy, within the framework of shifting policy instruments away from administrative controls toward macroeconomic management and financial incentives, would be appropriate." The importance of that recommendation was highlighted by the medium-term scenarios. Without such a renewed liberalization effort, the need to maintain adequate growth rates could easily force India to give up its cautious borrowing policy, thereby increasing its debt service ratio beyond acceptable limits. However, recent press reports, as well as the statement by the Prime Minister to which reference was made in the staff report, gave rise to the expectation that such concerns would prove unjustified.

In general, he supported the staff analysis and recommendations as well as the proposed decision, Mr. Goos remarked. More specifically, given the large share of public enterprises in overall economic activity, the need to ensure their sound performance could hardly be overstressed. Not only was such performance crucial to the efficiency and competitiveness of the whole economy, but it also directly affected the budgetary position. Unfortunately, state-owned enterprises in India--with few exceptions, notably in the oil sector--were all operating at a loss or without making a profit. Therefore, he strongly endorsed the staff's recommendations aimed at improving the performance of those enterprises. The recent decision to open up to private investment certain industries previously reserved for the public sector was a most welcome development. It should help to alleviate the widespread lack of domestic competition that appeared to have contributed to a considerable misallocation of domestic resources and weakening of the external competitive position. He encouraged the authorities to press ahead with such liberalization measures. Similarly, a speedier liberalization of the industrial licensing system would be most helpful.

On the budgetary position, Mr. Goos noted, contrary to its initial intentions, the Government had apparently been unable so far to reverse or even halt the rising trend of expenditures and of the public sector deficit relative to GDP. Already in 1983/84, the Government had announced that budget expenditures would be reduced substantially, an announcement that had been premature; the considerable lack of control over expenditure that apparently existed called for corrective action. In any event, cutting expenditure to strengthen public sector saving seemed imperative in order to curb bank borrowing, which would not only serve to contain inflationary pressures, but also be consistent with an enhanced role for the private sector and the consequential higher private demand for credit. Of course, he did not advocate expenditure cuts in priority sectors, such as agriculture and energy. However, given the scarcity of budgetary resources, all other sectors, including defense, should be carefully scrutinized for potential budget savings.

Another source of higher public sector savings, not mentioned in the staff report, might open up if the complex tax system, which tended to encourage tax evasion, were reviewed, Mr. Goos considered. Furthermore, the size of the country's black economy, which was estimated to be large, meant that a considerable part of the tax base was beyond the reach of the Government. Efforts to reduce the size of the underground economy might generate significant additional revenue.

The continued weakness in export performance undoubtedly remained a matter of concern, Mr. Goos commented. The longer-term repercussions of that weakness were spelled out in the staff report. Like the staff, he felt that an intensified use of modern technology was an essential prerequisite for strengthening the country's export capacity, which in turn required adequate imports of capital goods and technological know-how and hence more forceful and comprehensive import liberalization measures. He also supported the staff's recommendation that such measures should be supplemented by more active use of exchange rate policy in order to provide an additional stimulus for exports and overall growth.

The close convergence of views between the staff and the Indian Government on the priorities for future action was encouraging, Mr. Goos remarked. Provided that the Indian Government translated its intentions into timely action, he was confident that the new reform drive would lead to a sustained strengthening of the domestic economy and of India's international competitiveness.

Mr. Leonard noted that over the past few years India, assisted by the extended arrangement with the Fund, had achieved encouraging economic results. The adjustment measures taken and favorable external developments had permitted an increase in growth rates as well as a reduction of inflation, and had brought about enough improvement in the external balance to warrant the early conclusion of the arrangement. India had met all the performance criteria under that arrangement, a notable accomplishment, considering the number of countries that could not meet the conditions of their Fund-supported programs.

Despite the success of the extended arrangement, the appropriateness of some aspects of demand management policy was open to question, Mr. Leonard continued. Even more important, inadequate progress had been made in pursuing structural adjustment and reducing rigidities in the economy. The lackluster performance of the external sector was particularly in need of remedy. So far, balance of payments pressures had been limited, and external debt and debt service had been contained at manageable if growing levels, largely through import substitution, protectionism, and a complex tangle of exchange and trade restrictions. Exports had made a lesser contribution; indeed, India's export market share had noticeably declined. Unless that deteriorating trend were checked, the recent improvement in economic performance would be threatened. He had been surprised, therefore, by a reference on page 19 of the staff report suggesting that the authorities did not attach due importance to exports; however, he had been reassured by Mr. Sengupta's statement.

The various medium-term scenarios presented by the staff served to reinforce concern about export performance, Mr. Leonard added. Maintaining current trends in the export sector could present the authorities with the dilemma of either permitting a dangerous buildup in the debt service burden, or being forced to adopt policies that would reduce growth rates unacceptably. A viable balance of payments position with acceptable growth rates could be attained only through an ambitious expansion in India's export market share. He doubted that such an expansion could be achieved in the absence of further structural adjustments and without a more flexible and aggressive approach to exchange rate management.

The need for structural reform was just as evident in the domestic sector, Mr. Leonard remarked. India was in the midst of an attempt to move from annual growth of 3 percent in the 1970s to 5 percent in the 1980s; it had little other option if there were to be any significant increase in per capita incomes and consumption. The goal of 5 percent growth had so far been met, but the growth path had not been smooth or consistent. As shown in Table 1 of the staff report, manufacturing growth in each year of the Fund-supported program had fallen well below target, and the 5 percent growth profile had been met only because agricultural performance had been better than expected, partly for fortuitous reasons. In the economy as a whole, infrastructural and productive bottlenecks, including power shortages, had hampered the production of export and domestic goods.

A variety of factors diminished the performance of the Indian economy, Mr. Leonard observed. Inflexibilities and administrative intervention lowered productivity. Persistently poor rates of return to commercial enterprises, stemming in part from administered prices, inhibited the accumulation of financial resources and reduced the importance of the sector as a source of national savings. The situation was further aggravated by the continued inward-looking nature of the Indian economy. Although some progress had been made in that respect through the reduction of trade barriers, more might be done. The authorities' concern about the need to protect the domestic economy was understandable but needed to be measured against the advantages of freer access to outside sources of supply through specialization and greater integration with world markets.

As the staff had said, less direct administrative control over resource allocation and more reliance on the market was needed to improve productivity, Mr. Leonard agreed. In that respect, welcome measures had been taken to speed up applications for industrial licenses, to permit private investment in more areas of the economy, and to reduce some tariffs. Those liberalizing measures should be extended. The study being undertaken by the authorities on the possibilities for greater reliance on financial and fiscal instruments, in lieu of physical controls on trade and industry, was therefore encouraging; he looked forward to the results.

Although structural adjustment was important, the need for strong demand management remained pressing, Mr. Leonard considered. During the review of the 1984 Article IV consultation report, his chair had expressed concern about the increase in inflation. Fortunately, the rate of inflation had apparently moderated somewhat over the past months. However, the expansion in fiscal policy during the first half of 1984/85 had been larger than expected and had hampered the authorities' efforts to contain liquidity growth. The rate of wholesale price inflation over the past year had also greatly exceeded that of India's major trading partners. Those were worrisome developments--particularly in view of the country's inflexible exchange rate policy--and it was hard to conclude that they could do other than hinder efforts to improve export competitiveness.

His chair therefore urged the authorities to re-examine their fiscal policy stance, since a smaller fiscal deficit would help to reduce pressure on liquidity growth and the balance of payments, Mr. Leonard stated. On the revenue side, the authorities could improve the outlook by opening up wider areas of domestic activity so as to increase competition. The result might be that parallel market activities would be channeled into the official economy and the tax base extended accordingly. Moreover, the authorities' intention to reduce the rate of monetary growth was gratifying, although it remained to be seen whether the target of 15 percent growth in the 12-month period to March 1985 was realistic in view of the 19 percent increase in M-3 during the 12 months ended January 1985.

Efforts to modernize industry and improve efficiency should not be allowed to detract attention from the need to sustain development of the agricultural sector, nor should they deflect investment flows from agriculture, Mr. Leonard considered. He therefore welcomed the authorities' indication that the major objectives of the Seventh Plan were to increase food supplies, employment, and productivity. To India's credit, it had already become self-sufficient in foodgrains; indeed, further economic development still largely depended on increasing the quantity and quality of food consumed by the poorer and largest part of the population.

The close collaboration between the World Bank staff and the staff of the Fund on the extended arrangement exemplified the importance of such cooperation in designing adjustment programs of the type undertaken by India, Mr. Leonard remarked, and he looked forward to its enhancement in future. Given the challenges facing India in pursuing further structural adjustment, it remained important for the two organizations to continue to work together closely. Perhaps one area for immediate collaboration might be an improved statistical system, the existing one being subject to a number of deficiencies that, as the staff had correctly noted, must be remedied if greater reliance were to be placed on macroeconomic management.

He had made a number of criticisms and suggestions, Mr. Leonard concluded, but they should not be interpreted too negatively. He and his authorities had great respect for the measures already taken by the Indian Government. Indeed, the shift to a 5 percent growth environment was an ambitious undertaking that could hardly have been contemplated if so much had not already been achieved. He hoped simply that the new growth trend could be sustained, and that needless pressures on the balance of payments could be avoided. His chair was encouraged by the recent statements on economic policy by the new Prime Minister, and looked forward to enhanced macroeconomic management and broader structural reforms.

Mr. Lundstrom observed that following the drought-related difficulties and depressed activity in 1982/83, economic performance in India had exceeded expectations in 1983/84. In the wake of economic growth abroad, output had expanded markedly. On the basis of provisional figures, the improvement in the latter year in the current external account and the overall balance appeared impressive. Relatively high activity could be expected in 1984/85, with no deterioration in the relative external position, but those encouraging results should not obscure the problems still to be overcome. To cope with them, and to improve efficiency and flexibility in the economy, further structural reforms to remove institutional rigidities and to eliminate bottlenecks seemed to be required, together with a more comprehensive liberalization of the pricing system and trade restrictions.

More specifically, the Indian authorities' intentions to improve the structure of the economy lay at the heart of their economic policies, Mr. Lundstrom noted. Although progress had been made in simplifying industrial licensing and pricing policies, direct controls and restrictions remained widespread, and their impact on overall performance was difficult to assess. However, to the extent that capacity utilization could be taken as a partial indicator, the performance of major industries had been relatively weak. Thus, while some improvement had been recorded in the early 1980s, the most recent figures on capacity utilization in selected industries did not point to an increase since 1981/82, except in the aluminum and coal sectors. Moreover, the provisional figures for the first months of fiscal year 1984/85 indicated substantially lower capacity utilization than targeted, notably with respect to public sector steel production. That assessment contrasted somewhat with the staff view, on page 10 of SM/85/41, that capacity utilization had increased since 1981/82. Admittedly, the most recent figures were preliminary and covered only part of the production year; they might therefore be influenced by seasonal and other factors, although he would expect the figures to be comparable, given the way in which they were presented in Table 19 of SM/85/41. He wondered whether the staff had obtained more up-to-date information. In any event, capacity utilization generally remained low.

The second important aspect of Indian economic policy was the Government's comprehensive intervention in foreign trade, Mr. Lundstrom observed. The essential features of import policy had remained unchanged during the period under review, according to the staff. Although access to imports had been liberalized somewhat, the easier policy stance had been aimed mainly at complying with exporters' demand for foreign goods. However, by any measure, imports still accounted for only a small proportion of economic activities and were largely linked to exports. In that sense, the domestic economy was segregated from the foreign sector, which in the longer term could hamper adequate domestic cost and price performance, the structure and volume of production, and hence efforts to promote competitiveness in the exporting industries. In other words, the low import share appeared to leave little room for further import compression because of the need for inputs in high-priority areas of production and capital formation.

As shown by recent developments, export growth had lagged significantly behind the expansion of demand in foreign markets, implying a considerable loss of India's market shares, Mr. Lundstrom noted. More precisely, from 1980 to 1984, export volume had risen by only 1.6 percent compared with a cumulative market growth of 14.2 percent, implying an export elasticity as low as 0.1 compared with an average elasticity of 0.8 during the 1970s. One factor behind that slow growth might be major supply constraints reflecting the complex system of regulations in the Indian economy. Another explanation might be that for many years it had been more profitable to produce for the domestic market than for export markets, especially as the relative attractiveness of the latter had declined in recent years. There might thus be a case for a more flexible exchange rate policy, as proposed by the staff, although the judgment on that score was rendered difficult by the lack of adequate quantitative measures of price competitiveness. While the combination of domestic factors and foreign competitiveness in a broad sense had undoubtedly impeded export growth, India's heavy dependence on slow-growing markets in Africa and Eastern Europe might also have played a role. With appropriate domestic policies, there would seem to be some scope for diversification of India's exports, with respect both to countries and to products.

In that connection, Mr. de Groote and others had already noted the comparatively modest role of foreign trade in the Indian economy, Mr. Lundstrom continued. In 1981, the most recent year for which comparable statistics were available, India's exports as a proportion of GDP had stood at less than 7 percent, while the average for all non-oil developing countries had been close to 19 percent and for Asian countries nearly 27 percent. For China, the figure had been approximately 10 percent. According to Fund statistics, only two member countries had lower export shares than India, whose exports accounted for only 0.5 percent of world exports. Of course, the mere size of the country was partly responsible: India's population was almost twice that of Africa. But India also pursued a less foreign-trade-oriented economic strategy than most other countries.

From the medium-term projections, it was evident that adequate export growth would be crucial in the year ahead if debt service were to be kept below 20 percent of exports, Mr. Lundstrom stated. Although the debt service ratio was not excessive at present, he fully endorsed the authorities' continued cautious approach to external indebtedness. Their policy of permitting foreign commercial borrowing for project-related purposes only was certainly warranted. However, they should probably place more emphasis on attracting nondebt-creating capital flows from abroad, for instance, in the form of greater recourse to foreign equity investment.

India had made commendable economic progress in several respects, Mr. Lundstrom observed. Its impressive adjustment record was noteworthy. The Government's development strategy, particularly with respect to agricultural and regional development policies, had produced encouraging results, not only by making India less vulnerable to poor weather but also by alleviating problems in low-income and backward areas through a wide range of programs. Moreover, the Seventh Plan under preparation appeared to put further emphasis on improving overall efficiency and flexibility in the economy. He had noted from Mr. Sengupta's statement that the ongoing redirection of policy was intended to address the productivity and capacity utilization problems forcefully and that measures were being devised to deal with sluggish export performance. The countries in his constituency wished India every success in those endeavors. He supported the staff appraisal and the proposed decision.

Mr. de Maulde considered that the 1985 Article IV consultation with India was most timely, allowing the Board to take stock of India's situation one year after the authorities' decision to forgo SDR 1.1 billion under an extended arrangement and upon the termination of the Sixth Plan. The staff reports showed clearly that even though the authorities were no longer constrained by the obligations deriving from a financial arrangement with the Fund, they had not relaxed the stance of their adjustment policy. The success of the program also demonstrated that an extended arrangement, when conceived and applied with flexibility, could help member countries to deal with economic imbalances without impairing the prospects for growth.

Of the remarkable results obtained in various areas, Mr. de Maulde continued, the most impressive was the achievement of self-sufficiency in foodgrains. The basic question was to what extent the improvement noted so far was adequate or warranted further efforts in the direction pursued so far. The present orientation of the authorities' economic policies, as reaffirmed by Mr. Sengupta, probably furnished an implicit answer, since the Government remained committed to pursuing the adjustment effort while creating the conditions for growth. On balance, he agreed with the staff that--given the constraints of a mounting external debt, which was still nevertheless manageable, and of some inflationary pressures, although the latest data provided by Mr. Sengupta were reassuring--a need remained for a firm domestic macroeconomic policy, both on the demand and the supply sides. The authorities had to determine the appropriate mix of fiscal and monetary policies while making efforts toward the adoption of structural measures.

The difficulty of bringing down the general government deficit was a cause for concern, Mr. de Maulde considered. The staff report showed that slippages had occurred mainly on the expenditure side, revenues having been more in line with the budget estimates. Thus, expenditure restraint was called for, especially on subsidies; a strong case could be made for a reduction in fertilizer subsidies, given the increase in farmers' incomes. The staff seemed somewhat pessimistic about the outcome for the central government deficit for 1984/85, and he would be interested in having the latest data available from the staff or Mr. Sengupta.

Monetary policies seemed to have become more restrictive, Mr. de Maulde noted. On the whole, recent developments, especially the decision to reduce the rate of growth of monetary expansion to 15 percent by March 1985, were welcome. Interest rate policy should also be flexible so as to mobilize savings.

As for the external sector, the rise in the debt service ratio and the increased cost of external resources, due to India's recourse to less concessional flows, highlighted the need to strengthen the country's export performance, Mr. de Maulde remarked. In that respect, he would be interested in learning from the staff or Mr. Sengupta which kinds of exports and which markets were to be given the highest priority, and what investment strategy was contemplated. The medium-term scenarios depicted on pages 26, 27, and 28 of the staff report demonstrated the importance of policies geared toward a more dynamic export performance. Although an adequate exchange rate policy would also play a central role, the unanswered question was why exports had been below expectations. There were several possible answers, but, like many other Directors, Mr. de Groote and Mr. Wicks in particular, he shared the staff view that removing impediments to the proper working of market mechanisms was an essential prerequisite. The authorities' intention to simplify administrative controls and to liberalize further imports was certainly a step in the right direction. The World Bank's expertise might be put to good use if it were given a mandate to look at the general means for further improving the supply side of the economy.

To conclude, Mr. de Maulde remarked, in view of the achievements already registered, there was room for reasonable confidence about India's prospects in the period ahead.

Mr. Fujino considered that India's adjustment policies since 1981 could be judged successful. Progress had been made in terms of higher economic growth, lower inflation, and the maintenance of a viable external position. It was also noteworthy that savings and investment in relation to GDP had been kept relatively high throughout the period of the Sixth Plan, establishing an important precondition for sustainable economic growth. However, the economy's fundamental problems remained unresolved. Severe poverty and a large and growing population underlined the need for accelerating growth. The economy was still suffering from a number of inefficiencies and weak international competitiveness, as a result of various complicated factors that might be difficult for the Fund, with the expertise available to it, to assess fully. Persistent efforts should be made to enhance the efficiency of investment spending, to increase the capacity utilization ratio, and to mobilize further resources, mainly from the public sector.

As in many other developing countries, the scope for economic development in India was constrained by external considerations, Mr. Fujino continued. The staff's medium-term scenario indicated that the economy would have to be supported by a much more dynamic export sector, as many Directors had emphasized, if the authorities were to achieve satisfactory economic growth while maintaining a sound external debt structure at the end of the 1980s. While agreeing with the staff that export promotion should be a primary policy objective, he also felt that scope remained for further import substitution. A case in point was India's remarkably successful import substitution in the oil sector; a rapid expansion in domestic oil production had dramatically reduced the share of oil in total imports from 42 percent in 1980 to 25 percent in 1983. Progress had also been made in reducing fertilizer imports, but India was still a major importer of fertilizers nonetheless. Domestic output of pulses and oil seeds remained rather stagnant, despite the adjustment in support prices, and imports were likely to continue to be large. Persistent efforts to increase the output of those commodities would provide the authorities with scope to import more capital goods or spare parts, which were at present subject to heavy import regulations.

As for export promotion, Mr. Fujino went on, exchange rate policy should of course play an important role, as Mr. Wicks and other Directors had pointed out. While the real exchange rate had remained stable over the past few years, the question was whether it was currently appropriate. The report on recent economic developments showed that the profitability of exports had for many years compared unfavorably to that of sales in domestic markets. Considering the relatively small size of the export sector in the economy, a modest depreciation of the rupee should not have a serious inflationary impact and could effectively serve to promote exports.

Implementation of key elements of the structural adjustment policies pursued in recent years would also have to be accelerated in order to strengthen India's international competitiveness, Mr. Fujino considered. He had in mind, first, the elimination of supply bottlenecks in key sectors such as electricity, coal, transportation, and irrigation; second, improved access to imported inputs under a more streamlined import regime; third, liberalization of industrial regulations; and fourth, flexible pricing policies. A number of steps had already been taken in those areas, without any convincing indication that productivity had significantly improved. For instance, capacity utilization in the electricity sector remained below 50 percent, and most state electricity boards continued to incur substantial losses. According to the report on recent economic developments, the reasons for that poor performance included inflexible pricing policies, overstaffing, poor maintenance of existing capital, and a shortage of coal. It was evident that problems in those four areas were combining to cause various inefficiencies in the economy. It was encouraging that the authorities intended to give priority to improving productivity, as Mr. Sengupta had mentioned, in quoting from the Prime Minister's speech.

The consolidated deficit of the Central Government and state governments still seemed to be on a rising trend, Mr. Fujino observed. Although the overall deficit for the current fiscal year was budgeted to decline to 9.8 percent of GDP from 10.4 percent of GDP in the past fiscal year, that target might be exceeded by a sizable margin. India's private savings rate, at some 19 percent of GDP, was relatively high by any standard, particularly considering the low level of incomes and the large proportion of the people living below the poverty line. Therefore, future increases in savings, which were essential for maintaining a high investment rate, would depend heavily on the performance of the public sector, and particularly on the enhanced profitability of public enterprises. Although the financial position of those enterprises had improved greatly in recent years, the improvement had been largely due to higher revenues from the oil sector. Continued efforts would be necessary to improve the profitability of other enterprises, including those in the key industrial sectors such as coal, steel, fertilizer, and electricity, through the structural adjustment policies that he had already mentioned.

The recent rise in subsidies, including those on sugarcane exports and on fertilizer, were a matter for concern on the expenditure side, Mr. Fujino commented. Over the medium term, efforts should be made to reduce those subsidies by lowering production costs; in the meantime, subsidy policies should be carefully examined in light of the overall situation of the public finances. In his opinion, subsidies were but one factor contributing to the larger than expected increase in expenditures, which according to Table 32 in SM/85/41 had increased across the board. Mr. Sengupta had mentioned the deferral of expenditure, which would presumably be not a basic solution but a temporary measure; as he understood it, a basic review was under way, and he would welcome a more detailed explanation of the background of the recent increase in spending and how it could be dealt with in the future.

On monetary policy, Mr. Fujino considered, structural adjustment policies aimed at enhancing productivity and international competitiveness could be carried out smoothly only in a noninflationary environment. Inflationary tendencies caused by the drought of 1982 had not yet subsided, reflecting higher than programmed monetary expansion in recent years. Like the staff, he believed it important to achieve the target of reducing the rate of growth of monetary expansion to 15 percent by March 1985.

Finally, Mr. Fujino observed, it was clear from the medium-term debt projections in Table 8 of SM/85/27 that India was in need of a large and continuous flow of concessional assistance. All industrial countries, including Japan, were trying hard, under difficult budgetary circumstances, to increase their overseas development assistance. However, pragmatically, it would become more and more difficult to secure sufficient concessional flows as time went by, and he would appreciate the staff's view on the realism of the estimates in that table of such flows. With its abundant human and natural resources, the Indian economy had great potential to grow much more rapidly if determined structural adjustment efforts were accompanied by prudent demand management policies. He wished the authorities every success under the coming Seventh Plan, and supported the staff appraisal and proposed decision.

Mr. Dallara considered that India's adjustment efforts aimed at achieving short-term macroeconomic objectives had been successful on the whole. Yet the implementation of structural reforms seemed not to have moved forward either particularly far or rapidly, raising questions in his mind about the possibility of achieving lasting economic growth within the context of a sustainable external position over the longer run.

So far, real economic growth had been satisfactory, Mr. Dallara went on. Inflation had fallen significantly in 1982/83; despite a resurgence above 12 percent in 1983/84, a lower rate was forecast for 1984/85. Moreover, Mr. Sengupta had provided evidence of continuing progress against inflation. The balance of payments performance, in terms of the ratio of the current account deficit to GDP, had been better than expected. However, the components of the deficit had been different from the assumptions in the original program, both exports and imports having fallen short of expectations; export growth had been especially disappointing, but oil imports had also declined.

Another goal of the extended arrangement had been to increase the overall efficiency of the domestic economy, with the help of structural reform of industrial and trade policies, combined with careful demand management, Mr. Dallara continued. Despite some liberalization of the import and industrial licensing regimes, significant structural problems remained, with potentially important implications for exports and overall growth prospects in the medium term. Infrastructural bottlenecks were a periodic problem. The poor financial performance of the non-oil state enterprises, which dominated the industrial sector, appeared to be an impediment to investment. The high and rising marginal capital output ratio put into question either the accuracy of savings and investment data or the basic efficiency of investment. The continuation of a highly complex system of industrial licensing and of import and export restrictions and incentives must surely obstruct the ability of the economy to respond promptly and productively to opportunities for economic growth and export.

He doubted whether the potential benefits that might be derived from foreign investment were being fully exploited and whether legislation against monopolies might be limiting economies of scale, Mr. Dallara said. Some of the policy improvements that might help to correct structural problems and rigidities could include a strengthening of the public finances to reduce the overall credit demands of the public sector and to facilitate the growth of the domestic sector, the further adjustment of administered prices, and more market-oriented incentives for production and exports. It was encouraging that the Seventh Plan recognized the need to enhance industrial competitiveness and raise the productivity of investment. Indeed, many of the problems that he had mentioned appeared to have been in the minds of those constructing the plan. Further liberalization of import controls and of industrial licensing could contribute greatly to the necessary shift away from heavy dependence on administrative controls. He had been particularly interested to learn that the Government had established a number of committees of experts to study ways to increase economic efficiency, including one to study the possibility of increased reliance on financial and fiscal instruments in lieu of direct controls on trade and industry, that committee being expected to present its report toward the end of 1985 or early in 1986. Should that committee recommend such a policy shift, it would become particularly important, as the staff had pointed out, to improve the collection of data, which were wanting in certain areas.

Despite the containment of the current account deficit of the balance of payments, the poor performance of exports could not but be a cause for disappointment, Mr. Dallara observed. Exports had risen by less than 1 percent during the three-year program under the extended arrangement, compared with a target in excess of 5 percent. Chart 3 in SM/85/27 showed the related fact of India's steady loss of export market shares, especially since 1978/79, a development that had contributed significantly to the increase in the debt service ratio in 1983/84. It was difficult to assess the extent to which import liberalization had been achieved in recent years; the staff had suggested that the overall level of protection had declined in 1983/84, and that imports targeted for liberalization had risen by 10 percent annually over the period of the extended arrangement. He did not wish to minimize the progress made against such a large array of restrictions and controls, but import and export policy for 1984/85 evidently did not embody significant further liberalization. He hoped that the liberalization effort was not faltering; its continuation and acceleration, coupled with a more active exchange rate policy, could improve export prospects, as the staff had suggested. At the same time, while the authorities prudently viewed a debt service ratio in excess of 20 percent as excessive, the medium-term scenarios in the staff report suggested that such a ratio might well materialize in 1987/88, in the absence of a fairly large gain in exports or other developments. Although the authorities seemed well aware of the need to improve their export performance, their reference to the suppression of imports to avoid an unacceptable debt service ratio was disturbing.

Concerning the role of fiscal and monetary policy in avoiding a resurgence of inflation, Mr. Dallara noted with some concern the upward trend of public spending and budget deficits. Although the ceilings under the extended arrangement on bank credit to the Government had been respected, the central government deficit itself had exceeded program estimates in both 1982/83 and 1983/84. In fact, with respect to the consolidated accounts for the Central Government and state governments, and the union territories, there had been a rather steady rise in the ratios of revenues and expenditures to GDP from 1980 to 1984. The consolidated deficit in those four years had been about 9-10 percent of GDP, with a similar deficit in prospect for 1984/85. Since those consolidated accounts excluded the state enterprises, the extent to which the public sector was contributing to total credit demand was probably understated. Recent data on credit to the public sector in 1985 indicated that the central government budget deficit could exceed the forecast, although Mr. Sengupta had stated that new measures had been taken to control expenditures. Certainly, the overall fiscal trend underlined the importance of maintaining close control over public spending and fiscal deficits. Continued resort to increases in the excise tax on imports was not one of the better ways of dealing with the fiscal situation.

In sum, the continuation of India's traditionally prudent financial management in many areas during the period covered by the extended arrangement had clearly had some favorable effects on growth, inflation, and the balance of payments, Mr. Dallara observed, although he feared that the country had not yet taken full advantage of the opportunity to carry out more structural changes in industry to make it more efficient and internationally competitive. Therefore, he welcomed the interest displayed by the new Government in addressing those fundamental problems. More generally, India's case seemed to raise the issue of the emphasis attached to structural reform under programs supported by extended arrangements. If his recollection was correct, the basic argument for India's program had been that it would, among other things, help to contain the balance of payments or bring about a modest improvement, during a period of significant liberalization and major structural measures. The fact that the balance of payments outcome had been better than expected, whereas progress in dealing with India's structural problems had been less than desirable, raised a question that had been addressed in a staff paper reviewing upper credit tranche arrangements and some issues of conditionality (EBS/84/227, 11/7/84), namely, the extent to which the Fund--and indeed members--had at their disposal the proper instruments to encourage structural reform. The modalities for encouraging progress toward structural reform raised more questions in his mind than any particular aspect of India's performance.

Mr. Salehkhou noted that the Article IV consultation with India provided a good opportunity to review the economy's performance under the 1981 extended arrangement with the Fund and the medium-term economic outlook following the voluntary termination of the arrangement by the authorities. India's recourse to Fund resources had not been dictated by severe or unsustainable pressures on the balance of payments but rather by the need to maintain the economy's traditional external stability while a new adjustment strategy was implemented. Although India had achieved remarkable economic progress since its independence, including self-sufficiency in foodgrains, the development of a diversified industrial sector, and the realization of significant social gains, overall performance had remained below the country's human and economic potential. Furthermore, a number of structural distortions had limited the economy's ability to counter the deterioration in the terms of trade that had begun in the late 1970s and to withstand the impact of world recession.

The adjustment policy supported by the extended arrangement had aimed at stepping up economic growth as well as at introducing far-reaching structural reforms, without putting undue pressure on the balance of payments or on prices, Mr. Salehkhou recalled. The program had envisaged in particular a gradual shift in economic policy from administrative regulations and physical controls to the use of economic and fiscal instruments to improve efficiency and strengthen domestic resource mobilization. The staff had been cautious in assessing the success of the program, especially in view of significant departures from the original assumptions and the relatively weak response of exports to the new policies. However, performance under the extended arrangement seemed to have been largely satisfactory as the broad objectives of the program had been achieved, the performance criteria had been consistently met, and better than expected balance of payments developments had enabled India to forgo the last purchases under the arrangement.

Developments with respect to growth, inflation, and the external current account deficit had also been mostly in line with program targets, Mr. Salehkhou added. However, while the success of structural reforms could be assessed only over the medium term, progress toward more efficient use of internal resources and better external competitiveness seemed to have been limited. Moreover, performance in a number of areas had fallen short of the program targets, particularly with respect to the central government budget deficit and public sector savings and investment. Liquidity growth also continued to be strong, despite several policy changes in 1983/84 aimed at dampening inflationary expectations without jeopardizing credit to support productive activities.

With respect to India's economic policies and outlook since the termination of the extended arrangement, Mr. Salehkhou noted with encouragement that the highest authorities had reaffirmed their commitment to the program policies and structural reforms. In that connection, he found himself in broad agreement with the staff's analysis. On external policies, he had taken note of the authorities' view of the exchange rate as only one of the instruments for strengthening the external balance and improving international competitiveness. Thus, although they had taken measures to maintain the real value of the rupee, they would continue to give equal emphasis to pricing policies and efficient use of resources. The staff review also showed that export-oriented policies initiated under the program had not resulted in a marked improvement in export performance, because the expected increase in India's market share had not materialized. He wondered to what extent protectionism in major industrial countries might have affected India's export performance and would appreciate the staff's comments.

The external debt service ratio of India remained low, Mr. Salehkhou observed, reflecting the authorities' traditionally prudent borrowing policy and the high share of concessional credit in overall debt. However, the strengthening of the balance of payments had been due more to favorable financial flows than to an improved trade balance, so that the growth of external debt had accelerated; more important, the share of interest payments in the debt service burden had increased significantly, from 34 percent at the initiation of the extended arrangement to 52.9 percent in 1983/84, reflecting greater recourse to commercial borrowing. That trend, and the various medium-term scenarios presented in the staff report, underlined the need for India to strengthen the adjustment process under way in order to maintain adequate real economic growth without an excessive accumulation of external debt. In that context, the authorities' approach to external financing continued to be adequate because it discouraged recourse to foreign resources for balance of payments purposes and stressed the relation of such financing to development projects. As Mr. Sengupta had stated, success in that area would also depend on the volume of concessional assistance that India would receive in the medium term.

With respect to financial policies, Mr. Salehkhou concluded, the new administration was taking action in response to the higher than expected budgetary expenditures and the resulting impact on net bank credit to the states and Central Government as well as on the objectives of expanding support to the private sector and productive activities. While the fiscal deficit did not seem to give cause for particular concern, the dominant role of the public sector in the Indian economy suggested that the authorities' actions should be directed at the need for more effective implementation of the budget and at strengthening further the efficient use of financial resources by the public sector, which was expected to be a major objective of the forthcoming development plan. Finally, he supported the proposed decision.

Mr. Pérez observed that the structure of the staff report clearly illustrated the relative importance of India's current economic problems. The bulk of the document was devoted to examining the real sector of the economy, the distribution of supply, together with largely microeconomic and structural policies. Relatively little weight was given to macroeconomic developments, in contrast with the staff's economic analysis of most other member countries of the Third World. That assessment reflected India's satisfactory macroeconomic performance in maintaining adequate price and exchange rate stability as well as the prudent demand management policies followed by the authorities. Those policies had resulted in a moderate current account deficit and in relatively low foreign indebtedness. India's debt was also still moderate in relation to the size of the economy, although, like that of many other developing countries, it had grown substantially since the second oil shock of 1979-80. It was therefore gratifying that the authorities took a cautious approach to foreign commercial borrowing, which, they considered, should be directed to the financing of economic objectives and not used for general balance of payments support. Undoubtedly, that caution had served India well in the past, because it had enabled the country to avoid the difficult and compromising debt-related situations of a considerable number of developing countries in the past few years. In that respect, the authorities' policy objective of maintaining the debt service ratio below 20 percent was well taken.

Sluggish economic growth in the past probably reflected deep structural problems in the Indian economy, Mr. Pérez considered. The high level of domestic savings in relation to national product--probably among the highest in the world for countries with comparable per capita incomes--was encouraging. Moreover, over 70 percent of domestic savings had traditionally been generated by households. Such well-established patterns of behavior gave India a broad savings base and thus the opportunity to maintain high investment ratios. The worrisome fact that increasing resources had been devoted to capital formation without leading to a sustained and acceptable rate of growth of output probably reflected, at least in part, inefficiencies both in resource allocation and in the application of sectoral policies, together with government regulation of various aspects of economic activity.

Agriculture remained the dominant force in India's economy, Mr. Pérez commented, and it was to the agricultural sector that the Government had devoted its greatest efforts in order to procure an increased food supply.

The policy mix consisting of promoting the use of modern production techniques and of financial incentives to farmers in the form of support prices and subsidized credit, as well as improvements in the distribution system and the management of stocks, had succeeded in increasing per capita grain output, besides alleviating the hardship associated with the severe drought of 1982.

In contrast to the relatively adequate scope of agricultural policies, Mr. Pérez continued, industrial policies appeared to have fostered inefficient production trends for quite some time. Government regulations of all sorts were apparently pervasive in the Indian economy, particularly in the industrial sector. The improvement of both government finances and resource allocation would depend crucially on the performance of public sector enterprises, which accounted for over 70 percent of the value added in manufacturing and depended on central government transfers for more than half their capital expenditures. Therefore, the increased profitability of some enterprises--particularly in the oil sector--was encouraging, although many non-oil public enterprises were still registering losses or, at best, rates of return below market averages. The emphasis in the Seventh Plan on improving productivity and overall economic efficiency was certainly well placed. Equally welcome were the recent statements and policy actions of the new Government in the same direction.

A more efficient public sector would not only have an immediate effect by lowering capital/output ratios, but also have an impact of the first order on the Government's finances, helping to reduce the public sector deficit and, hence, increase the availability of savings to the private sector, Mr. Pérez considered. While it was true, as noted by the authorities, that the large public sector deficit was associated with the predominant role of the state in capital formation, it might be desirable to allow for a more decentralized process of investment. However, a reduction of the public sector deficit remained a necessary condition for more active participation in the economy by the private sector as long as a cautious monetary policy was followed to maintain price and exchange rate stability.

As for India's medium-term economic prospects, the staff's inclusion in its report of alternative scenarios provided the type of sensitivity analysis that the Board had been requesting on a standard basis for medium-term projections, Mr. Pérez noted. He agreed with the staff assessment that although those scenarios were intended to be illustrative, they underlined the importance of heightening domestic efficiency as a means of promoting export competitiveness, if a long-term viable external position were to be maintained. He would add only that a strategy aimed at export growth led to a more "natural" process of import substitution, since more cost-effective domestic products would be gradually substituted for imported inputs, reflecting comparative advantage more faithfully than when import substitution resulted from an explicit policy of centralized resource allocation. Finally, he supported the proposed decision.

Mr. Jaafar considered that the staff had given an impressive account, in Parts III and IV of SM/85/27, of the authorities' aspirations and achievements under the extended arrangement. He attached great importance to the objectives articulated in Part III, because they were both appropriate and timely for India, especially with reference to the promotion of efficient resource use, a dynamic external sector, and prudent demand management, among other objectives. While he was pleased that the broad goals of higher growth, low inflation, and a better external position had been achieved--in themselves outstanding results--it was regrettable that the staff had not been able to assess definitively the extent of improvements in efficiency and competitiveness because of the limited availability of data. That was all the more regrettable because both greater efficiency and competitiveness had eluded the authorities for so long.

Much remained to be done, judging from the information in the staff report on the continuing infrastructural bottlenecks, the poor performance of state enterprises, and low capacity utilization, Mr. Jaafar commented. Furthermore, the report of high and rising incremental capital/output ratios underscored the need to strive for a better quality of investment, especially in the public sector. In the light of the need to strive for efficiency, he endorsed the view that there was an urgent need to simplify the complex network of industrial regulations. He took note of the commendable changes already made, but understood that more had to be done. Similarly, he stressed the need for more import liberalization, which would contribute to promoting competition and better resource use in the economy.

The better than expected outturn on the current account of the balance of payments was gratifying, Mr. Jaafar remarked, but export performance, which had been less successful than expected, was a cause for concern if India were to realize its stated intention of expanding the role of the external sector. The concern was twofold, emanating as it did from rising debt service obligations and the need to promote efficiency. He agreed with the objective of limiting the debt service ratio to 20 percent, but the prospects for its achievement in the medium term seemed unlikely in the absence of a better showing on exports. The medium-term scenario served as an excellent model of the alternative routes that the economy might take in the years ahead. Admittedly, the scenarios were only indicative of the likely outturn, but Scenario C--with the 20 percent debt service cap as an objective--did not appear to be realistic because it would lead to an extremely low rate of growth of imports. On the other hand, Scenario A seemed somewhat idealistic, as the authorities themselves had indicated, because of the rather ambitious export growth target, unless more were done to improve export competitiveness and efficiency. Thus, Scenario B remained the most likely outcome. All the scenarios served to underscore the importance of an outward-looking policy for India. In that connection, he joined Mr. Wicks in drawing attention to the role that direct foreign investment could have in promoting the transfer of technology and efficiency in India.

It was in relation to export performance and competitiveness that he wished to refer to the exchange rate of the rupee, Mr. Jaafar observed. In Part IV, Section 6 on the exchange and payments system, as well as in Chart 4 of the staff report, he noted that the rupee had depreciated against the U.S. dollar and the yen but appreciated against sterling and the deutsche mark. On the other hand, the overall exchange rate index had shown a depreciating trend lately. Without the benefit of an assessment by the staff of the appropriateness of the current exchange rate of the rupee, it was not possible to know whether there was any scope for promoting exports through a more competitive exchange rate policy.

The authorities' reaffirmation of their commitment to financial stability was indeed a positive move that would ensure continuity of the adjustment policies undertaken under the extended arrangement, Mr. Jaafar continued. He had noticed that prices had begun to increase again recently, for various reasons; if that trend continued unchecked, it could pose a serious problem later on. He had therefore been pleased to note from Mr. Sengupta's statement that some progress had been made in reducing inflation. However, close attention to liquidity growth remained relevant and important. The report of a sharp increase in credit in the first half of 1984/85, which had been larger than expected--at Rs 48 billion against Rs 58 billion for the entire fiscal year 1983/84--was a cause for serious concern. Because the liquidity growth stemmed from expansionary budgets--of the Central Government, but especially of the states--it was not entirely inappropriate to call on the authorities to take the necessary steps to prevent a further deterioration.

On the size of the public sector and the overall public sector deficit, Mr. Jaafar noted the rising trend in expenditure as a share of GDP and the lagging revenue performance, leading to persistently high deficits. He was of two minds about the situation. Concern over the growing share of savings pre-empted by the public sector, and the small share left for the private sector, had not been taken lightly in India, as the staff had said, especially in view of the reportedly high incremental capital/output ratio, which was a reflection to some degree of the efficiency with which reserves were used. At the same time, in the context of economic development, social objectives could not be ignored, an especially pertinent factor in India.

Finally, Mr. Jaafar remarked, although he did not yet appreciate the extent of the problem relating to the quality and timeliness of statistical data to which reference was made in the staff appraisal, he had been disturbed to perceive that the ability of the staff to evaluate monetary developments in India had been impaired to some extent. He had in mind in particular the statement by the staff on page 31 of SM/85/27 that "...the strong growth in unspecified monetary liabilities creates uncertainties for interpretation of movements in key monetary and credit aggregates." The problem should be rectified as soon as possible. In that connection, he had been encouraged to observe recent moves toward computerized data collection in India.

Mr. Suraisry expressed general agreement with the staff analysis and support for the proposed decision. India had made impressive economic progress in recent years, assisted by a successful extended arrangement with the Fund. The overall picture was currently one of strong and diversified growth, moderate inflation, and balance in the external accounts. Those were commendable achievements, owing much to the authorities' consistent pursuit of cautious financing policies and a well-planned development strategy. India provided an encouraging example to other Fund members of adjustment through growth. Looking ahead, there was room for further progress in several areas if the economy were to realize its full potential. There were still weaknesses in the public finances; investment under the Sixth Plan had fallen short of the targets in key sectors; export performance had generally been below expectations; and the debt service ratio was rising. It was therefore important to maintain the momentum of adjustment and to strengthen the balance of payments over the medium term.

On the fiscal side, the authorities' continuing commitment to prudent policies was vital in mobilizing new resources for development, Mr. Suraisry stated. The 1984/85 budget was, however, proving considerably more expansionary than intended, and the rapid growth in current expenditure could jeopardize the authorities' anti-inflationary objectives. It was therefore helpful to learn from Mr. Sengupta that supplementary measures had been introduced to restrain expenditure. The authorities might nevertheless have to press ahead with the tax compliance program to remedy recent shortfalls in revenue. It would be helpful if the staff, or Mr. Sengupta, had any further information about the outcome of the major review of fiscal policy initiated in November 1984.

He agreed with the staff that it would be important to assign priority to strengthening the finances of the state governments, Mr. Suraisry added, if the states were to make their planned contribution to the public investment program. There was also scope to improve the financial position of the public enterprises, several of which remained in financial difficulties. A concerted effort to strengthen public finances along those lines would facilitate monetary management and avoid possible crowding out of the private sector's demand for credit. The action taken to reduce the growth of overall liquidity seemed appropriate in view of the need to dampen inflationary expectations. He also supported the authorities' move to strengthen the banking system, which played a crucial role in mobilizing and allocating private savings in India.

On the supply side of the economy, far-reaching measures to reduce regulations and improve incentives had led to a more efficient allocation of resources, Mr. Suraisry noted, thus contributing to the rapid growth in agricultural and industrial production and to the development of the oil sector. The removal of the remaining rigidities and bottlenecks would promote the objective of making the economy more efficient and competitive, which, he had been pleased to note from Mr. Sengupta's statement, was indeed one of the authorities' main priorities. A high-level committee was examining the possibility of dismantling existing controls on trade and industry, the type of reform from which the private sector could derive considerable benefit.

Commendable steps had also been taken to liberalize imports and simplify import licensing procedures, Mr. Suraisry observed. While there was scope for further liberalization, as the staff suggested, the authorities had shown courage in resisting domestic pressures for protection and in going against the worldwide trend toward higher trade barriers. It had already been noted that exports accounted for a small share of gross national product; the authorities were well aware that a strong export performance was vital if the economy were to grow steadily in the future, and if India were to avoid overreliance on foreign borrowing. To that end, the authorities would have to coordinate a set of policies aimed at enhancing export competitiveness, developing new markets, and expanding India's share in existing markets. To conclude, India's economy was on the right course, and if the authorities followed the same pragmatic and well-balanced policies that had worked well in the past, as he was confident they would, the prospects seemed encouraging.

Mr. Rye noted that India's record in recent years had in most respects been a good one. The new Government's vigorous efforts at reform seemed appropriate, not least in the overhauling of the administration, the key to translating policies into practice. Looking ahead, there were areas for concern. Real GDP growth was expected to diminish in 1984/85. The rate of inflation, although apparently declining, remained considerably above that of India's major trading partners. Although strong capital inflows had maintained adequate gross reserves, the debt burden was expected to increase. Since the reduction in the consolidated budget deficit in 1981/82, the ratio of the overall budget deficit to GDP had exceeded expectations each year, largely reflecting a rapid growth in expenditures. That was surely a matter of concern, particularly as the same trend seemed to be developing in 1984/85. He had not been fully convinced by the points made by the authorities to justify that increase in spending, and wondered whether the staff or Mr. Sengupta could provide further information on budgetary trends.

With the buildup of excessive liquidity growth and inflationary pressures, Mr. Rye continued, it was encouraging that the Reserve Bank of India had modified reserve requirements, raising the statutory liquidity ratio from 35 percent to 36 percent and postponing the release of impounded cash balances. However, the growth of world money had continued to be strong during the first quarter of 1984/85. He agreed with the staff's emphasis on the role played by the banking system in mobilizing financial resources, adding that export growth prospects depended largely on the performance of the private sector, and he wondered whether the considerable rise in the already large number of public enterprises was contributing to the efficiency of the economy; perhaps there was scope for rationalization.

On industrial policy, economic efficiency was rightly seen as a prerequisite for improved export performance and better performance of the economy generally, Mr. Rye noted. He strongly encouraged the authorities to step up the process of liberalization. In connection with the industrial licensing system, the complex network of regulations designed to promote a number of government objectives, although they had been revised somewhat, seemed to call for priority attention. Surely there were better ways of achieving those objectives without encumbering the industrial sector with so many bureaucratic regulations. More generally, the possibilities on which the authorities were focusing for increasing reliance on financial and fiscal instruments in lieu of physical controls represented, prima facie, the right approach. It was encouraging that decisions had recently been taken to allow private investment in some areas previously reserved for the public sector and to eliminate some licensing requirements. However, there had been no change in the capacity limit--Rs 200 million--to which industrial licensing requirements applied; a further review of that scheme seemed warranted, as did greater relaxation of the licensing scheme as a whole. It was also disappointing that import/export policies for 1984/85 did not, in the staff's view, constitute a further move toward liberalization. He made that comment in full appreciation of the difficulties of resisting protectionist pressures, as mentioned by the Indian authorities.

Finally, Mr. Rye remarked, notwithstanding the distance that India still had to go, he supported the staff view that remarkable progress had been made in achieving self-sufficiency in foodgrains, the rapid development of oil production and of a diversified industrial sector, and the spread of technical education.

Mr. de Beaufort Wijnholds expressed his full support for the staff appraisal, which showed that India's economy had performed quite well in recent years but that some important further changes were necessary to maintain its upward momentum. The staff had emphasized that whereas performance under the policy program supported by the extended arrangement had been satisfactory in a broad sense, important objectives having been met, there had been some disappointments, particularly with respect to export performance. The achievement of a satisfactory balance of payments outturn together with high growth could be attributed to a large extent to import substitution, namely, the raising of domestic oil production, as well as to lower prices for oil imports. The value of net oil imports had fallen by about SDR 2 billion since 1980, a positive development in itself, but not one on which India could rely to reach the medium-term goals for growth and the external position set out in Part VI of the staff report, on India's medium-term prospects.

The staff had stressed the desirability of improving external competitiveness as well as the need for policies to foster competition in the domestic economy to raise productivity and bring about a further shift from administrative controls toward macroeconomic management, Mr. de Beaufort Wijnholds continued. Convincing arguments for those views had been presented in the staff report, and it was heartening that the Indian authorities appeared broadly to share them. Implementing such an approach would be important for the pursuit of adequate microeconomic as well as suitable macroeconomic policies, including those providing sufficient incentives to the private sector. He shared the staff views on demand policies and the need for further import liberalization.

The three scenarios on medium-term prospects highlighted the problems confronting the Indian authorities in the years ahead, Mr. de Beaufort Wijnholds observed. Scenario A, in most respects a satisfactory outturn, would involve a considerable increase in export market shares, contrary to historical trends. The other scenarios were based on the gradual historical loss of market shares and might be more realistic but would constitute a rather disappointing result. He hoped that India's envisaged policy shift would make it possible for current export market shares at least to be retained in coming years, thereby enabling the country to record better results than those foreseen in Scenarios B and C, in which either commercial borrowing would rise too fast or import growth would be insufficient. On the subject of exports, he wondered whether the staff could give an estimate of the loss of export proceeds on account of the restrictions on tea exports.

In the past, India had shown great reluctance to accumulate external debt, particularly nonconcessional liabilities, and it had thus been spared the trauma of a debt crisis, Mr. de Beaufort Wijnholds noted. The authorities had indicated once more their determination to keep the growth of external debt within bounds, as Mr. Sengupta had confirmed. The wisdom of that stance was undeniable. However, it would not be easy for the authorities to keep the debt service ratio from rising beyond 20 percent. That ratio had moved up unexpectedly rapidly recently, and the average interest rate on medium-term and long-term debt had risen from 2.4 percent in 1980/81 to 4 percent in 1983/84, reflecting an increase in the share of commercial borrowing in total external debt. India was no doubt receiving tempting offers from the international banking community, given the borrowers' market in international credit for the limited number of countries considered creditworthy. But India should continue to view such offers ascetically. A more forthcoming attitude toward nondebt-creating flows, in particular foreign direct investment, would on the other hand be welcome.

With respect to commercial borrowing, figures recently published by the Bank for International Settlements showed that in mid-1984 India had had unused credit lines with international banks for no less than \$2.7 billion, almost the same amount that it had had outstanding to the banks at that time, Mr. de Beaufort Wijnholds commented. Over one third of that debt, or \$1 billion, was short term, with a residual maturity of one year or less. The staff, in the report on recent economic developments, estimated outstanding short-term debt in mid-1984 at SDR 400 million, a figure that might be on the low side, especially as there were likely to be short-term suppliers' credits outstanding as well. Of course, differences in the definition of maturity and in other respects might count for part of the apparent discrepancy. His point was that the lack of official statistics on India's short-term external debt was to be regretted. If that debt suddenly turned out to be much higher than estimated, India's situation might be complicated significantly. The problem of the timeliness and quality of statistics in general, to which the staff and a number of Directors had alluded, made improvements in that area desirable to permit better monitoring of developments in the short run.

Mr. Mtei observed that the Indian economy had continued to make progress since the 1984 Article IV consultation. The growth rate in 1984/85, although projected to be lower than the 8 percent achieved in 1983/84, was expected to remain high, reflecting increased output in both the agricultural and industrial sectors. The balance of payments position was also expected to improve, with reserves being at a comfortable level. Aided by exogenous developments, including favorable weather and substantial capital inflows, the adjustment policies set in place had helped the economy to rebound from its sluggish performance in 1982/83. As a result, the authorities had been able to cancel the extended arrangement with the Fund, thereby releasing committed resources of SDR 1.1 billion for use by other deficit countries able to agree on Fund arrangements.

It was encouraging that the authorities intended to continue to implement policies designed to establish the basis for sustained economic growth in an environment of stable prices and a viable external payments position, Mr. Mtei added. However, the re-emergence of inflationary pressures in 1983/84, if not adequately contained, could endanger the progress made. The authorities' commitment to adjustment augured well for the future of India, particularly as their development strategy was being developed in a medium-term framework and continued to stress the importance of implementing supply-oriented policies with the objective of promoting efficiency and structural reform.

Satisfactory progress had not been made on the fiscal front, however, Mr. Mtei continued. The central government deficit as a percentage of GDP had continued to increase over the past two years and was envisaged to grow further in 1984/85. He could understand the authorities' view of the major role that the public sector continued to play in capital formation in India--accounting for more than 75 percent of nonhousehold investment--and in generating savings. But it was important to note that the degree of improvement in productivity in the overall economy would depend largely on the implementation of policies promoting the efficient use of resources in the public sector. It was therefore crucial for efforts aimed at improving the performance of public corporations to continue, and for priority attention to be given to expanding capacity in key sectors such as electricity, transport, and agriculture. It was also important to ensure the availability of adequate resources to meet the needs of the private sector.

Monetary policy in recent years had been directed at containing inflationary pressures, Mr. Mtei remarked. However, liquidity growth in 1983/84 appeared to have been excessive, thereby further accelerating the increase in the consumer price index. It was encouraging to note the Government's recent efforts to reduce the growth in liquidity, including a slowdown in credit expansion to the public sector. Such a step was necessary, given the need to arrest inflationary pressures and maintain India's competitiveness in international markets. He also welcomed the measures already taken to strengthen the financial position of banks and those under consideration to enhance the operational efficiency of the banking sector. The flexible approach toward the adjustment of interest rates had also contributed to the mobilization of domestic savings.

India's external position had continued to improve in 1983/84, with the current account deficit as a percentage of GDP declining to 1.5 percent, Mr. Mtei observed. The overall balance of payments deficit had also been subtantially reduced, reflecting increased capital inflows. However, export performance had been below the program target; while that shortfall could be attributed to the weakness in international commodity prices, the continuing decline in the longer-term ratio of export volume and market growth should receive the authorities' attention. At the same time, it was not enough to encourage the Indian authorities to increase export production; it was equally important for India to have freer access to markets.

India's debt service burden was not excessive compared with that of many other developing countries, Mr. Mtei noted. However, the authorities were right to approach foreign borrowing cautiously in order to ensure that the debt burden remained manageable. The medium-term prospects illustrated in the three different scenarios in Table 8 of the staff report were most illuminating. Illustrative as those scenarios were, they clearly indicated the need for sustained effort to improve domestic resource allocation, enhance the performance of the export sector, and maintain a cautious external borrowing policy. Fortunately, the Indian authorities were aware of the challenges ahead and were willing to continue their adjustment effort, in which he wished them every success.

Mr. Alhaimus recalled that during the discussion of the 1984 Article IV consultation with India, the Board had appropriately commended the authorities for their economic management and successful implementation of the extended arrangement, as well as for the decision to terminate that arrangement early in the wake of a favorable economic outturn. Since that time, the developments in the Indian economy indicated that staying on the prudent course of adjustment with growth charted in that arrangement had led to further gains in economic performance. During 1984, driven by strong agricultural growth of over 10 percent, the economy had grown at an estimated rate of 8 percent, while industrial growth, which had been slow in the recent past, had picked up, export growth had resumed, and reserves had risen to approximately five months' imports.

He was in broad agreement with the staff appraisal, Mr. Alhaimus remarked. Among the more notable and encouraging developments cited in the staff reports was that foodgrain production for the past two years had broken earlier records. Policy efforts, which had been directed for some time to achieving a rapid and stable expansion of production, especially that of foodgrains, and which had emphasized the extension of modern production techniques and the provision of adequate financial incentives, had apparently paid off rather well. If those recent gains in productivity were secured, and if output at current levels were sustained in the coming years, India would not only fully establish its emerging self-sufficiency in foodgrains but even become a net food exporter. That trend was particularly welcome, India's dependence on food imports having been substantial not too long ago.

A related matter of some policy interest on which more analysis and information might be useful concerned the distribution of those gains in production, Mr. Alhaimus remarked. Policymakers in India had in the past attached a certain priority to the issue, and it would be helpful to have an estimate from the staff of the possible distributional effects of various agricultural policy choices, such as price support programs and supply-side policies that emphasized the diffusion of technology and the development of infrastructure. Some knowledge of the impact of growth-oriented agricultural policies on the distribution of rural income would help to determine the socially appropriate weight that might be attached to various policy choices.

Recently, the Indian authorities had announced their intention to introduce a major policy reform with the objective of inducing rapid industrial growth, rendering Indian industry more efficient and competitive, and boosting export earnings, Mr. Alhaimus continued. For those purposes, policy was expected to be reoriented toward reducing the role of the Government, developing an adequate infrastructure for greater private sector involvement in the economy, and modernizing domestic industry. The initial steps included improved procedures for obtaining industrial licenses, some import liberalization and a reduction in duties on most high-technology imports, and the rationalization of domestic pricing policies; reform of the financial markets was also being considered. Yet the extent to which the objectives of industrial and export growth were realized was likely to depend on the degree of procedural simplification attainable in the administrative process, and on the manner in which domestic industry, which had been developed largely with the aid of protective policies, was introduced to competition, especially from external sources. To promote an orderly transition to an internationally competitive industry that would minimize the adverse effects, the authorities might have to remove protective barriers in a number of well-planned steps, the timing and sequence of which might need careful consideration. For example, increased domestic competition, financial reform to broaden the stock market, and encouragement to domestic industry to modernize might have to precede the opening up of the economy to foreign competition on a significant scale. Those and other issues had no doubt already been discussed by the committees mentioned by Mr. Sengupta, and some indication of current thinking on them might be helpful at the present stage.

The medium-term scenarios presented in Table 8 of the staff report indicated that if industrial and export growth at a rapid enough rate were realized, as the authorities hoped, India's reserve and debt service position would remain reasonable in the period ahead, Mr. Alhaimus noted. The different scenarios did suggest however that it would be important for the maintenance of stable growth and for the continuation of the current prudent debt policy that the policies contemplated by the authorities should be implemented at an appropriate pace to achieve the needed dynamism in export performance.

Finally, Mr. Alhaimus remarked, although transfers were expected to increase over the rest of the decade, according to the medium-term scenario, the expectation in the report on recent economic developments was that remittances, which constituted a large proportion of transfers, had declined by some 4 percent during 1983/84. That decline might be indicative of a future trend, and it would thus be useful if the staff could explain the basis on which it expected remittances to decline and transfers to increase over the medium term.

Mr. Jensen said that he supported the proposed decision. His chair joined other Directors in commending the Indian authorities for the sound economic policies they had been pursuing in recent years to achieve structural reform in key sectors and alleviate the most critical imbalances in the economy. The statistical evidence was conclusive. Real output had performed well while inflation had been kept under control. There was no evidence of severe difficulties in the external position, especially compared with the critical imbalances suffered lately by most other non-oil developing countries. The Indian Government had followed conservative policies on external borrowing, most loans having been contracted on concessional terms. The debt service ratio was still moderate, in spite of the low value of exports in relation to GDP. India's international reserves were also comfortable in terms of import requirements.

It was important to stress the increased resilience required by the Indian economy, particularly by the agricultural sector, whose sensitivity to rainfall seemed to have been dramatically reduced, Mr. Jensen observed. Appropriate financial policies had been pursued, and an increasing flow of savings had been attracted by the financial system, including funds from nonresidents. Both gross domestic investment and savings had been sustained at high levels, but without being fully reflected in the rate of growth of output. As noted by others, some bottlenecks had affected India's economic performance adversely, specifically resulting from some questionable decisions on resource allocation, as reflected in the low capacity utilization of industry. Nevertheless, the new strategies aimed at improving competitiveness and efficiency that had been announced by the authorities were welcome. The recent statement by the Prime Minister showed a strong commitment to strengthening those policies; Mr. Sengupta's comments in that respect were also reassuring.

The medium-term projections in the staff report usefully reinforced the need for further improvement in international competitiveness and export performance if India wanted its economy to continue to grow without excessively increasing its debt service burden, Mr. Jensen concluded. With respect to India's balance of payments viability in the medium term, it would be interesting to know which industries had the actual or potential capacity to increase the volume of exports, especially as policies aimed at specific sectors of the economy were currently of great interest in India. It would also be interesting to know what effect, if any, the close geographical location of Southeast Asian exporters of manufactures was likely to have on developments in India's external sector.

Mr. Arias considered that India had turned in an impressive performance and had bright prospects for both the immediate future and the medium term. The staff's policy advice was good in substance. He himself would place the greatest emphasis on the need to expand exports and efficient import substitution, along with the growth of agricultural output. Those were indeed the objectives of the authorities, and there were fortunately no economic emergencies to distract them from their medium-term task. It was obvious that India's success depended, as Mr. Sengupta had stated, on the continued availability of adequate concessional finance. India not only needed but deserved that financial assistance.

Mr. Obame said that his chair was in broad agreement with the staff appraisal. Like others, he encouraged the authorities to consolidate the results already attained. While he recognized that India had made commendable progress in many respects, further improvement was needed in some areas. He joined others in stressing the importance of promoting export competitiveness, efficiency, and modernization throughout industry, and of placing more emphasis on agricultural output. He welcomed the commitment of the Indian authorities to introduce structural reforms throughout the economy. He supported the proposed decision.

The Executive Directors agreed to resume the discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/26 (2/20/85) and EBM/85/27 (2/22/85).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/23, Supplement 2 (2/20/85), EBAP/85/42 (2/19/85), and EBAP/85/44 (2/20/85) is approved.

APPROVED: November 21, 1985

LEO VAN HOUTVEN
Secretary