THE ECONOMIC HISTORY OF INDIA

INDIA AND THE INTERNATIONAL MONETARY FUND 1944-2017

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I am delighted to be at the National Archives of India today, to address the distinguished scholars and officials on The Economic History of India – India and the International Monetary Fund 1944-2017. I wish to thank the Director General, Deputy Director Archives and the School of Archival Studies for organizing this special lecture. India's economic history has been marked by several critical milestones amongst which are the crisis years of 1966, 1981 and 1991 and India's emergence from the economic crisis as the fastest growing major economy of the world. This paper focuses on India's relations with the International Monetary Fund and the economic reforms adopted by the Nation over the past 25 years.

INTRODUCTION

India is an original member of the IMF. Its bustling democracy and reform-oriented leadership always received support from the Fund management. As a member of the G 20 and G 24 member countries, with a chair at the IMF since 1944, India's contribution to the IMF has been phenomenal. India lends a powerful voice of support for African member countries on PRGF programs in the IMF Board. It acts as a bridge between the G 7 member countries and Emerging Market economies, a supporter for reforms in the CIS member States and above all a voice for economic progress and development in all of South Asia.

India's quota was the fifth largest in 1945. There were serious concerns in Parliament over the utility of membership of the IMF especially when the whole system of quotas worked as to give predominance to the United States of America while undermining the economic significance of India. That said, it was felt that India should lend its support to an Institution which was intended to put an end to the disastrous practices of competitive depreciation of currencies by establishing exchange rates. India's membership to the Fund was duly ratified by the Legislative Assembly on 29th October 1947. Following the 7th Quota review India lost its nominated seat on the IMF and had to settle for an elected seat. India's position on the elected category was further eroded when the Government of the People's Republic of China sought to re-enter the Fund in April 1980. Today, China has the 3rd largest quota on the IMF and India has the 9th position.

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[2] The author is grateful to Shri Naveen Kumar Anandkar in the computer facility of Rajasthan Tax Board for helping with the powerpoint presentation on the research paper for the oration

IMF's Managing Directors in India

Christine Lagarde the Managing Director IMF was in New Delhi to address the students of Lady Shriram College on March 16, 2015 on the subject "Seizing India's Moment". This is what she said.

> "Here is your country. This is a special moment for India. Just as many countries around the world are grappling with low growth, India has been marching in the opposite direction. This year already, India's growth rate is expected to exceed that of China, and by 2030, it is will overtake China as the most populous country in the world. The conditions are ripe for India to reap the demographic dividend and become a key engine for global growth. It is on the verge of a new chapter, filled with immense promise..…. So we know India can run—judging by your cricket record! Can it fly? I believe it can. As India grows and takes its rightful place in the global economy, the focus should remain on sound policies and inclusive institutions….At the current juncture, the world needs a vibrant India and India needs the world! As one of the largest commodity importers in the world, an open and transparent multilateral system for trade and financial flows will be essential to support India's vibrant economy. With growing economic size and power come greater leadership expectations. We look forward to seeing India becoming even more active on the global stage—in fora such as the G-20 and the IMF. The IMF is a global multilateral institution where countries like India deserve a bigger say. We are working precisely on that—on implementing reforms that would lift India to the top 10 shareholders at the IMF…Today, the elements are all aligned to make India a global powerhouse. **This is India's moment. Seize it**. Chak De India!"

Dominique Strauss Kahn one of the most accomplished Managing Directors of IMF echoed similar sentiments too. In a 2010 speech at the FICCI in New Delhi Strauss Khan said the following:

> "Since my last visit to India—about three years ago—the world has suffered the worst financial crisis since the 1930s. India has weathered the crisis remarkably well, thanks in large part to sound macroeconomic and financial policies. Now, India's growth is amongst the highest in the world—making it a driving force of the global recovery. India has traveled a remarkable distance over the last generation. Rapid growth has lifted hundreds of millions out of poverty. And innovation has put India in the vanguard of technologically advanced nations. India has truly become an economic superpower. The time has come for India—and Asia more generally—to play its rightful role in the global framework of economic governance."

The Managing Director of the International Monetary Fund (IMF), Mr. Dominique Strauss-Kahn, in 2009 made the following statement regarding India's commitment to invest up to the equivalent of US$10 billion in IMF notes.

> "I welcome the announcement by India of its intention to support the Fund's lending capacity through the purchase of up to US$10 billion worth of IMF notes. This investment will help

> underpin the international financial system by ensuring the Fund has adequate resources to meet the financing needs of its membership, demonstrating the commitment of the Indian authorities to multilateral cooperation."

The Role of the International Monetary Fund

The International Monetary Fund (IMF), in its lending practices "seeks to help member countries to attain over the medium term a viable balance of payments position in the context of reasonable price and exchange rate stability, a sustainable level and growth rate of economic activity and a liberal system of multilateral payments." (Guitian, 1981 p 3). The Executive Board of the IMF of which India is an Original member, has developed broad policies for Fund lending. The IMF staff has developed the theoretical and empirical underpinning for Fund conditionality. The Fund's approach in program countries is aimed at reducing domestic expenditure to a level commensurate with national income. The Fund hypothesis is excess domestic spending directly by Government or indirectly by monetary expansion would worsen the current account balance. In 1956, Jacques J. Polak Director Research IMF developed a dynamic general equilibrium model which is the foundation of all programming in the Fund.

A basic tenet of the Fund's approach to macroeconomic stabilization is that countries should maintain a competitive exchange rate. In all cases where the exchange rate is overvalued, it is reduced by depreciation. A great majority of the countries borrowing from the Fund, undertook to depreciate their exchange rates, before the beginning of a stand-by arrangement. At times, the initial gains from depreciation were frittered away through subsequent wage and price inflation. In many cases, the country authorities announced a large devaluation to restore international competitiveness after an extended period of erosion of competitiveness resulting from a combination of loose monetary and fiscal policies and an inflexibly managed exchange rate.

Adjustment of economic policies from unsustainable causes was always extremely difficult. In this regard, the Fund laid down structural conditionality covering macroeconomic variables and conditions necessary to implement the specific provisions of the articles of agreement. Further the Fund has also laid down standards for fiscal policy. The Fund pays a lot of attention to the quality of Government spending and revenue practices, without explicit conditionality. Reduction of inflation is critical to the success of an adjustment program and external viability cannot be ensured unless the overall budget deficit is reduced. In this regard, the Fund lays down external debt limits limiting the overall amount of external debt that a country could take while undertaking a Fund supported program. The Fund also insists on prior actions which are in the nature of corrective actions before drawing on Fund resources.

India's IMF Programs

Since 1944, India has availed 3 IMF programs:

(a) In the 4th Plan, India felt that there was need for external assistance for import liberalization. Discussions were held between Ashok Mehta Minister of Planning and Pierre-Paul Schweitzer Managing Director IMF on April 20, 1966 in Washington DC following which India had agreed on 36.5 percent rupee devaluation to bring domestic prices in line with external prices, to enhance competitiveness of exports to address the country's trade and balance of payments. Along with devaluation, several existing special export promotion schemes providing import entitlements against exports, and the scheme for tax credit certificates were abolished.

(b) In 1981, India entered into an arrangement with the IMF to borrow in SDR 5 billion over a 3-year period under the Extended Fund Facility Arrangement. The improvement in the balance of payments was faster than expected. This enabled the Government to terminate the IMF arrangement in May 1984 after drawing SDR 3.9 billion out of the SDR 5 billion originally envisaged.

(c) The balance of payments crisis of 1991 was one of the biggest challenges in India's economic history. The rupee was devalued in 2 stages on July 1 and July 3 1991 and the cumulative devaluation was about 18 percent against major currencies. Along with the exchange rate adjustment, significant structural reforms were introduced in India's trade policy. The third major reforms were the changes introduced into the framework of industrial licensing, role of public sector, MRTP Act and foreign direct investments and foreign technology agreements. These measures were accepted as part of the conditionalities accepted with the IMF loan in July 1991.

The 1966 Program

The 1966 IMF Annual Report[3] says the following:

> India's balance of payments position was under pressure throughout 1965, and the difficulties continued into 1966, necessitating a sizeable use of Fund resources despite severe tightening of restrictions. As the year 1965 opened, exchange reserves had already been reduced to a low level by increased payments for food inputs occasioned by the shortfall in domestic production and by delays in the repatriation of export proceeds. In March, a stand-by arrangement of US$ 200 million was approved by the Fund.

The Government took steps designed to slow down the monetary expansion, including raising the bank rate to 6 percent adopting a substantially less expansionary budget for the fiscal year beginning April 1, 1965 and imposing a 10 percent surcharge on all but the most essential

[3] IMF Annual Report 1966 pages 109-110

imports. In August a supplementary budget was adopted including additional domestic taxation and simplification and rationalization of import tariff, which also had the effect of increasing further the duties on most imports. However, the tempo of monetary expansion has in fact continued unabated, in part because of unexpected developments affecting the Union Government's budgetary position and deficits in State Government budgets.

Exports failed to increase in 1965. However, this was the result of a change, toward the end of 1965, in the system of recording exports, which has resulted in lower export figures for 1965 than would otherwise have appeared. On the other hand, debt service payments continued to increase. In the latter part of 1965, exchange reserves increased steadily because of the disappearance of earlier delays in repatriating export proceeds, some inflow of banking capital, and tight import restrictions – which however, soon began to affect domestic industrial production adversely. Moreover, by the end of the year, the basic payments position was seriously aggravated by a pause in the inflow of external assistance and by a domestic drought of unprecedented severity, which sharply increased requirements of imported food grains. In order to meet the balance of payments of the drought, a drawing of US $ 187.5 million was made from the Fund in March 1966. Reflecting this, and the Remittance Scheme, foreign exchange reserves increased substantially further in the five months of 1966. The Remittance Scheme which operated from November 1965 to May 1966 affected a more depreciated exchange rate to certain inward remittances by providing for the issuance of transferable certificates against which import licenses up to 60 percent of the value of remittances could be issued.

In a most far reaching policy change designed to effect a basic improvement in the balance of payments position, India devalued the rupee by 36.5 percent early in June 1966. Simultaneously, export promotion arrangements in the form of import entitlement schemes and tax credits were abolished. In order to avoid deterioration of export prices, export duties were imposed on a dozen commodities including tea and jute goods. Import duties which had been increased sharply in 1965, were reduced somewhat, but the net effect was to increase the landed cost of imports substantially. The authorities also expressed hope that with sufficient assistance forthcoming from friendly nations or institutions abroad, it would be possible to liberalize imports soon, so as to meet in a substantial measure, the needs of the economy for raw materials and spare parts.

Rupee was devalued by 36.5 percent to bring domestic prices in line with external prices, to enhance the competitiveness of exports and to address the country's trade and balance of payments problems on June 6, 1966. The US dollar which was equivalent to Rs. 4.75 now rose to Rs. 7.50 and the pound sterling from Rs. 13.33 to Rs. 21. Special export promotion schemes were abolished as part of trade reforms on the same day. The devaluation of the rupee was seen as India succumbing to western pressure. The Government declared a plan holiday. The fourth five-year plan was abandoned in favor of three annual plans in the wake of disruptions in the economy on account of two years of drought, two wars, and the devaluation of the rupee. The annual plans guided development with immediate focus on stimulating exports and searching for efficient uses of industrial assets.

The United States allocated 9 lac tonnes of grain under PL 480 to help India fight the famine in Bihar consequent on three years of drought. President Lyndon Johnson signed a Congressional resolution on April 20, 1966[4] and said that the Indian government would use the time gained by foreign assistance to mount a determined and effective drive to raise the country's agricultural output.

Prime Minister in her radio broadcast Person to Person[5] on April 24, 1966 said

> The fear that we have sold out under western pressure or that we are likely to be dominated by foreign capital is absurd. The commanding heights will always be with us. We seek more aid at this juncture in order to end aid. The government is fully committed to the objective of socialist and democratic society but it was not wedded to any dogma. Our socialism was one that was related to the country's needs and aspirations and the reality of the Indian situation.

The RBI history[6] says the following on the 1966 devaluation of rupee

> The meeting of the Union Cabinet to decide on the devaluation was convened on the morning of Sunday June 5, 1966 so that the decision could be conveyed to the IMF and its agreement obtained. The Cabinet approved the proposal but not without heated debate. Pierre-Paul Schweitzer of the World Bank convened an unscheduled meeting of the Board on the same morning and commended the Indian decision, concluding the hope that 'the momentous decision would pave the way for foreign aid necessary of trade liberalization.'
>
> Having secured the Fund's approval, Sachindra Chaudhri announced the devaluation in a special broadcast to the nation at 9 pm on Sunday. The new parity was to take effect from 2 am on Monday, June 6, 1966. As was standard practice in these matters, the Reserve Bank also issued a notification closing banks to the public for two days.
>
> The devaluation failed; it did not achieve its objectives. According to the Reserve Bank's explanation at the time, the "adjustment in relative prices, costs and pattern of investment" necessitated by the devaluation proved "even more difficult because of serious drought" which affected Indian economy for the second year in succession. The promised foreign aid did not materialize.

On June 6,1966 the Finance Minister[7] Sachindra Chaudhuri firmly rejected suggestions that the

[4] The Hindu dated April 21, 1966 page 1
[5] The Hindu dated April 25, 1966, page 1
[6] History of the Reserve Bank of India 1957-69

Government of India yielded to external pressure and agreed to devalue the rupee. The Finance Minister said that the Government spent long hours considering if there was any alternative to devaluing the rupee and ultimately it was decided that no measure would yield the remedy they sought. The Governor of the Reserve Bank of India, P.C.Bhattacharya said that devaluation was not a panacea for all evils but only a beginning to enable the country to promote further development, and all efforts would be made to contain inflationary pressures and promote internal discipline. The IMF said that it had concurred to the devaluation of the Indian rupee to a new par of 7.50 to the US dollar. The IMF hoped that devaluation of the rupee would bring about a substantial increase in Indian exports, which upto now had grown at a very small rate. Much would depend the IMF said, on foreign economic aid being mobilized for that purpose.

Newspapers[8] were quite supportive of the Government. The Hindu said that continued pressure on the balance of payments position has been aggravated by the aftermath of the Chinese and Pakistani aggression and the severe drought of the past year. With exports remaining sluggish and a slowing down of foreign aid, Indian industries dependent on imported raw materials or components were working well below their capacity. It is against this background that the devaluation decision must be viewed. It is just possible that it could have been avoided if the Aid India consortium had taken a more sympathetic and understanding view of the Indian situation – which had taken an extremely difficult turn as a result of the India-Pakistan conflict and suspension of foreign aid. Projects with high proportion of foreign exchange should be given a back seat for the present. The media also said that a modest Plan on the basis of available internal and external resources and keep in readiness a number of schemes which could be taken up when additional resources are available.

The RBI history notes that despite the package of policy measures announced in June 1966, aid commitments never approached the levels which the Indian government had earlier been given to understand it could expect from the World Bank and other members of the consortium. India and the World Bank were agreed on the need for non-project assistance of US $ 900 million annually for three years after the devaluation, in addition to project assistance of US $ 300 million and the latter committed itself to raising the amount. The first US $ 900 million was slow in coming, and was received November 1966. This was followed by protracted delays in the release of the committed funding for the second year resulting from delays in IDA replenishment. India received US $ 295 million in 1967-68 and US $ 642 million in 1968-69. With devaluation, there was a sharp price rise in 1966-67 and growth in industrial production dropped sharply. Devaluation was accompanied by import liberalization measures but imports failed to revive. The failure of the devaluation resulted in slowing down of reforms and moderation of growth targets.

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[7] The Hindu June 7, 1966 page 1

[8] The Hindu June 7 and June 8, 1977 page 6

Presenting the Union Budget 1971-72 (Interim) Finance Minister Y.B.Chavan[9] said that

> The honorable members would be happy to know that by the end of the current fiscal year, we would have repaid all outstanding drawings on the International Monetary Fund (IMF) that we had to make during the critical years of 1966 and 1967. In addition, we have fulfilled our obligations in relation to an increase in our International Monetary Fund quota from 750 million to 940 million dollars. We have also been an important beneficiary of the scheme for the creation of Special Drawing Rights.
>
> While the overall improvement in our foreign exchange position during the past two or three years has been unmistakable, I cannot help emphasizing that there is no room for complacency whatsoever in regard to our balance of payments. There has also been a substantial increase in import licenses issued for the maintenance of the economy, the full impact of which is yet to be felt. Much greater and continuing effort on a wide front would also be necessary if the target of a 7 percent per annum increase in export earnings set in the Fourth Plan is to be realized year on year. The outlook regarding net inflow of aid remains uncertain. This is particularly so, in respect of readily usable aid such as non-project assistance and refinancing of our heavy debt repayments.
>
> Against this background, it would be prudent on our part to seize every worthwhile opportunity for export promotion as well as import substitution and to exercise maximum restraint on the imports and consumption of less essential items. This underlines once more the need for keeping firm rein over costs and prices, and for the deployment of fiscal instruments to regulate consumption. The priorities in investment have to be guided by the exigencies of the balance of payments. Let us not forget that our objective is to combine growth not only with social justice but also self-reliance."

The 1981 Program

The Balance of Payments situation changed dramatically in 1979-80 as agricultural growth suffered and industrial bottlenecks emerged owing to shortages of power, coal, cement and a deterioration of labor relations, difficulties with ports and railway transportation. Infrastructure inadequacies bedevilled the economy and these were accentuated by a poor monsoon which affected hydel generation. Inflation soared from 3 percent in 1978-79 to 22 percent in 1979-80. The external terms of trade worsened significantly owing to higher prices for imported petroleum and fertilizers. Trade deficit zoomed. Government undertook deficit financing on an unprecedented scale with expansion of credit to trade, commerce and industry. Bank lending to both food and non-food sectors contributed to the rise in credit to the commercial sector.

To meet the short term cyclical imbalance, India drew SDR 266 million under the compensatory

[9] Speech of Shri Yeshwantrao Balwantrao Chavan Minister of Finance introducing the interim budget for the year 1971-72 dated 24.3.1971

financing facility (CFF) from the IMF, but even so, the country's international reserves slid down to 3 ½ months of imports.

The 1981-83 program was implemented at a time of Low or No conditionality period in the Fund when the Fund was eager to meet the financing request of non-oil producing member countries and conditionality was not as strong or effective as it later became.

Geoffrey Howe the UK Chancellor of Exchequer at the 1979 IMFC said that,

> "Now that the rules of conditionality have been liberalized, I hope that developing countries will find it acceptable to work closely with the Fund to help them overcome their problems."

Dr. M.Narasimham[10] served as Executive Director (India) IMF and was the architect of India's 1981 IMF program.

> "After the second round of oil price increase in 1979, the shape of India's balance of payments which had fared reasonably well between 1974 and 1978 had taken a turn for the worse and was a matter of concern. As Executive Director World Bank, I met a few friends from the IMF and asked them how the Fund would react if a country like India were to approach the Fund for a medium term facility to cushion the structural impact on balance of payments because of the oil price increase. Their response was positive and encouraging. On a subsequent visit to India, I tried to convince the Finance Minister R. Venkatraman about the need to approach the Fund under the extended fund facility for a medium term program. He was not enthusiastic. Subsequently, I met Prime Minister Indira Gandhi and said "Madam, we should get an IMF loan as the balance of payments outlook is not rosy due to the oil price increase." Subsequent to that discussion, Finance Minister R.Venkatraman, and Secretary Department of Economic Affairs R.N.Malhotra visited Washington DC. I was elected as India's Executive Director to the IMF during the Annual Meetings of 1980.
>
> At the Fund, Jacques de Larosiere was the Managing Director. I had known him when he was in the French Treasury as Finance Minister. De Larosiere had considerable empathy for India and for developing countries in general. I was very familiar with the Fund having worked as Division Chief in the Asian Department of IMF. I met every single Executive Director in the IMF to present India's case for a medium term loan under the Extended Fund Facility. The United States said, India can go to the markets instead of IMF. I told him that "we don't want to get into a debt trap." Ambassador K.R.Narayanan and I went to meet the US Treasury Secretary. The Treasury Secretary said the United States was opposed to the Indian program. They were not convinced about the balance of payments need and felt that the Find was getting into investment financing contrary to the principle that the Fund resources would have a revolving character. The Treasury Secretary told me that while they were not happy with the loan, they did not wish to oppose it if it came to the Board, the United States would abstain when it came to voting.

[10] Dr. M.Narasimham Interview dated June 19, 2017 at ASCI Hyderabad

> The November 1981, discussion on the Executive Board took place all day. Every single Executive Director spoke, all 20 of them. My reply took one hour, I responded to each one of them. I maintained that Government of India's policy on exchange rates would be guided by its balance of payments. I said that India is not walking into the Fund on a stretcher. We are walking into the Fund like walking into a clinic. I added that the IMF should not be regarded only as lender of last resort. It was cooperative and it was natural for countries to turn to the cooperative lending institution before seeking other sources of finance and I added that India has been a responsible member of the Fund and we would continue to be so. We wanted this more as a back-up to our reserves so that we could continue with our program of liberalization.
>
> I pointed out that the loan was also unique in that the loan was back-loaded, rather than front loaded which indicated it was not for crisis relief. I also added that if we did not use it we would be quite prepared to return it earlier than scheduled. This is precisely what happened. Three years later we surrendered part of the loan. At the end of the marathon meeting, the Board formally approved the Indian request, with the US abstaining. de Larosiere was was almost euphoric with the the way the discussion in the Board went and the approval of the loan and he often told me that he regarded the EFF loan as the highlight of his tenure in the Fund upto that point, as the loan and the manner it was handled by the Fund was evidence of the Fund's willingness to be flexible in its approach and no insist on its usual menu of conditionality, especially when countries acted, as he felt India did, in a responsible manner and showed earnestness in tackling their problems by imposing self-imposed conditionality on themselves.
>
> de Larosiere had an almost personal commitment to the loan and he took great pains to convince other directors, particularly the US about the need for their support for the loan. He felt that while the loan was important for India, it was no less important for the Fund as a visible demonstration of its willingness to assist a responsible country and be flexible about it. The second year program was approved without any hitch around the middle of 1982. Even the US which had abstained in the November 1981 meeting, decided to support the program.
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> The successful negotiation and the passage through the Board of the EFF loan and the second year program, were without doubt for me the high point of my years in Washington DC."

The Economic and Political Weekly[11] in November 1981 said that an interesting affirmation that is currently being made with great gusto by those who negotiated the IMF loan is that the terms and conditions laid down down by the IMF on the grant of the loan are after all no different from the strategy and thrust of India's own Sixth Five Year Plan. What indeed is required by the IMF is that the Plan itself should be implemented and necessary discipline observed by the Indian authorities. The IMF conditionalities should therefore not be regarded as an imposition. They represent a convergence of outcomes and interests between those controlling the IMF and clients in India.

[11] Economic and Political Weekly Vol XVI Nos 44, 45 & 46 Special Number November 1981 pp 1723 to 1726

On February 27, 1982 Finance Minister Pranab Mukherji[12] said the following in his Budget Speech for 1982-83:

> "I would now like to refer to the balance of payments situation. As the House is aware, there has been a substantial reduction in our balance of payments since 1979-80 primarily because of sharp increases in import prices, particularly of oil and oil products. Anticipating these developments, the Government made timely arrangements to negotiate a line of credit of SDR 5 billion from the International Monetary Fund under its Extended Fund Facility. This was necessary to avoid the disruption in our economy for want of essential imports and to gain time for readjustment to the new situation. The line of credit has been accepted in order to support an adjustment program drawn from our strategy of planned development. It will help us implement our policies which have been sanctioned and approved by our people and Parliament.
>
> The main elements of the Government's strategy for restoring the viability of our balance of payments in the coming years are first and foremost, an increase in the domestic production of petroleum and petroleum products, fertilizers, steel, edible oils and non-ferrous metals. These account for nearly 60 percent of total imports. The Government has taken necessary action to step up production and investment in these and other critical areas.
>
> Exports have increased by 15.4 percent in the during the first 8 months of the financial year, which is encouraging. However, in several areas, particularly in our traditional exports, such as textiles fabrics, jute and tea, we are facing unfavorable world market conditions. While sustaining exports of these and other traditional commodities much greater effort is now needed to expand these exports for which world markets are now growing. In recent years, our receipts from invisibles, particularly remittances by non-resident Indians have shown a healthy growth. This has been a stabilizing factor in our balance of payments, and we must continue to provide adequate facilities for growth of receipts from this source.
>
> The past two years have been years of crisis management and recovery. It is a measure of our success that the economy is now back on the rails. This provides us an opportunity to initiate further efforts for moving the economy forward and to achieve the medium term adjustment."

Rahul Khullar[13], IAS (1975) one of India's seminal civil servants who served as Private Secretary to Finance Minister (1991-94) says

> "It is quite surprising that India went through the 1981 IMF program without major reforms. Mr. Narasimham, the Executive Director IMF, who negotiated the IMF program, did not yield much

[12] Speech of Shri Pranab Mukherji Minister of Finance introducing the Budget for the year 1982-83 Lok Sabha debate 27.2.1982 para13 pp 3

[13] Khullar, Rahul, 2017 Interview with V.Srinivas, New Delhi dated May 20, 2017

> ground on the reform front. He assured the Prime Minister Mrs. Gandhi that he had succeeded in persuading the IMF to permit flexibility to develop a fully home-grown program. In the 1981-84 period, the Government did start changes e.g. Export Oriented Units and SEZs were established. But the pace of reforms was slow. Following the 1984 elections, the reforms continued. But there were no major overhauling reforms. Gradualism ruled."

Finance Minister Pranab Mukherji[14] introducing the 1984-85 budget said

> "Our strategy for bringing balance of payments under control after sharp deterioration that occurred in 1979-80, has paid rich dividends. In view of the improvement in our payments position, the Government has voluntarily decided not to avail of the balance of 1.1 billion SDR under the Extended Fund Facility of the IMF. While intervening in the debate on the IMF loan in this House in December 1981, the Prime Minister had this to say and I quote
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>> "It does not force us to borrow, nor shall we borrow unless it is in national interest. There is absolutely no question of our accepting any program which incompatible with our policy declared and accepted by Parliament. In is inconceivable that anybody should think that we should accept assistance from any external agency which dictates terms which are not in consonance with such policies."
>
> This was true then, and it is true now.
>
> Belying the prophesies of a self-styled Cassandra, the economy has emerged stronger as a result of the adjustment effort mounted by us. None of the dire consequences of that we were warned has occurred. We have not cut subsidies. We have not cut wages. We have not compromised on planning. We have not been trapped in a debt crisis. We have not faltered in our commitment to anti-poverty programs for the welfare of our people. We entered this loan arrangement with our eyes open. We came out with our heads held high.
>
> We hope that our decision to forgo the balance of the amount available to us under the IMF loan would be in a small way, help the IMF to provide greater assistance to other developing countries. I must also take this opportunity to express our appreciation for the goodwill and mutual understanding that has marked our relationship with the IMF during the entire EFF arrangement."

The RBI's history says that India's EFF experiment was a classic case of a country's readiness to accept self-imposed conditionality in adjusting its economy to a changed structural scenario and aimed at tackling the root cause of the problem. It could be claimed as a precursor for member country's ownership of conditionality and adjustment programs.

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[14] Speech of Shri Pranab Mukherji Minister of Finance Introducing the Budget for the Year 1984-85 Lok Sabha debate 29.2.1984

The IMF programs of 1966 and 1981 helped tide over periods of high inflation and difficult balance of payments position faced at that point of time. That said, they were modestly successful in bringing economic reforms to the Indian economy. In the 1979-81 period, the IMF itself was in a period of low conditionality for non-oil producing countries and did not press for major structural reforms or performance criteria. The discovery of oil reserves in Bombay High led to complacency of possible reduction in oil imports and improvements in the fiscal and balance of payments positions. Although there was no devaluation of the rupee after 1966, the exchange rate policy was aimed at gradual depreciation of the rupee to maintain price competitiveness of the exports sector. Expansionary fiscal policy continued in the 1980s, and the automatic monetization of budgetary deficits by issuing adhoc Treasury bills strained credit policy. India entered the 1990s with structural rigidities and imbalances in the economy, pronounced macroeconomic imbalances despite a significant growth rate of 5 percent. Several adverse domestic and external developments precipitated in the balance of payments (BOP) crisis in 1991. From this crisis, emerged a comprehensive reform agenda backed by an IMF program which was effectively implemented.

The 1980s

The 1985-86 Long Term Fiscal Policy(LTFP)[15] was formulated in pursuance of a commitment given by the Government as part of Union Budget 1985-86. The long term fiscal policy was to impart a definite direction and coherence to the annual budgets. Secondly it was envisaged to shift to rules based fiscal and financial policies and less reliance on discretionary case-by-case administration of physical controls. It also envisaged an effective coordination of of different dimensions of economic policy – fiscal policy, monetary policy, industrial policy and trade policy. The LTFP was to be an effective vehicle for strengthening operational linkages between the fiscal and financial objectives of the 7th Plan. The alleviation of poverty was the centrality of the Long Term Fiscal Policy. The Long Term Fiscal Policy envisaged that center's resources for 7th Plan period as 10.1 percent of GDP, of which 1.4 percent would be finance by net capital flow from abroad, 5.1 percent would be financed by domestic borrowings and 3.6 percent by public savings. The Budgetary deficit as a percentage of GDP was to decrease from 1.3 percent to 1.1 percent under the LTFP. In the face of persistent droughts and agrarian distress, the LTFP projections could not be sustained. The budgetary deficits for the 5 years were significantly off target, there was an expenditure boom and the tax collections were off targets. Although the Economic Surveys kept maintaining that the fiscal management in immediate future must aim at correcting these imbalances to step inflation, contain balance of payments pressures, the policy pronouncements did not translate into effective implementation.

The Economic Survey for the year 1988-89 said thus:

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[15] Long Term Fiscal Policy December 1985, Ministry of Finance (Department of Economic Affairs)

> "Though it has not been appreciated, it must be recognized that high levels of fiscal deficits tend to spill over and contribute to high current account deficits in the balance of payments. An improvement in the current account of the balance of payments requires a commensurate reduction in the overall savings –investment gap of the economy. In a situation such as ours where the recent widening of the savings-investments gap is largely attributable to deterioration in the budgetary performance will contribute substantially towards a sustained improvement in the balance of payments."

The Economic Survey[16] for the year 1989-90 said thus:

> "India's balance of payments situation has remained under considerable pressure during 1989-90 despite a buoyant trend in exports and a slow-down in the growth of imports. Deterioration in our balance of payments position during the 7th Plan period is due to several unfavorable factors such as deceleration in the growth of domestic oil production bunching of repayment obligations to the IMF and other sources, limited availability of concessional assistance and a rise in debt service payments on external debt. The continuing strain on our balance of payments is reflected in steep depletion of foreign exchange reserves which stood at Rs. 5531 crores at the end of January 1990."

Prof Madhu Dandavate introduced the Union Budget for the year 1990-91. (1) The scenario could not have been more grim. The Finance Minister presented to the Lok Sabha the ground realities of that period. The Central Government's budgetary deficit was Rs. 13,790 crores as on 1st December 1989, a level nearly double the deficit projected for the whole year in 1989-90 budget. Wholesale prices had risen by 6.6 percent since the beginning of the financial year. The balance of payment was under strain and foreign exchange reserves (excluding gold and SDRs) were down to around Rs. 5000 crores. Stocks of food grains had fallen to 11 million tons. The GDP growth was projected at 4-4.5 percent, industrial output growth projected at 6 percent and agricultural output growth projected at 1 percent. The price rise and pressure of inflation strained fiscal balance. Budget deficit was expected to be substantially higher than the projected Rs. 7337 crores and the growth rate of aggregate monetary resources was 16.5 percent in 1989-90.

Trade performance wasn't very encouraging either. Although exports grew by 38 percent and imports by 21 percent in rupee terms in the first nine months of 1990-91, the pressure on foreign exchange reserves continued and improvements in trade account were not sufficient to counter-balance the increase in debt-service obligations. Trade and current accounts deficits were financed through depletion of foreign exchange reserves and growing recourse to foreign borrowings. To combat the pressures on the balance of payments and to ensure a viable situation over the 8th Plan period, exports were accorded the highest priority. It was recognized that the alternative of higher foreign borrowing to finance essential import requirements runs the risk of

[16] Economic Survey 1989-90 pp 7-8

mortgaging India's hard won economic independence, which was unacceptable. The Finance Minister outlined fiscal measures for promotion of export production for earning high net foreign exchange.

The budget recognized that the import bill for bulk items was increasing rapidly. The oil consumption was rising at around 8 percent resulting in a huge outflow of foreign exchange on this account. India's foreign debt had doubled in the period 1985-90 adding to vulnerability. The Government exhorted people to make sacrifices to meet challenges in order to preserve India's economic independence and spirit of self-reliance. The Government prepared the Nation for a period of austerity and hardship in order to avoid excess foreign borrowings.

Fiscal imbalance was the root cause of the twin problems of inflation and difficult balance of payments position. Government said that the management of deficit required containment of expenditure growth. The restraint of expenditure required careful consideration of the areas of public spending involving explicit and implicit subsidies. On the revenue side, the major challenge was tax compliance. Tax evasion was rampant, generating black money with serious adverse effects on the economy fuelling inflation and conspicuous consumption. Black money was also generated by shortages, artificially pegged prices and detailed physical controls. The leakages from public expenditure programs also caused serious distortions in the economic and social structure of the society.

The Reserve Bank of India's history says that the monetization of fiscal deficit resulted in higher liquidity growth over and above the overhang of liquidity carried from earlier years and the consequent expansionary impact on money supply. To some extent, the Union Budget for 1989-90 sought to correct the growing imbalances between revenues and expenditures. However, the outcome turned out to be much worse because the imbalances did not stem from any let-up in government revenue mobilization but due to increases in the government expenditure which in turn was financed by larger borrowings and the budget deficit. The Centre's budget deficit in 1989-90 (according to Reserve Bank records) was much higher, by about 30 percent, than the budgeted amount. Likewise the Reserve Bank credit to Central Government was in 1989-90 more than twice the actual for 1988-89. The spill-over of fiscal deficit into current account deficit was visible. The aggregate absorption in the economy was in excess of domestically produced goods and services. The imbalances between aggregate demand and supply ultimately spilt over into the BOP and the gap had to be met by either running down the reserves or increasing debt. The fiscal deficit was nurtured by a large expansion in net Reserve Bank credit to Central Government against the issue of adhoc Treasury Bills, which was automatic monetization of deficit.

The Economic Survey[17] for the year 1991-92 said thus:

> "The first signs of the current payments crisis became evident in the second half of 1990-91 when the Gulf war led to a sharp increase in oil prices. Foreign exchange reserves began to decline from September 1990. They declined to a level of Rs. 5480 crores (US $ 3.11 billion) at the end of August 1990 to Rs. 1666 crores (US $ 896 million) on 16th January 1991. During the period the Government took recourse to the IMF by drawing Rs. 1177 crores (US $ 60 million) from the reserve tranche during July-September 1990. Again in January 1991, the Government made a drawing of Rs. 1884 crores (US $ 1.025 billion) under the compensatory and contingency financing facility (CCFF) and a drawing of Rs. 1450 crores (US $ 789 million) under a first credit tranche arrangement (FCT). The purchases from the International Monetary Fund in January 1991 amounted to Rs. 3334 crores (US $ 1.814 billion). Nevertheless the decline in reserves continued unabated."

On December 27, 1990 Finance Minister Yashwant Sinha made a statement in the Rajya Sabha on the Current Fiscal Situation on the strategic issues in the management of the Indian economy. (2) The scenario presented highlighted the persistence of large fiscal imbalances, serious balance of payments and considerable inflationary pressures on the price level. The Finance Minister said that the performance of the economy during the second half of the 1980s was impressive in terms of growth rates, but this was associated with the emergence of macro-economic imbalances. The widening gap between income and expenditure led to mounting budget deficit. The fiscal deficit fluctuated around 2 percent of GDP, the revenue deficit was more than 8 percent of GDP. The fiscal deficit burden was met through borrowings. The burden of serving the debt became onerous. Interest payments in 1990-91 alone constituted 20 percent of total expenditure of central government and 4 percent of GDP as compared with 10 percent of total expenditure and 2 percent of GDP in 1980-81. The balance of payments situation was also under considerable strain. Current account deficit was 2.2 percent of GDP as compared with 1.3 percent of GDP during 6th Plan period. Current account deficits were financed by borrowings. The Finance Minister informed the House that it was clear that the Indian economy was facing a serious fiscal crisis and very difficult balance of payments position. The Gulf Crisis and the shortfalls in domestic crude oil production led to a further deterioration in the fiscal situation.

The Finance Minister said that the soft options stand exhausted and it was imperative to start making the necessary macro-economic adjustments. Additional taxation measures were introduced namely the gulf surcharge of 25 percent and a further surcharge of 7 percent on corporation tax. On the indirect taxes side, auxiliary customs duties were introduced. Expenditure controls and rationalization of subsidies were proposed so that the expenditures are better directed at the poor. Even in December 1990, the Finance Minister maintained that the

[17] Economic Survey 1991-92 pp 4-17

Government would be in a position to overcome the crisis and manage the economic difficulties.

The 1991 Program and Economic Reforms

On August 27, 1991, the Finance Minister addressed the Managing Director IMF for an 18-month stand-by arrangement in an amount equivalent to SDR 1656 million. A memorandum of economic policies setting out the economic program of the Government of India for the period 1991/92 and 1992/93 was also submitted. The Government also requested for an additional purchase under the compensatory and contingency financing facility (CCRF) with respect to any remaining excess in oil import costs or shortfall in merchandise and remittance earnings for the year 1991. The Government indicated its willingness to enter into a comprehensive structural adjustment program, supported by an arrangement under the Extended Fund Facility.

Government agreed for the quarterly performance criteria for 1991/92 with ceilings on overall borrowing requirements of the union government, ceilings on net domestic assets of the RBI, a sub-ceiling on RBI credit to the Government and floors on net official international reserves. Government agreed for 3 reviews of program implementation on March 31, 1992, September 30, 1992 and March 31, 1993. Government agreed to formulate a comprehensive program for tax reform and introduce a detailed tracking system of quarterly expenditure reviews.

The Finance Minister clarified the role of the IMF and the World Bank in the Indian economic policy making in his budget speech. He said

> "It has been alleged by some people that the reform program has been dictated by the IMF and the World Bank. We are founder members of these two institutions and it is our right to borrow from them when we need assistance in support of our programs. As lenders, they are required to satisfy themselves about our capacity to repay loans and this is where conditionality comes into the picture. All borrowing countries hold discussions with these institutions on the viability of the programs for which assistance is sought. We have also held such discussions. The extent of conditionality depends on the amount and the type of assistance sought. However, I wish to state categorically that the conditions we have accepted reflect no more than the implementation of the reform program as outlined in my letters of intent sent to the IMF and the World Bank, and are wholly consistent with our national interests. The bulk of the reform program is based on the election manifesto of our Party. There is no question of the Government ever compromising our national interests, not to speak of our sovereignty."

The IMF history says the following:

> "The politics of borrowing from the IMF is always complex, but in India it was especially so. On the one hand politicians had long viewed the IMF conditionality with some disdain. As soon as it became know that the government was applying for a stand-by arrangement, its leaders would be attacked in Parliament, and in the press for subjugating the interests to foreign domination. On the

> other hand, most of the countries' economic and financial officials had good relations with the IMF and an unusually high degree of trust had developed on both sides over the years.
>
> The working relationship was a little unusual, in that the authorities knew full well what they needed to do to qualify for the Fund's seal of approval and financial support. The decision to devalue for example was not made at the insistence of the Fund but on the understanding that the Fund would approve it and that both sides believed that it was necessary and was in India's interest. As had been true for the 1981 negotiations, these discussions were amicable and collegial."

The RBI history says that in financial terms, the IMF's assistance was small compared with the dimensions of the crisis. In 1991-92, the withdrawals from the IMF amounted to US$ 1.2 billion as against India's short term debt of US$ 6.0 billion at the end of 1990-91, with overnight borrowing in international capital markets of the order of US$ 2.0 billion. India's decision to seek assistance from the IMF perhaps came a trifle late. The Governor's letter in late 1989 and early 1990 clearly hinted at the possibility of approaching multinational institutions.

The adjustment strategy entailed a set of immediate stabilization measures adopted in July 1991 most notably a 18.7 percent depreciation of the exchange rate and further tightening of monetary policy including increase in interest rates, designed to restore confidence and reverse short term capital outflow. The IMF staff report noted that the implementation began with the final 1991/92 budget, of a comprehensive program built around the twin pillars of fiscal consolidation and a radical structural reform to shift away from the policies of the past. India had also committed to mobilization of substantial exceptional financing to maintain a minimum level of imports so as to avoid a major disruption to the economy. The initial stabilization package was accompanied by a special action to maintain reserves at a minimum working level, including gold backed external borrowing, purchases from the Fund and the provision for quick disbursing aid from the World Bank, the Asian Development Bank and several bilateral donors.

The Fund recommended that the key macroeconomic objectives of the program include an easing of the payments situation and a rebuilding of gross international reserves to over 1½ months by the end of 1992/93; economic growth of 3-3 ½ percent in 1991/92 followed by a gradual recovery in 1992/93 and a reduction in inflation to no more than 6 percent by end of 1992/93. The current account deficit was targeted at about 2 ½ percent of GDP in 1991/92 and 1992/93. The structural benchmarks for the program were in the areas of industrial policy, trade liberalization, domestic pricing policies, public enterprises reforms, financial sector reforms, tax reforms and expenditure control. The crisis management measures adopted included utilization of gold to raise foreign exchange resources, liberalization in the policy for import of gold, India development bonds and non-resident deposits, liberalization of import licensing, liberalization of tariffs, industrial deregulation, foreign investment policy and significant steps in the exchange rate policy.

In many ways, the IMF program of 1991/92 ensured India's integration into the global economy.

India and the 2008 Global Economic Crisis

By 2009, India had arrived on the international economic scene. The Indian economy had grown at 8.6 percent for 5 years, and it was opined that if the rate of growth kept up, India would be transformed like China with US $ 1 trillion economy doubling 8 ½ years[18]. It was projected that poverty would be reduced at an unimaginable speed and the 11th Five Year Plan had projected an annual growth rate of 9 percent rising to 10 percent by 2011. Indian policy makers had reckoned that India may not be severely affected from the 2008 Global Financial Crisis largely because of public ownership of banks, strict prudential rules laid down by RBI and limits on external commercial borrowings. That said, Indian stock markets witnessed a 60 percent loss in values, foreign portfolio investment slowed down and rupee lost 20 percent value against the dollar reaching Rs. 50/ dollar, with the global financial freeze accelerating the currency depreciation. Government borrowing rose sharply and abruptly in the crisis years of 2008-09 and 2009-10. The Reserve Bank of India managed the borrowing program by maintaining easy liquidity conditions[19]. The growth forecast was revised from 9 percent to 7.1 percent and even that proved optimistic, although India remained the second fastest growing economy in the world after China.

Expectations that the Indian economy is 'decoupled' from the West were completely belied. The stock markets' sharp decline in response to global crisis were the first indications of global developments retaining their hold over Indian markets. Foreign institutional investors were pulling out. The current account deficit widened. Remittances and earnings from software exports that had propped up the current account in the past showed signs of declining. Software exports to the U.S. were under strain.

India's corporate sector was increasingly integrated with the world. India's IT companies which derived 85 percent of their revenues from exports to United States and Britain, employing 2 million workers witnessed job losses.

An analysis by the IMF of the Indian corporate sector suggested that the global crisis could have a serious impact on the Indian corporate sector and near-term growth. The significant volatility in the exchange rate, equity prices, and interest rates triggered by the global crisis, together with the decline in global economic activity and capital flows were to weigh on India's firms. The IMF estimated that the economic growth impact could be over four percentage points; with GDP growth rate in 2007/08 at 9 percent, the IMF estimates implied a deceleration to around 5 percent[20]. As capital flows to India declined in the immediate aftermath of the crisis, the IMF

[18] The Economist October 11, 2008
[19] Duvvuri Subbarao., *India and the Global Financial Crisis – Transcending from Recovery to Growth*., Comments of Dr. D. Subbarao, Governor RBI at the Peterson Institute for International Economics, Washington DC, April 26, 2010., RBI Speeches
[20] India *Selected Issues*., International Monetary Fund, January 23, 2009

suggested that India could prepare for the return of capital flows to Emerging Markets by continuing with capital account liberalization and pro-growth reforms. On the sharp decline of the rupee, the IMF said that an exchange rate depreciation is likely to be less inflationary when output was slowing.

In the G-20 meeting[21] in October 2008, Governor RBI, Duvvuri Subbarao had urged advance economies to keep the emerging market central banks in the loop on financial market developments as they viewed them and also on their proposed policy responses. The US Treasury and the Federal Reserve had conducted regular briefings for select emerging market economies including India. The advanced economies had to resort to unconventional monetary policies and quantitative easing and large scale asset purchases to flood the system with liquidity. The lowest policy rate India reached during the crisis was 3.25 percent while several advanced economies had reached near zero percent policy rates.

On February 16, 2009 the Union Finance Minister appraised the Parliament of the Global Financial Crisis. In his budget speech, Finance Minister, Pranab Mukherji[22] said

> "The global financial crisis which began in 2007 took a turn for the worse in September 2008 with the collapse of several international financial institutions, including investment banks, mortgage lenders and insurance companies. There has been a severe choking of credit since then and a global crash in financial markets. The slowdown intensified with the US, Europe and Japan sliding into recession. Current indicators of the global situation are not encouraging. Forecasts indicate that the world economy in 2009 may fare worse than in 2008.
>
> A crisis of such magnitude in developed countries is bound to have an impact around the world. Most emerging market economies have slowed down significantly. India too has been affected. For the first time in 9 months of the current year, the growth rate of exports has come down to 17.1 percent. ..Industrial production has fallen by 2 percent…In these difficult times, when most economies are struggling to stay afloat, a healthy 7.1 percent rate of GDP growth still makes India the second fastest growing economy in the world."

The Government decided to relax the Fiscal Responsibility and Budget Management Act targets in order to provide for much needed demand boost to counter the situation created by the global financial meltdown. The Fiscal Responsibility and Budget Management Act (FRBM) requires the government to commit up-front to a fiscal policy strategy over a multiyear period. The FRBM lays down the following: (i) reduction of the current deficit by at least 0.5 per cent of GDP in each financial year beginning with 2004/05; (ii) reduction of the overall deficit by at least 0.3 percent of GDP in each financial year; (iii) limit of 0.5 percent of GDP on the incremental amount of guarantees given by the central government; (iv) initial annual limit on debt accumulation of 9 percent of GDP, to be progressively reduced by at least one percentage point of GDP each year.

[21] Duvvuri Subbarao., *Who Moved My Interest Rate*., 2016 pp 21-45
[22] Interim Budget 2009-10, *Speech of Pranab Mukherji*, Minister of Finance February 16, 2009

A substantial fiscal stimulus was provided through two packages announced by the Government on December 7, 2008 and January 2, 2009 to provide tax relief to boost demand and aim at increasing expenditure on public projects to create employment and public assets. The Government renewed its efforts to increase infrastructure investments by approving several infrastructure projects. The Reserve Bank of India took a number of monetary easing and liquidity enhancing measures including the reduction in the cash reserve ratio, statutory liquidity ratio and key policy rates. The objective was to facilitate funds from the financial system to meet the needs of productive sectors.

The interim budget did not enthuse the media, who felt that despite the Rs. 30,000 crores allocation to NREGS, the issues of generating employment of non-rural workers was not addressed.

The Hindu[23] said

> "..India is among countries that have a high exposure to increased risk of poverty due to the global economic downturn. As the sectors that fueled the high annual economic growth rates brace themselves for hard times, job creation in these areas has also weakened. Specific measures to facilitate employment are called for in segments that are badly affected by the economic slowdown, such as Information Technology (IT), IT enabled services, textiles, gems and jewelry, and retail trade. … the entire issue of addressing the urgent issue of urban employment has been left to the successor government that will be formulating the full budget."

On February 19, 2009 the rupee hit 50/ dollar in a jittery market. The RBI's holding of US T bills rose by US $ 6.9 billion to US $ 23.1 billion in December 2008 as India's forex reserves rose from US $ 247.8 billion in November 2008 to US $254 billion in December 2008. Monetary authorities in China, Russia, Hong Kong, Norway, Ireland and Israel also added the lower yielding dollar asset to their foreign exchange reserves. China had added US $ 218 billion in 2008 while India added US $ 8.2 billion.

The Economic Times[24] said

> "On Wednesday, the rupee briefly breached the 50-mark against the dollar to end Rs. 49.97, with the market beginning to price in political risk, fiscal slippages and decline in interest of foreign fund houses in emerging market assets. What's pushing up the dollar in the international market is the pervasive interest even among central banks, in US Treasury bills. Despite the US slowdown and abysmal return in US T bills, funds, banks and sovereigns are buying these bonds, which are still perceived as safe haven.

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[23] The Hindu., "*Addressing Urban Job Losses*"., dated February 20, 2009

[24] The Economic Times., *Rupee hits 50 in jittery market.*, dated February 19, 2009

> In the face of these forces, the domestic currency market largely ignored RBI Governor D.Subbarao's sentiment that lower inflation and current account deficit in coming months could create the possibility of a rate cut. Some state owned banks sold dollars to prevent the rupee from dropping further, but this did not help."

India's 2008 Article IV Consultations with the IMF were concluded on February 6, 2009. The IMF projected India's growth to moderate to 6 ¼ percent in 2008-09 and further to 5 ¼ percent in 2009-10. Headline inflation came down from 13 percent to 4.4 percent in January 2009 and was projected to further drop to 3 percent by March 2009 and to 2 percent on average in 2009-10. Current account deficit was projected at 3 percent of GDP primarily due to oil import bill and deterioration in exports. For 2009-10 the IMF forecast that the current account deficit will narrow to 1 ½ percent of GDP. Capital inflows were expected to decline, with portfolio investment recording US $ 11 billion outflow and external commercial borrowing slowing down considerably. The foreign exchange reserves declined from a historic peak of US $ 315 billion in May 2008 to US $ 252 billion in February 2009. The stock market declined by 50 percent and the rupee declined by 23 percent. The RBI's measures had eased the domestic liquidity pressures and brought down interbank rates significantly. India's spending prior to the onset of crisis had risen significantly with the agricultural debt forgiveness, expansion of the rural employment guarantee scheme and 21 percent civil service wage hike.

The IMF recommended that India faced spillovers from the global crisis. The key short term policy objective was to sustain liquidity and credit flows. The monetary and structural policies had to bear the burden of adjustment given the high public debt – GDP ratio. The IMF felt that rising credit risk and liquidity pressures could put the financial system under strain. It was important that India took note of the potential bank re-capitalization needs and measures to promote early loss recognition, full disclosure of bad assets and filling of information gaps. The IMF supported India's gradual approach to capital account liberalization. It was felt that the sizeable fiscal stimulus should support economic growth in 2008-09. There remained concerns about fiscal sustainability given the high ratio of public debt to GDP. The fiscal space available was to be used for infrastructure and poverty related spending and for bank recapitalization if needed. The IMF reiterated that medium term fiscal consolidation remained a priority and should be anchored in the fiscal rules framework.

The 2009 Article IV consultations[25] of the IMF with India were concluded in January 2010. India's economy was one of the first in the world to recover after the global crisis. Prompt fiscal and monetary policy easing combined with a fiscal stimulus had brought growth to pre-crisis levels. Capital inflows were back on the rise and financial markets regained ground. Growth was projected to rise from 6 ¾ percent in 2009-10 to 8 percent in 2010-11. The IMF commended the Reserve Bank of India for commencing the first phase of exit from monetary accommodation and generally considered that conditions were right for a progressive normalization of monetary

[25] *India 2009 Article IV consultations*., International Monetary Fund., January 25,2010

stance. The withdrawal of the monetary stimulus was to be done in a gradual manner to soften the impact on long term interest rates and help anchor inflation expectations. India faced challenges in managing capital flows and the IMF recommended sterilized intervention to help reduce exchange rate volatility. The RBI's approach to use prudential measures in case of asset bubbles was also supported by IMF and tightening of capital controls was to be an instrument of last resort.

The financial system had weathered the global crisis well. The strengthening of capital of public sector banks and financial regulation, the higher provisioning arrangements introduced had all proven successful. There were issues of distressed assets and the insolvency framework. Infrastructure investment remained a priority and public institutions had an important role to establishing the framework for infrastructure financing.

The Fastest Growing Major Economy in the World

On February 28, 2017, India's quarterly estimates of Gross Domestic Product (GDP) growth rate have projected the Q3 GDP estimates at 7 percent. India remains one of the fastest growing emerging market economies driven by key structural reforms, normal monsoon and reduced external vulnerabilities. Inflation has declined from 6 percent in July 2016 to 3.4 percent in December 2016. The Government has continued to adopt the path of fiscal consolidation and the Reserve Bank of India has maintained an accommodative monetary stance. The current account deficit remains manageable and international reserves standing at US$360 Billion are at their highest levels. External vulnerabilities remain subdued. It also appears that the post-November 8, 2016 decision to withdraw the legal tender character of all Rs. 500 and Rs. 1000 notes and the re-monetization initiative has not undermined the growth momentum.

The macroeconomic scenario looks quite bright with the Union Budget adopting a fiscal consolidation path having achieved the fiscal deficit target of 3.5 percent of GDP in 2016-17 budget. Fiscal deficit is projected to further decrease to 3.2 percent of GDP in 2017-18. The revenue deficit is envisaged to reduce from 2.1 percent of GDP in 2016-17 to 1.9 percent of GDP in 2017-18. Continued progress in reforms provides a healthy environment for a marked improvement in medium-term prospects.

The Union Budget 2017 has identified the external uncertainties around commodity prices, especially crude oil, and signs of retreat from globalization of goods, services and people as pressures for protectionism as future challenges. Further the Union Budget noted that the US Federal Reserve's intent to increase policy rates in 2017 could lead to lower capital inflows and higher outflows in emerging market economies. That said, the economic risks are titled on the downside. With the key domestic risk of currency exchange initiative being successfully negotiated, the prospects for significantly stronger growth in coming months have brightened.

The transformational reforms launched by Government in 2016 include the passage of the Constitution Amendment Bill for GST and the progress in its introduction, demonetization of high denomination notes, enactment of an insolvency and bankruptcy code, amendment to the RBI Act for inflation targeting, enactment of the Aadhar bill for disbursement of financial subsidies and benefits. Further the Union Budget has made major reforms in merger of the Railway budget with the Union budget and the removal of plan and non-plan classification to facilitate a holistic view of all allocations for sectors and ministries.

Astute food management and price monitoring by the Government has helped to contain inflation. A number of measures have been taken by Government to control inflation and restore price stability. The steps taken include, increased allocations for the price stabilization fund, creation of buffer stock of pulses, announcement of higher MSPs to incentivize production, imposition of export duties and reduction of import duties on certain commodities.

In 2016, amongst the significant steps for monetary management and financial intermediation was the amendment in RBI Act. This amendment provides for an inflation target to be set by Government in consultation with the Reserve Bank of India once every 5 years. It also provides for a statutory base for constitution of an empowered monetary policy committee (MPC). The Government has fixed an inflation target of 4 percent with a tolerance level of +/- 2 percent for the period 2016-2021. The RBI has maintained an accommodative policy stance, which is duly reflected in the money markets.

The Union Budget has reiterated its deep commitment to fiscal consolidation. Such a commitment is critical for lowering the cost of credit to private sector and help price stability. The fiscal consolidation strategy envisaged further subsidy reforms. Significant efforts in this direction have been made with the oil subsidies and Aadhar linkages for better targeting of subsidies. There has been considerable progress on structural reforms with continued efforts to reduce poverty, increase financial inclusion and further trade liberalization.

On October 8, 2016 the Indian Finance Minister addressed the International Monetary and Financial Committee (IMFC) during the Fund-Bank Annual Meetings presented India as the fastest growing major economy globally with GDP growth at 7.2 percent, foreign exchange reserves of USD 372 billion, current account deficit of (-) 1.1 percent and CPI inflation at 5.05 percent. The economic transformation from an IMF program country to the world's fastest growing major economy in a period of 25 years represents a significant success story for India-IMF relations.

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