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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/28

3:00 p.m., February 22, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	N. Toé, Temporary
	D. C. Templeman, Temporary
J. de Groote	
	G. E. L. Nguyen, Temporary
	N. Haque, Temporary
H. Fujino	
	B. Goos
J. E. Ismael	
R. K. Joyce	G. D. Hodgson, Temporary
	H. A. Arias, Temporary
H. Lundstrom	
E. I. M. Mtei	A. Abdallah
	B. Jensen
	E. M. Ainley, Temporary
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; P. R. Narvekar, Deputy 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; A. B. Petersen. Legal Department: S. A. Silard. 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, H.-S. Lee, A. Vasudevan. Assistants to Executive Directors: J. Bulloch, J. J. Dreizzen, G. Ercel, V. Govindarajan, Z. b. Ismail, H. Kobayashi, R. Msadek, Shao Z., A. H. van Ee.

1. INDIA - 1985 ARTICLE IV CONSULTATION

The Executive Directors resumed from the previous meeting their consideration of the staff report for the 1985 Article IV consultation with India (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 considered that the authorities' greatest achievement had been in the agricultural sector. Ten years previously, the question had been whether India would ever be able to feed itself. The sustained growth in foodgrain output, while of course due to much longer-term factors than the extended arrangement with the Fund, was also associated with the recognition of the importance of adequate price incentives, which had been a central feature of policies supported by the arrangement. The extensive spread of irrigation had also been a factor, especially the major schemes rather than the less capital-intensive tube well developments or the greater application of fertilizers. The gains in productivity and the growth of income had been greatest in areas where resources had been most intensively applied to irrigation; nearly 80 percent of fertilizer use in India was associated with irrigated agriculture, mostly but not exclusively in those regions where wheat was intensively cultivated. The income distribution issues that arose from any particular agricultural development policy or strategy were beyond the competence of the Fund staff to discuss with the authorities, who were, however, sensitive to distributional issues and would no doubt have to address them in the context of their regional political policies.

Although the data were not fully adequate, Table 19 in the report on recent economic developments pointed to some improvement in the trend of capacity utilization in Indian industry from 1980/81, a year in which the extended arrangement had been negotiated, to 1983/84, the last year for which complete data were available, the staff representative continued. Even partial data for 1983/84 and 1984/85 indicated small further gains in capacity utilization for an important group of industries. Of course, those had been two consecutive years of fairly strong recovery in domestic activity from the drought-depressed conditions of 1982/83. In those circumstances, some further improvement in capacity utilization might have been expected. The fundamental question, which could not be answered because of the imperfections in the data base, was whether the gains were transient or the result of underlying economic processes.

The unregulated or underground economy was obviously a dynamic factor underlying the economic development taking place in India, the staff representative commented. Various estimates had been made of the size of the underground economy, some of which indicated that it might be equal to half of the measured official economy. The staff was not in a position to endorse or refute any such estimates, although it did feel a measure of concern about the fact that the underground economy was thriving on the evasion of, or accommodation to, regulations. The Indian authorities themselves were concerned about the situation, which went beyond purely economic considerations. The extent to which transactions in the underground economy could be brought into the net of the tax system was also a matter for conjecture. Much would depend on the authorities' success in restructuring the regulatory environment in which the business sector operated. The complexity of the tax system offered considerable scope for simplification, which in turn could lead to more willing compliance with or effective enforcement of the tax laws. The experience of other developing countries suggested that such goals were not out of reach, provided that the process of liberalizing the laws and regulations giving rise in the first instance to the incentives for doing business in the underground economy was firmly carried out.

In common with a number of Executive Directors, the staff had been concerned about fiscal developments in 1984/85, the staff representative said, but had not had complete enough information at its disposal to undertake the necessary systematic review of revenue, expenditure, and the financing of the budget. Credit by the banking system to the Government was the only complete measure available, and recent reports indicated that bank credit to the Government had continued to rise strongly during October and November 1984. The timing of the consultation discussions could perhaps be reconsidered, as Mr. Wicks had suggested, in an attempt to obtain a more satisfactory understanding of fiscal developments, but, from the staff's point of view, to admit that a comprehensive review was not possible, halfway or three quarters of the way through a fiscal year, would not be a very satisfactory solution. The essential requirement for the proper formulation and conduct of fiscal policy was the provision of better and continuing information on budgetary developments. That point had been made to the Indian authorities during the consultation discussions.

With respect to specific items in the budget, expenditure on fertilizers might increase strongly, the staff representative explained, largely because the authorities were finding it difficult to reverse the increase in the subsidy following the drought. Subsequent to the drought, there had been a need to lower the price of fertilizer in order to reduce excessive domestic stocks and give a stimulus to agricultural recovery. In addition, since the middle of 1984, prices of imported urea had been rising sharply.

Any attempt to increase revenue by raising taxes, specifically excise taxes on the domestic sale of petroleum products, would have to take into account the complexity of the tax system, the staff representative commented. Above all, the taxes would have to be collectible and not lead to undue distortions of relative prices. In 1983, when the international price of crude oil had fallen, the authorities had not reduced petroleum prices but had in effect increased them in rupee terms. The maintenance of domestic prices had been a major factor underlying the rising surplus in the petroleum sector that, by means of a deposit mechanism, had contributed to budgetary financing.

More important than efforts to increase revenue, the staff representative considered, was the paramount need to ensure the efficient use of resources in the public sector so that the aggregate contribution of the public enterprises--of the Central Government and of the state governments--was commensurate with the increasing flow of resources to the public sector.

The ability to control monetary expansion in 1984/85 resulting from the financing of budgetary operations was the most immediate concern with respect to monetary policy, the staff representative remarked. The available data indicated an acceleration in the rate of monetary expansion into the beginning of 1985, accompanied so far by a moderation of the rate of inflation rather than by an increase in prices. The leads and lags, and the causal links between monetary expansion on the one hand, and the adequacy of the domestic supply of goods and of wholesale prices on the other hand, called for further analysis.

As to the balance of payments outlook and strategy, the staff representative noted, one of the reasons why the staff considered that a much stronger export performance was desirable was its expectation that the strong support provided by remittances during the past three or four years was unlikely to continue in the future. Remittances had been more buoyant than had been expected when the program under the extended arrangement had been conceived, and the Indian authorities hoped that the present level would be sustained, in SDR terms, and thus increase in rupee terms. The staff was more inclined to believe that developments in West Asia and in other oil-exporting countries with close ties to India were not likely to prove sufficiently favorable to sustain a high level of remittances.

A second reason for seeking a better export performance was that the impressive degree of import substitution in the petroleum sector during the first half of the 1980s might not continue in the second half of the decade, in the absence of further major oil discoveries, the staff representative said. Some scope remained for import substitution through the domestic use of natural gas as a feedstock in urea manufacture. However, there were important prospective competing claims on gas resources; in recent months, the Indian authorities had agreed to accord some priority to the use of gas as a fuel in electric power generation. Thermal plants fired with natural gas could be put in operation with greater speed than could coal-fired plants. Furthermore, India seemed to be developing large reserves of gas, which, if not used in power generation, might have to remain unused--perhaps in great part--during the second half of the 1980s.

Export growth was also necessary, the staff representative believed, if India were to sustain the servicing of the higher debts that appeared inevitable. Nonetheless, the authorities had often said to the staff that India could not be expected to divert unduly its policy efforts and resources to the export sector, which, as had been mentioned frequently during the discussion, accounted for such a small share of economic activity. It was not that the authorities did not recognize the importance of export growth; rather, they recognized the difficulty of taking the specific measures for attaining a major breakthrough in export performance. The impact of the necessary measures on employment and income distribution was very real. For many policymakers, there were thus limits to what was attainable in terms of a major shift toward export promotion, even though some among them might recognize the need for moving in that direction.

The staff had not intended to suggest that a more active exchange rate policy would, by itself, be sufficient to achieve a more export-oriented strategy, the staff representative observed. The fundamental change would have to come through the more efficient use of resources and a domestic economy that was more competitive, both among local units of production and with those in the rest of the world. There was a broad consensus among the Indian authorities on the need for concurrent action to liberalize the industrial licensing regime and the import licensing system, and to tackle some of the key bottlenecks in infrastructure, such as those in steel, electric power, coal, and transportation. In an institutional environment in which controls--exchange, import, and administrative controls--remained the principal instrument of external adjustment, the current exchange rate might be appropriate; in moving toward an environment in which resources would be used more efficiently in the domestic economy, other policy instruments--demand management and the exchange rate--would have to come to the fore. Thus, the staff argued that more active use of exchange rate policy was necessary to put India on a path of external adjustment associated with a strong export performance in accordance with, say, Scenario A.

On the broader issues, the authorities' policy on prices and on diminishing administrative controls had been a fundamental part of the structural adjustment that had been central to the program under the extended arrangement, the staff representative remarked. The extensive adjustments in public sector and administered prices in the period preceding the presentation of the extended arrangement to the Executive Board had had important allocative effects, as well as effects on the mobilization of resources. It would be well to view that phase of price adjustment as an integral aspect of the policy stance supported under the extended arrangement and that had continued since. A good example of the shift toward solving problems through the price mechanism rather than through administrative controls was to be found in the description on pages 17-18 of the report on recent economic developments of the way in which the authorities had freed cement prices, thereby essentially eliminating shortages of cement. Similarly, a decision to bring new technology into the automobile industry and to increase investment significantly had led to a rapid expansion in capacity. A further move toward deregulation had been taking place in that industry during recent weeks, with the effective removal of the requirement that various types of vehicles be manufactured by different producers, the objective being to make more efficient use of resources in the industry.

The financial resources made available under the extended arrangement, during a period of great external pressure on the balance of payments and when much of the rest of the world had been undergoing severe and prolonged recession, had provided a cushion enabling India to pursue a policy stance that differed from the one taken after the 1973/74 oil price increase, the staff representative continued. Formerly, India had followed its traditional policy of reducing imports in order to retain its financial integrity. Toward the end of the 1970s, India had already begun to experiment with a different approach that had found an important measure of support under the extended arrangement, thereby enabling India to avoid the worst of the disruptions associated with much higher oil import prices and, subsequently, the impact of the weakness in its export markets. The legitimate debate between the Indian authorities and the staff at the time over the pace of liberalization of industrial policy and the role that import liberalization could play in the process had been intensified and extended, under the democratic system of government, into the community as a whole. The shift from administrative regulation of the economy to less direct control through policy design was continuing, as was evident from the comprehensive reports of the various committees to which Mr. Sengupta had referred in his statement. It remained to be seen whether there would be any significant lag in following up those reports, with the formulation of policy and the adoption of political decisions, which would then of course have to be carried out at all levels of the administration. Ultimately, much of the resistance to the liberalization of the economy might come from the business community, which had grown accustomed to the regulatory environment and, in doing so, had caused the black economy to grow and to thrive. The results of the reform process would not necessarily be quick or easy.

To take a more forward look, the magnitude of the adjustment to be undertaken, and the shorter time left for accomplishing it, owing to the appreciable increase in the debt service burden, posed a formidable challenge, the staff representative form the Asian Department noted. It had become evident during the consultation discussions that growth in export volume of 7 percent over the five years ahead was unrealistic, especially when account was taken of the share of primary commodities in total exports. Light engineering products and many consumer goods, which at present accounted for only about half of the total value of exports, would have to be looked to as the source of growth in exports. Certainly, the process of policy change and structural reform would have to be greatly accelerated if the economy were to move along the path of Scenario A; otherwise, a blend between Scenarios B and C would be the most likely outcome. Finally, the Indian authorities had made it abundantly clear that undue external indebtedness would be avoided.

Mr. Zhang reiterated his questions relating to exchange rate policy. Since there was apparently a disagreement between the staff and the Indian authorities on exchange rate policy, would a compromise have to be reached? Why was it necessary to use exchange rate policy to stimulate exports when so few commodities in India were produced for export? Was it necessary to change India's terms of trade, especially as a devaluation would be bound to raise domestic prices because it might not be possible to reduce the volume of essential imports?

The staff representative from the Asian Department responded that the Indian authorities and the staff would continue to hold discussions on exchange rate policy. Any differences of view were not fundamental, and the issue of a compromise did not arise. The staff was making the point that liberalization of the regulatory environment seemed an essential part of improving competitiveness and efficiency in the economy. Undoubtedly, the process of liberalization would call for imports of consumer goods, partly to achieve head-on competition in order to improve the quality of domestic consumer goods and partly to create incentives for increasing agricultural output. Experience in almost all countries that moved away from import controls showed that alternate mechanisms had to be found to regulate pressures on the balance of payments. It was important to note that, according to studies by the Industrial Development Bank of India, cost and price relationships continued to move in favor of incentives to produce for the domestic market. That pattern of incentives had to be shifted more in favor of output for export, largely by influencing the decisions of entrepreneurs, *based on the opportunities for greater profitability.*

Mr. Sengupta remarked that the underground economy was basically a reflection of shortages, and not only of administrative regulations. Shortages led to rationing of goods, for distributive reasons, thereby enabling a black or underground economy to emerge. Many different estimates had been made of the size of that economy in India, ranging from 8 percent to about 48 percent. The latter figure had been mentioned in an article by an Indian national, who had also cited figures of about 22 percent for the size of the black economy for the United States, 20 percent for Canada, and a much larger proportion for Italy; the author had also estimated the size of the underground economy in the United Kingdom at 34 percent. For India, the main issue was of course that the existence of the underground economy had an effect on the total availability of resources to the public exchequer. The Indian authorities were conscious of the problem, which they were trying to deal with through a number of measures, so far without a great deal of success.

In scheduling the Article IV consultations, Mr. Sengupta commented, it was of course necessary to bear in mind that the weather in India in April and May might be excessively hot.

Under the extended arrangement, in addition to fulfilling the performance criteria, various specific targets had been met or exceeded, including infrastructural targets relating to coal output, electric power, nitrogen fertilizers, rail traffic, steel, cement, and foodgrain output, Mr. Sengupta remarked. As noted in Table 1 of SM/85/27, real GDP growth had been targeted at 4.8 percent for 1981/82, with the actual result well above 5 percent.

The use of fertilizers and irrigation had increased substantially, Mr. Sengupta noted. Until very recently, most of the increase in productivity in the agricultural sector had been limited to areas growing wheat and to part of the rice-growing area. Yet from a distributional point of view, those were the areas where farmers were relatively rich and were moreover producing surpluses for sale. The Government had nevertheless followed a procurement price policy for foodgrains under which producer prices had remained remunerative, despite the increase in productivity, thereby countering the normal market response of commodity markets. The realization that the "green revolution" must be spread to all the nonwheat-growing areas, or the eastern belt, which was dominated by small farmers producing rice and by dry land farming, had led to significant expenditures in those areas, both in terms of research and in terms of actual programs. Under the Seventh Plan, emphasis would be given to building on the successes recorded so far under the agricultural growth program, to encompass in the forthcoming five-year plan those other areas in the eastern belt.

Capacity utilization was often a function of demand that increased as GNP increased, Mr. Sengupta observed. At the same time, certain physical bottlenecks also developed that had to be taken into account in setting policies. In fact, the liberalization of imports had been directed specifically at inputs required for the utilization of capacity.

Another policy aspect of the original program under the extended arrangement was promoting efficient import substitution, Mr. Sengupta added. As indicated in Table 49 of SM/85/41, total oil imports had fallen in value from SDR 5.19 billion in 1980/81 to SDR 3.3 billion in 1983/84. Similarly, fertilizer imports had fallen from SDR 721 million in 1980/81 to SDR 171 million in 1983/84. At the same time, many imports, including machinery and transport equipment, had increased in value from SDR 1.79 billion in 1980/81 to SDR 2.54 billion in 1983/84; chemical imports had increased from SDR 353 million to SDR 524 million; total non-oil imports had increased from SDR 7.18 billion in 1980/81 to SDR 9.9 billion in 1983/84.

India's export performance, in volume terms, had not been impressive, Mr. Sengupta remarked. Nevertheless, as he had noted in his opening statement, exports had increased in value terms by about 10 percent in a period during which world trade in value terms had been practically stagnant. In the short term, the value of exports was more important from the balance of payments point of view. For instance, exports could be diverted to markets where the value for the same volume was greater. Nevertheless, over time, the appropriate measure was the volume index, which had not moved in the proper direction. The authorities had taken a variety of approaches to the problem. As the Executive Board well knew, the exchange rate for the rupee was being adjusted regularly with respect to the basket, and the authorities had no intention of allowing the exchange rate to move out of step. It should be noted, however, that recent studies by the Reserve Bank of India showed that the effective exchange rate of the rupee had depreciated by 11.5 percent between 1971 and 1975, and by another 17 percent between 1975 and 1979. From 1981 until 1983, the rupee had appreciated with respect to the pound sterling and the deutsche mark, and depreciated with respect to the yen and the dollar, but since 1984, the real effective exchange rate had again been depreciating quite sharply. If India were to increase its exports of nontraditional items, where supply bottlenecks--and thus the need for imports--had become crucially important, it would have to do so in Europe, Japan, and the United States. Traditional exports and exports of primary commodities were not necessarily affected greatly by exchange rate developments; much depended upon the elasticities and the terms of trade effects. Little relationship had been discerned between the depreciation of the exchange rate from 1971 to 1979 and the growth of exports.

The role of the exchange rate was not being ruled out, Mr. Sengupta added. It was simply that the exchange rate was but one variable in the whole system, and the authorities were examining the functioning of the system in its entirety. Even if exports did account for only a small share of economic activities in India, the Government would not denigrate the importance of the export sector. Indeed, policymakers in India spent a great deal of time exploring the different ways of promoting exports. In doing so, the problem encountered was how to segregate the export market from the domestic market: the large domestic market immediately absorbed any increase in the supply capacity of an export industry. His authorities therefore considered it important to look at the supply curve of a particular industry in its entirety, identifying the industries with a major export potential but not overlooking the domestic market, and attempting to increase productivity through modernization across the industrial spectrum. In sum, the Indian Government took the relatively small share of export activities in total economic activities as implying the need to develop an overall industrial development strategy rather than one aimed at developing a capacity to export to a few markets abroad. It was not, as was said in India, a question of export-led growth, but a question of growth-led exports. As capacity increased in certain sectors, exports from them would increase as well.

The Indian Government was conscious of the domestic resource cost of production and wished to root out any inefficiencies, Mr. Sengupta observed. However, it should be noted that even the private business community regarded public enterprises not as competitors, but as providers of complementary inputs, markets, and even financial services. Public financial institutions that provided money to the private sector accounted for a substantial share of the budget. Many private firms, even large ones, were able to raise money in the market only after receiving 50 percent or 60 percent of their financing requirement from those public financial institutions, which therefore acted as catalysts in the provision of financing instead of taking funds away from the private sector. The fact that there had been very little of a crowding-out effect could be seen from the impressive growth in the funds raised by nongovernment companies in the capital market: an increase of Rs 893 crores in 1982/83, of Rs 1,023 crores in 1983/84, and, in the first eight months of 1984/85, of Rs 1,300 crores, a figure that would reach more than Rs 2,000 crores for the year as a whole.

Mr. de Groote remarked that it would still be interesting to have a study of the role of the exchange rate policy in India on the occasion of a future Article IV consultation. Mr. Sengupta had mentioned supply bottlenecks for sectors with the potential for economic expansion in response to oil demand. Exchange rate adjustments were meant precisely to elicit a response, based not only on the elasticity in external demand, but also in external supply, thereby restoring profit margins in domestic enterprises.

Mr. Sengupta responded that he had not intended to give the impression that the exchange rate was unimportant. Rather, his point had been that the exchange rate was one of many variables determining the level of exports. The other factors, which might sometimes be more important, were those affecting the shape of the supply curve.

Mr. Fujino commented that although he recognized that the reduction of the budget deficit was a policy priority, he would nevertheless be interested in learning what provisions there were for controlling expenditures, for instance, by way of systematic reviews.

Mr. Sengupta replied that certain new measures had recently been adopted. First, the administered price of steel had increased within the past few days. Second, certain monitoring restrictions had been placed on overdraft expenditures by the states. Finally, the Government was doing its best to curtail nonplanned expenditures, although it was preoccupied more fundamentally by finding other ways to control inflation than by curtailing expenditure.

The Chairman remarked that he had been rather surprised to learn that some Directors considered that there had been structural and financial slippages under the extended arrangement. He would not wish the discussion to leave the impression that the program had been successful only as an exercise in macroeconomic containment and that it had been oblivious to structural adjustment. Although many structural improvements still had to be made, there had been enormous progress, including significant adjustments in pricing policies that had transformed the foundations of the economic system in India. Although many might have wished for more by way of import liberalization, the major measures undertaken in that area in the period preceding the extended arrangement should not be overlooked; the further measures of liberalization adopted in the early 1980s, although moderate, had been quite an accomplishment, introduced as they had been in the midst of a recession and in the face of protectionist pressures. The extended arrangement had helped the authorities to resist pressures that might have led them to retreat toward protectionism.

If there was any cause for disappointment, the Chairman observed, it was with the performance of exports. Structural problems relating to incentives, alleviation of the regulatory burden, modernization, and enhanced productivity would be at the heart of any attempt to deal with the fundamental and complex economic problems that India would have to resolve to achieve adequate export growth in the years ahead. The question was whether the monitoring procedures under extended arrangements were efficient enough to identify lagging performance and thus enable additional corrective measures to be adopted. As far as India was concerned, the relevant data on exports had been subject to frequent revision and had become available to the staff only after undue delay; a more timely indication of developments might have made it possible for the staff to offer better advice on how to improve export performance. As had been noted during the discussion, for an extended arrangement to be successful, a comprehensive and timely statistical base was essential.

Mr. Templeman commented that his authorities had great admiration for the long-standing prudence and caution of India's macroeconomic policy and recognized the progress that had been made. Nevertheless, statements during the discussion and references in the staff report, inter alia, to the neutrality of exchange rate policy, the lack of competition between the public and private enterprises--each having an assigned role in the economy--and export growth in volume terms of less than 1 percent, led him to wonder whether the opportunities for introducing dynamism into the economy and for taking the necessary risks to achieve India's general economic and development objectives were not being lost. He had been encouraged by Mr. Sengupta's statement, and by the recognition of that fundamental problem by the Indian Government and its determination to take action. The role of the Fund in such circumstances was a broad issue, for discussion elsewhere, although India's experience under a major program, supported by an extended arrangement, could make a contribution to the Fund's knowledge in that field.

The Chairman made the following summing up:

Directors expressed general agreement with the thrust of the staff appraisal and commended the Indian authorities on the success of their economic policies. With regard to the performance of the Indian economy during the period of the extended arrangement, Directors noted that the important objectives relating to higher economic growth, reduced inflation, and the avoidance of a deterioration in the current account balance had been largely achieved. Steps toward industrial deregulation and import liberalization and measures to strengthen public sector savings were also likely to enhance economic efficiency once those structural measures had their full effect. India's decision to terminate the extended arrangement on May 1, 1984, thereby releasing committed resources of SDR 1.1 billion, was again welcomed by several Directors.

Directors noted that the resurgence of growth in 1983/84, stemming largely from the increase in foodgrain production, was becoming more broad based in 1984/85, and that industrial growth was expected to accelerate to 8 percent. The easing of supply bottlenecks in key sectors such as power, transportation, and coal had also made an important contribution to the growth of the industrial sector. With a second good year of agricultural production, real GDP growth was expected to exceed 4 percent, following a rise of 8 percent in 1983/84. Inflationary pressures, which had been contained in early 1984/85, had shown a tendency to re-emerge in later months, but timely measures had been taken by the authorities, and the rate of inflation at end-December had been reduced to less than 6 percent. Nonetheless, several Directors urged the authorities to monitor price developments carefully so that timely action could again be taken to prevent the resurgence of inflationary pressures should that prove necessary.

Directors noted that public expenditures had been rising at a faster pace than budgeted for 1984/85 and expressed concern that the fiscal deficit of the Central Government might again exceed the budgeted level. While recognizing that the public sector had a special role to play in the Indian setting, a number of Directors stressed the importance of containing expenditure growth, and thought that a reduction of the deficit--and even perhaps of the size of the public sector--would be conducive to greater efficiency in resource allocation over the medium term. More immediately, with the limited scope for expanding borrowing from the nonbank public, the financing needs of the Government were adding to the difficulty of reducing the rate of credit and monetary expansion. The problem was exacerbated by an apparent deterioration in the financial position of the states. In that respect, Directors noted that the financial performance of public enterprises, except in the petroleum sector, continued to be disappointing, as was particularly apparent in operations of the state electricity boards. Although the causes might be diverse, Directors stressed that the weak financial performance reflected underlying inefficiencies which should be rectified. In that regard, Directors generally endorsed the efforts of the authorities to increase the financial responsibility of public sector corporations as one way to improve the efficiency of their operations.

Measures taken during 1984/85 to slow the rate of monetary expansion were generally welcomed, and it was felt that a deceleration of monetary growth was needed if the success in controlling inflation were not to be jeopardized. Several Directors stressed the danger of fully accommodating the additional credit needs of government. Improved monitoring of current budgetary developments were seen as essential for achieving the required flexibility and most effective stance of credit and monetary policies.

A number of Directors noted that, despite the high rates of domestic growth in 1983/84 and 1984/85, the current account deficit had remained stable in relation to GDP. The accelerated development of India's oil resources, and the associated drop in oil imports, had made room for the larger flow of imports resulting from liberalization measures and the rise in economic activity. Some Directors, however, expressed disappointment that the process of import liberalization had not been further advanced in the import policy for 1984/85. It was also stressed that export performance had been disappointing from both a shorter-term and a longer-term perspective and that that development could be attributed only in part to the weakness in overseas demand. The diminution of India's export market shares in recent years was seen by Directors as indicating a need for a reappraisal of policies, and more especially for placing greater emphasis on increasing the competitiveness of Indian goods and enhancing financial incentives for exports. A number of Directors indicated that more active use of exchange rate policy would be appropriate in conjunction with other measures, including in particular liberalization of industrial and import policies, in order to achieve the needed strengthening of the performance of the Indian economy, including exports.

Some Directors noted that the capital account had been substantially stronger than expected in recent years but cautioned against undue reliance on inflows of nonresident deposits because of the high cost to the economy. The cautious attitude of the authorities toward commercial borrowing was welcomed. Directors noted that India's debt service ratio had risen more rapidly than foreseen, albeit from a low base. However, the prospective hardening of the average terms on which India had been able to attract foreign savings and the weaker than expected export performance had contributed to the rising trend of the debt service ratio. Several Directors noted the importance of foreign direct investment in the financing of investment needs in the future.

Commenting on the medium-term outlook, Directors noted that the strength of economic growth, the viability of the balance of payments, and the growth of foreign debt and debt servicing would be determined in large part by the success of policies to strengthen India's export performance; accelerated development of India's energy resources could also play a major role. Significant changes would be needed to improve export performance, and more generally the efficiency of resource use in the domestic economy. In this respect, Directors stressed the importance of moving to a more liberal regulatory environment, in both industrial licensing and import control, allowing industry greater access to modern technology and establishing conditions that afforded adequate incentives to improve industrial efficiency. Improved access to imported inputs and recent initiatives in industrial policy were welcomed.

Directors noted the staff's comments on difficulties arising from the availability of economic and financial statistics and urged the authorities to seek to improve the data base for purposes of monitoring fiscal, monetary, and external developments in a comprehensive and timely manner.

Directors agreed that the next Article IV consultation with India should be held on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to India's exchange measures subject to Article VIII, Section 2, and in concluding the 1985 Article XIV consultation with India, in the light of the 1985 Article IV consultation with India conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions described in SM/85/41 are maintained by India in accordance with Article XIV, except that the restriction arising under the remaining bilateral payments agreement with a Fund member is subject to approval under Article VIII, Section 2. The Fund encourages the authorities to terminate the bilateral payments agreement with a Fund member as soon as possible and to further simplify the exchange system.

Decision No. 7911-(85/28), adopted
February 22, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/27 (2/22/85) and EBM/85/28 (2/22/85).

2. LEBANON - TECHNICAL ASSISTANCE

In response to a request from the Lebanese authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/85/50 (2/19/85).

Adopted February 22, 1985

APPROVED: November 26, 1985

LEO VAN HOUTVEN
Secretary