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Transcript of interview with

<u>RAJA CHELLIAH</u>

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FOREWORD

The following is a transcript of an oral interview conducted by the authors of the World Bank's fiftieth anniversary history: John P. Lewis, Richard Webb and Devesh Kapur, *The World Bank: Its First Half Century,* Washington, DC: Brookings Institution Press, 1997. It is not a formal oral history, and it is not a systematic overview of the work of the person interviewed. At times the authors discussed the planned publication itself and the sources that should be consulted; at other times they talked about persons and publications extraneous to the Bank. Some interview tapes and transcripts begin and end abruptly. Nevertheless, the World Bank Group Archives believes that this transcript may be of interest to researchers and makes it available for public use.

[Begin Tape 1, Side A][1]

CHELLIAH: . . . in terms of funding, it must be of a large country. In terms of per capita it may not be very large, but it terms of *[inaudible]* amounts, the amount, the volume of aid flowing through the Bank has been quite substantial. And in terms of concessional assistance and even in terms of total flow of resources, the share of the Bank has been quite substantial as far as India is concerned. So there’s no doubt about it, that the Bank has played a key role in terms of external assistance to Indian development. But as you know we raise nearly 95 percent of our, of the total funds, resources needed for investment internally. We usually, in the Indian *[inaudible]* bank, region of 90 percent. But that ten percent is critical because it brings in foreign exchange and some technical advice and some influence on priorities because to the extent that the Bank is willing to give money in some areas, and there is prioritization of investments in the plan.

But I think until very recently the Bank has been dealing with projects, but from the time I have been here the Bank has been giving policy advice in relation to particular sectors, for instance the transport sector, that you should follow this kind of policy and you should issue global tenders, when it comes to irrigation then the structure of tariffs and power and so on. So it's been until the last five years or so, I would say, it's been mainly policies in regard to particular sectors. They have given--tried to bring about changes with advice.

But more recently I think they've been talking about some macroeconomic policies and financial sector reform, trade reform, fiscal reform. I think this has been so for the last five years or so, from 1985, when we started out with some visible degree of reform in the 1985-86 budget, Rajiv Gandhi's first budget. So I think they took the cue from there and felt that reforms could be urged upon the government of India, and they started doing that. But this is my broad impression. I’m not one of the people--I've not been very intimately connected with the Bank's activities in India, more with the *[International Monetary]* Fund here because I'm dealing with finances and budgets and fiscal policy and things like that.

LEWIS: Could they have felt that in the past five years your need for advice was greater than in the past? That is, India has been a pretty inflation-resistant country typically, traditionally, and this has changed quite recently.

CHELLIAH: Well, I think there are three reasons why these shifts could have taken place. One is that the cumulative impact of following wrong policies became really--it crossed the limit of tolerance. So they created a regime and a tariff regime. It was so complicated, so irrational and so prohibitively high. And this is an accretion of years of doing wrong things, you know, years of folly, let me put it that way. Of course, you're recording it, but I don't mind saying “years of folly” because I think it was foolish. So that's one.

The second, of course, is the perception--which I referred to earlier--that there was willingness on the part of the policymakers to undertake reforms. This was especially

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[11]Original transcript by Brookings Institution World Bank history project; original insertions are in [ ]. Insertions added by World Bank Group Archives are in *italics* in *[ ]*.

so from 1985 to 1987, the first two years of the Rajiv Gandhi era, when things were happening and liberalization was proceeding, before he got caught in a number of political difficulties when the reforms were stopped, so to speak, in their track.

The third is, of course, the excessive financial indiscipline leading to fiscal disequilibrium and then to balance of payments issues. Unfortunately, this development coincided with the development in relation to liberalization so that many people who did not want liberalization could say, “See what happened? You liberalized, and you got into trouble both with the budget and with the balance of payments.”

LEWIS: Right.

CHELLIAH: But then this is an independent development. There is no connection between having a large fiscal deficit and liberalization because liberalization is, has to do with bringing in imports on a more rational basis, shifting goods from import control to tariff control. That has nothing to do with the fiscal imbalance. You could say that leads to the closing down of some unprofitable industries in the country, but that's not really what happened. Industry grew during this period at 8.5 percent per annum. Industrial production growth the highest we have ever recorded. It's an independent development of government undertaking expenditure commitments far in excess of the capacity to raise revenues. Given the limitations, administrative limitations, limitations of the--arising from the low level of income of the majority of people and so on and so forth, then we can grow only at some rate. For instance, in the ‘80s Government of India's expenditures grew around 17 percent per annum in normative terms whereas the revenues grew only around 15 percent. You can't sustain this kind of disparity. Perhaps only America could because it can make the rest of the world bear all of its costs, but not India. But we can't imitate President *[Ronald W.]* Reagan. Rajiv Gandhi was doing that. I mean, only not he, but also his successors. V.P. *[Vishwanath Pratap]* Singh was his finance minister, and he also didn't understand finance.

So there were a number of reasons why they couldn't control expenditure, but . . .

LEWIS: Why did discipline break down?

CHELLIAH: It’s very difficult to understand how it came about because from 1973-‘74 we have been very prudent. There was a burst of inflation after the first oil shock, and there was some imbalance. Then at that time Mrs. *[Indira P.]* Gandhi took advice from a number of economists, and she did control government expenditure, clamped down on many things, items that corrupt balance.

LEWIS: Yes, *[Chidambaram]* Subramaniam was the finance minister at that point, wasn't he?

CHELLIAH: No, he wasn't at that time. By the time he came the situation already stabilized as far as inflation was concerned.

And all of this, then we had all the remittances coming in from the *[Persian]* Gulf, and there were years even--believe it or not--years even when the prices were not rising at all, and the reserves were going up. And they were asking, “What shall we do with these reserves?” There was a time. That was '77, '78, '79. This is during the time that the Janata government was in power. So they claimed that they had brought in on. Of course, they had not. It was the result of what had been done earlier.

So from 1980, when Mrs. Gandhi came back to power, they started the liberalization in a very small way, but inflation was still under control—6, 7 percent, something like that.

I think the beginning of the troubles was the recommendation by the Seventh Finance Commission which suddenly raised the proportion of taxes to be shared with the state governments. And I think it was a mistake on the part of the central government who accepted that recommendation. The president, according to the constitution, could reject the recommendation and modify it. But that immediately led to deficits, what we called the revenue account of the budgets. We have these two accounts. That was the beginning.

WEBB: When was that?

CHELLIAH: That was in the year ‘77-‘78 or ‘78-‘79. So sorry; I beg your pardon. This came in the--what was the—‘83-‘84?

LEWIS: ‘83-’84, uh-huh. Mrs. Gandhi was in power. Just before she was assassinated in ‘84.

CHELLIAH: Let me check again. The recommendations of the Eighth Finance Commission ended in--no, I think I'm right earlier. It was ‘79-‘80, the Seventh Commission.

Then came the Eighth Commission, which made it worse. They added another 5 percentage points to be shared.

LEWIS: Every five years there's a Commission?

CHELLIAH: Yeah, and then the last Commission, the one which said, “No more increases,” that was the one of which I was a member. And then we created difficulty because already the government of India was in great—it was in the red, so we had to say that.

LEWIS: So this was really a--part of the problem or the source of it was the revenue-sharing sort of concept.

CHELLIAH: It started with that.

LEWIS: Starting with that, yes.

CHELLIAH: And then the other things were added. The cumulative impacts of borrowing and not getting returns out of it, that really the interest burden fell on the budget. So as you know when you cross a certain point, then the interest starts snowballing, and the interest started growing very fast. We had to borrow to pay . . .

LEWIS: This was domestic borrowing?

CHELLIAH: Domestic borrowing, mainly. Mainly domestic borrowing. So during the ‘80s the total debt increased very fast.

KAPUR: Do you have a sense, given that the Bank in ‘82 and especially by ‘84-‘85 had really been sort of well aware of these sorts of problems in Latin America because the debt crisis there had broken out by ’82, that they were beginning to warn the government of India, seen their experiences elsewhere?

CHELLIAH: I don't know whether they started doing that as early as that, but the signs were clear even in ‘83. In fact, one of my lectures--I don’t know if I can find a copy of it, lectures given in Calcutta--I had said that this whole fiscal crisis is creeping up on us, and unless we do something about it in the next five years, it’s going to bring about great financial chaos in the country. But at that time nobody listened to what was being said. But after ‘86-‘87 I think the Bank was saying it and many people in India were saying it. But then after ‘87 the reason why we had accentuation of the financial problem is really political.

LEWIS: The breakdown?

CHELLIAH: The breakdown of the political system. Mr. Gandhi got caught up in the Bhopal scandal and many others, and there was a big fight between him and his erstwhile finance minister, and then nobody bothered about it. Everybody wanted to give away more, more, more programs to get votes. It became a matter of buying votes through give-aways.

And then came V.P. Singh, and he did even worse things. So the political instability and breakdown of the political system in a sense at the same time. Then this meant also breakdowns in the political systems in several states. There are some states now where they find it difficult even to pay salaries.

When I was recently in Washington--I was doing some work with the Bank—I found that one of the cities in Connecticut . .

LEWIS: Went into bankruptcy.

CHELLIAH: Bankruptcy!

LEWIS: Bridgeport.

CHELLIAH: I think several of our state governments ought to—are in the position of having to file for bankruptcy now! *[Laughter]*

LEWIS: Right. Which states are you--is it like Bihar, Orissa, the poorer states?

KAPUR: Orissa is doing reasonably well.

CHELLIAH: Well, I think even West Bengal is finding it difficult to pay salaries.

KAPUR: Which is why the Marxist union is--last month they raised, doubled the tariffs for milk, pushed through a 25 percent increase in power tariffs. You know, for the rich it might not seem high but for them it's . . .

WEBB: What was the position of the central bank during all this period? Were they warned? They weren't--there was no deficit—there was no printing money, or was there?

CHELLIAH: Well, what they—what happens to India is that the Government of India issues more treasury bills to be taken up because--special treasury bills to be taken up by . .

[Brief interruption]

CHELLIAH: Sorry.

WEBB: The central bank . .

CHELLIAH: Ah! The central bank--the Government of India issues treasury bills, and against the treasury bills the Reserve Bank lends them money. Therefore, the balance of the Government of India with the Reserve Bank goes up.

WEBB: Well, they were in fact financing.

LEWIS: Oh, yeah. You borrowed from the central bank.

CHELLIAH: We borrowed. And then correspondingly they print notes to—they don't--it's not notes printed and given to the government as such, but there is an expansion of money supply that way.

WEBB: Is the central bank here not relatively autonomous?

CHELLIAH: No. Not at all autonomous.

LEWIS: It's very much the creature of the Finance Ministry.

WEBB: It is? Oh.

CHELLIAH: They've been asking for this autonomy.

LEWIS: It kind of gives the appearance of it, in that they traditionally have had quite distinguished leadership. [both speaking at once]

CHELLIAH: Mainly *[inaudible]*

LEWIS: And only occasionally you get some hack put in who looks very political, but you've had people like L.K. Jah and I.G. *[Patel]*, all these distinguished . . .

KAPUR: And Manmohan *[Singh]*.

LEWIS: And Manmohan. They've all been very distinguished governors.

CHELLIAH: But not autonomous.

LEWIS: Not autonomous.

CHELLIAH: Autonomous maybe in other areas, you know, in relation to debt supervision of the commercial banks and improving the financial system, you know, opening of new branches and things of that kind. I don't think the government directly intervenes. But in terms of lending to the government of India, they're are not autonomous. That's what I mean.

LEWIS: This is a former governor of the central bank who tried to be autonomous--in Peru!

WEBB: I'm a Peruvian. I worked in the central bank for a few years.

CHELLIAH: I think that is what we need in fact in India, that as of now they have done in Germany and in New Zealand and so on.

WEBB: Chile has just introduced a very strong . . .

CHELLIAH: Chile too. But you should agree upon a certain amount of accommodation at the beginning, the governor of the reserve bank and the minister of finance, and then there should be no exceeding that limit unless the government go to parliament and gets a special resolution passed that there is very great emergency and so on. But the government is not willing to accept that recommendation, but they have to do that.

Anyway, we were talking about the Bank because the Bank is not responsible for any of these things. But possibly the Fund was responsible in the sense that they were not tough enough, tough enough with India. When we went in for the extended Fund facility in the early--you know, after the second oil . . .

LEWIS: That was in '81, I think, when you did that.

KAPUR: Would I.G. Patel have negotiated that?

CHELLIAH: No, I think *[M]* Narasimhan. Narasimhan, and Manmohan Singh was there. Narasimhan was our *[World Bank]* Executive Director. I don't know who was the—well, he was Finance Secretary.

LEWIS: Who?

CHELLIAH: M. Narasimhan.

LEWIS: Oh, yes.

KAPUR: Who was in charge of . . .

CHELLIAH: He’s now the chairman of the committee on financial reforms.

LEWIS: It’s the counterpart to your committee. We've been hearing that it's the counterpart to your commission.

CHELLIAH: Yes, counterpart, yes. Committee, not commission. Only a committee.

LEWIS: Oh, I see.

CHELLIAH: Less exalted.

LEWIS: When are you reporting?

CHELLIAH: Well, our interim report is to reach them within the first week of December because only then they can put some of these things in the budget.

LEWIS: I see.

KAPUR: Is this the thing which potentially has the thing to reduce VAT?

CHELLIAH: Trying to do, extended. We already have—we already have a modified value added tax system, but to extend it beyond the manufacturing level requires the consent of the state governments.

KAPUR: And to reduce this, say, state sales tax *[inaudible]*

CHELLIAH: So what happened was that we had a very good opportunity when we got this extended funds facility to have carried out reforms more than we did. Then we could have, with Rajiv Gandhi coming in ‘85, we could have done--we could have fairly completed the reform 90 percent by this time [tape seemed to skip] this fiscal imbalance had not been allowed to come in. So--but we have lost a lot of time.

WEBB: How do you see the World Bank, then? Would you venture, what is your sense of how the World Bank is--sense, this is your just a general sense of the World Bank in India?

CHELLIAH: I really don't know much about how it works, but I think the Bank has been moving with the general thinking on development and problems of developing countries as it takes place in the academic world. You know, they were not saying much against development planning and so on in the early days, that that was the fashion, and they went along with it. And then the disillusion with that that has taken place in the academic world, they also shared. But perhaps after Reagan coming in there is a little more of identification with the American point of view. That is the general perception, and I think--I went on a World Bank mission to China to look at their inter-governmental fiscal relations.

LEWIS: When was that?

CHELLIAH: This was in May, and I came back only in August.

LEWIS: I see.

CHELLIAH: And a large number of people were saying that, those, you know, from different developing countries who are working in the Bank were telling me this, that they feel that there is little more of the American stamp coming in after this, after the Reagan presidency, and that is continuing. But otherwise I think they have been, generally been following thinking in the academic world. And of course in the academic world the fashions change and so often the fashions change. Now nobody would say a word about planning.

WEBB: Do you think the Bank has changed the expenditure pattern here, the government expenditure pattern, in some direction?

CHELLIAH: I don't think so because, you see, when India started out with these--the Bank has been involved in India in relation to public-sector projects. That meant power, transport, irrigation, largely--and railways, transport includes railways, large amounts of money have come to railways. And communications also, roads.

Then in the early ‘80s Mrs. Gandhi started out with these poverty-alleviation programs, that is, it is not possible to ask the poor to wait for the fruits of developments to percolate down, so we ought to do some direct intervention in terms of poverty-alleviation programs. And I think that was also at that time the Bank's philosophy. They had also put some emphasis on that.

LEWIS: But the Bank didn't do much along--in fact, I think there was actually--I don't think there was a contemporaneous. The Bank was on that wicket in the '70s.

CHELLIAH: Yeah.

LEWIS: And then the Reagans and so on, and structural adjustment came in, and the Bank got off that one just as Mrs. Gandhi was sort of getting on it. But the Bank hasn't done much of anything with respect to IRDP *[Integrated Rural Development Programme]* or public works.

CHELLIAH: Education, yes.

LEWIS: Education.

CHELLIAH: Because there their interest is in primary education. It is more recently, yes.

WEBB: But it's a small proportion, as you were saying, of the investment, so there is a lot of room for fungibility.

CHELLIAH: You see, they’re--I think, I don't know the figures, but they have been giving some program lending, *[inaudible]* some program lending which could be used in this way in addition to project lending.

KAPUR: But insofar as the Bank has shifted its lending to India--and more generally, especially in the last few years--either to policy-based sort of nonpublic lending as well as to social-sector lending, the social-sector lending is essentially free foreign exchange because there's no import for that. So in that sense the country does get somewhat a fungible or largely fungible foreign exchange which may or may not be significant fraction of imports, but in that sense has it at all affected or at least nudged India in the sort of . . .

CHELLIAH: Not perceptively. It has helped—no, as you said, it has helped emphasize some priorities in terms of spending on education and things of this kind, but not really significantly. It's only now they are thinking in terms of policy-based lending, like this national renewal fund and IFC *[International Finance Corporation]* coming in with greater investment in the private sector.

KAPUR: If the government is to go on, *[inaudible]* strongly believes that there was a lot of fungibility in these resources in defense expenditure. And I wondered--I don't know how you feel.

CHELLIAH: Fungibility was there. But then you asked me the question whether that, the Bank influenced the pattern of spending. That's different from fungibility. [both speaking at once] Fungibility, of course. And he knows more about this because he has been involved in these projects. I have not been.

But there is a perception in India--there was a perception among the leftists and to some extent some journalists and so on--that the Bank tries to push their philosophy down your throat if you want money and all that, but I think it's less justified in the case of the Bank than in the case of the Fund because the Fund gives, you know, lends money in crisis situations and it also gets the money back, so it does lay down conditions. But to be fair to the Bank, I think they have—they have, even after the Reagan era, I do not think they insist that the government should not spend money or the public sector should not exist or things of that kind. Now I think the Americans are saying that the Bank should lend to the private sector.

LEWIS: Yeah. Yes, they have been. And oddly enough it came up in connection with the IFC, which of course that's the mission of the IFC. Now the Bank and the U.S. wanted the main Bank to lend without guarantees to the private sector.

KAPUR: *[inaudible]* the capital increase of the IFC.

LEWIS: Yeah, yeah, and they finally got the capital increase, and sort of a, some kind of a non-binding commitment, I guess, as far as the Bank is concerned.

KAPUR: Right. Insofar as the recent changes in the Government of India or the sort of liberalizing, to put it in quotes, the '80s and then perhaps more in the past few months, how much of it is your perception of these changes really emanating from within the country, you know, just a feeling of political change or how much is the sense that the . . .

CHELLIAH: Mainly indigenous.

KAPUR: It is primarily indigenous.

CHELLIAH: Primarily indigenous, influenced of course by events abroad. From ‘79 they had been liberalizing in China, and the success of that responsibility system in agriculture and their special economic zones, the way their exports are rising--all of these things have influence on us. And I think then the demonstrated failure of the socialist system in most parts of the world even before ‘89 collapse had its own influence on people, so they were writing to the newspapers and so on. Though the faithful support did not change much. They are not changing now, even today.

LEWIS: K. N. Raj is not changing very much, huh?

CHELLIAH: Hasn’t he? I don't know. I haven't met him for quite some time.

LEWIS: Oh, I haven't either, but I . . .

CHELLIAH: I think he has changed. The persons who have not changed are people like Ashok Mitra, Amir Bakshi, people like that.

LEWIS: Yeah, yeah, yeah, people like that. Actually, I was wrong to mention Raj because Raj is a good Marxist, who nevertheless is a market Marxist all the way. He believed the market has quite a useful mechanism.

CHELLIAH: I think he is far more sensible, but he hasn't been very active these years, for the last few years. I think these Marxists of West Bengal and others in India holding this banner of communism reminds me of a remark by George Bernard Shaw. He told these missionaries going and converting people in the Eastern countries, he said, “You are going to do this, and one day they are going to mount a crusade against you agnostics in the ‘80s.” So that's what these fellows are trying to do. They say that “We will preserve the purity of Marxism-Leninism.”

LEWIS: Right.

CHELLIAH: So that--I would say it is largely indigenous, and this new younger group of people coming in who are not influenced by the socialist ideas of the ‘40s and the ‘50s, take someone like Rajiv Gandhi or his brother or many younger executives who helped him like Arun Singh, they don't have any ideological hang-ups. They're moved by magic, and they look at things and how things can be done. And the growth of this managerial class in India has also meant influencing thinking in various ways about how this is to be done. And I doubt very much whether, except for the writings of academics abroad, whether Indian or non-Indian, I don't think influence outside forces is counterproductive. I don't think it will be to happen here or in China because you know these are very strong-minded people, and they will do what they want to do.

But even in regard to the present program, some people think that it is all the tail-twisting by the Bank and the Fund. I don't think that is true because while before the 1989 elections Mr. Rajiv Gandhi was not willing to say things openly, because he had been told that if you say these things they will paint you as anti-socialist, anti-poor, pro-rich and all this, and he was afraid. And I remember I was then a member of the

Planning Commission, and he told us that, “I agree with all that you say, but we'll say it after the elections.” So he wanted us to take out even very mild things like, you know, “I think we should reform the urban land ceiling acts” which is a disaster, really. But he said, “I agree with you.” And then this trade equalization.

LEWIS: Oh, yes.

CHELLIAH: I think he said, “I'm convinced now that it should go,” but he wasn’t willing to say it.

But by contrast the 1991 elections, before that he got a manifesto prepared in which he said, “I'm going to invite foreign investment. I'm going to open up the economy. We must liberalize further.” He said openly all that he had to say. By the time, you know, he was convinced, a number of others had convinced him that hiding the truth from the people is not going to help you. If you believe it, say it. And if you look to the Congress manifesto you'll find most of the things they are doing now are already there.

LEWIS: Is the manifesto for . . .

CHELLIAH: The election.

LEWIS: ‘89? [all speaking at once]

KAPUR: The June election.

CHELLIAH: ‘91. And he was killed.

LEWIS: Yes, I understand.

CHELLIAH: But the manifesto was issued three months earlier, two months earlier.

And *[P. V.]* Narasimha Rao was the chairman of the drafting committee of that manifesto. He said--I had myself sent him some positions saying that you must now say it openly. I don't whether he took heed of it, but at any rate they did it.

So that was already there, and this crisis, which led them to go to the Fund and the Bank, sort of helps the Bank and the Fund then to put a little more pressure on them, to stick to what they want to do, but give in, I would say. I mean, they can stand pressures against the people who say, “Don't do this.”

LEWIS: Because they say they're getting pressure from the outside?

CHELLIAH: Yeah.

LEWIS: Yeah, I think that can very often become a good way to play the influence of the donor.

WEBB: Is it just largely a ploy, or is the Bank/Fund money really absolutely necessary now? Is India really desperate at this moment, do you think?

CHELLIAH: For Fund money, yes, and Fund approval, yes, because the international financial community had lost confidence in India's viability and its capacity to repay. So the crisis started out like this, that they were not able to refinance the short-term debts. People were not willing to lend, so they couldn't roll over the short-term debts. And that was--that crisis could only be solved if they went to the Fund and got a stand-by, and then the Fund certifies--an agreement and a program with the Fund is often a prerequisite for getting any money from the private market nowadays, as you know, coming from Latin America. So we were in that position. So we had to go to the Fund, and what the Fund gave us immediately enabled us to meet our obligations, short-term obligations, so we didn't have to default. And then the stand-by agreement now means that, a stamp of approval by the Fund that they are willing to lend money to the Indian government under the conviction that India will repay. So India then can go to others and say, “Look, the Fund is doing it.”

And the Bank then said, “If you have an agreement with the Fund, then we are willing to help you.” So the Bank would not have helped unless the Fund had said okay. So we get the extra money from the Bank.

Then the Japanese said, the Germans said, “Well, we can give you some fast-disbursing aid provided you have the agreement with the Bank and the Fund.” So even if the Fund gives us only two billion or one billion, the total we will get will be much more.

WEBB: Has the World Bank’s leverage really increased?

CHELLIAH: I don't know. I think the World Bank leverage comes in when we ask for an S-A-L, structural adjustment loan, from the Bank--which we are asking for, I think.

LEWIS: It's been a matter of policy not to ask for that up until now, isn't that right?

CHELLIAH: Yeah, so now I think the Bank is saying that you should do business, which is largely in line with what the government wants to do, but the Bank is interested in the reform of the trade regime and the tariff regime. As far as trade regime is concerned, there's been a lot of change. Now I think only 10 percent of our imports are under import controls, except for the banned items. There are some banned items which is not in keeping with, you know, academic thinking but we have some banned items, consumer goods, luxury consumer goods, so-called luxury consumer goods. They're not allowed to be imported commercially. Incoming passengers can bring a little bit with them as a part of baggage.

Now, apart from that, apart from the banned items, I think import controls now restrict 10 percent of the imports. The rest are all under tariff, but the tariff itself is very irrational, the tariff structure, and very high. So one of the things that our committee, my committee has to do is suggest these reforms.

But the real problem there is the dependence of the government on revenue from tariff, and that comes from this sharing problem because these Finance Commissions, wrongly in my view, raised the share of personal income tax to 85 percent of it will be handed over to the states, and of the union excise duties, 45 percent will be given to the states. If the central government wants to raise revenue, it has to raise revenue for itself, without sharing the states. It has to raise revenue either through the corporation tax or the customs, both of which they have utilized, I think very wrongly.

So if I--now there has been a devaluation of 20 percent, basically, and earlier around 10, 15 percent, you know, creeping kind of devaluation--so if I recommend reduction of import duty rates by 30 percent, it would not affect industry. They'll still get the same duty protection as they were getting before the devaluation started in January. But I can't do it because of the tremendous fall in revenue to the government, which means the government cannot fulfill its obligation, its promise to the IMF to bring down the deficit to 6 percent of GDP or whatever the agreement is.

WEBB: But there must be a lot of prohibitive tariffs that, if you reduced them, you would begin to get more imports.

KAPUR: *[inaudible]* are not that high.

CHELLIAH: Well, not immediately.

WEBB: Not immediately.

CHELLIAH: But this is an immediate problem. This is where I've been telling my friends in the Fund, "Why are you so orthodox and doctrinaire? We should ask for structural reform rather than the squeezing of the fiscal deficit beyond a point." But those fellows are monetarists, and they will stick to that. And the Bank says you must reform the tariff, and the Fund says you've got to lower the budget deficit. So you have to come to a balance as between these two. But who will advise god, you know! I have here two gods! *[Laughter]*

LEWIS: How about the interplay between these gods? Do they—do you have a sense that they . .

CHELLIAH: Well, I've been talking with Oktay Yenal here, and he says, "I fully agree with what you say." I hope he tells them.

Well, I think the Fund will relax a bit; I think that they're taking a negotiating position. They think that unless they say this, these fellows won't do, but later on they might relax a bit. That's what I'm telling the government, but the finance secretary and others are very nervous.

But I think in Government of India now there is conviction that we must reduce the tariff and we must reduce the spread of the tariff and what the Bank says is right. And we are going to suggest drastic reform of the structure to be carried out within the next six years or so, six, seven years, at least.

And I think that only--the major, the major obstacle to it is the dependence of the government on customs revenue.

LEWIS: Going back again to this revenue-sharing excess, in a sense.

CHELLIAH: That and their own excess expenditure. I mean, both.

KAPUR: But also there are sectors which you can't touch like agriculture. Agriculture is basically untouchable. There are sectors which have any impact at all, which are probably are very difficult to . . .

CHELLIAH: Well, actually the way they can do is the excise is also high that . .

[End Tape 1, Side A]
Begin Tape 1, Side B]

CHELLIAH: . . because some sections are not taxed, some areas are not taxed. For instance, services are not taxed because we don't have a value added tax. We have an excise, it's called, on commodities, and sales taxes on goods are levied by the state governments. They are not allowed to levy taxes on services. Thank god they're not, otherwise, they'll mess up that also.

Now, then there's a lot of inflation. This is a vicious circle. You have inflation, therefore you have higher rate, because you have higher rate even more inflation, then you have more rate raising. So you have high rates, a lot of inflation. So I can't raise the rates. The Bank and the Fund people say, "But why don't you reduce the tariff and shift the burden to excises." But the excises are already high.

WEBB: Imports are a very small proportion of the GDP, aren't they?

CHELLIAH: Yes.

WEBB: Five percent?

CHELLIAH: No, it's—it must be eight, nine percent now.

WEBB: Oh, eight, nine.

KAPUR: Because of oil there's *[inaudible]* a commodity.

WEBB: Does oil pay a duty? Probably not?

CHELLIAH: It does pay some customs duty.

WEBB: It does? Do government corporations, companies, pay duty on their imports?

CHELLIAH: Yes.

WEBB: They do. It's a true payment. It's not offset by a . . .

CHELLIAH: No. Well, they may get something else up ahead, but it's unrelated.

LEWIS: This has been very informative. Your report will be out—is it going to be out in public?

CHELLIAH: No, not now. I think they will publish it, put it on the table of the house, Parliament, when they act on it. And then they will say, “We have accepted this” or “We’ve not accepted this.” So February.

WEBB: There's a lot of history happening right now. [all speaking at once]

LEWIS: Yeah, this is a very eventful time, this period.

KAPUR: At the same time, you know, I mean, is it within the terms of reference not only to look at the revenue raising side but also the expenditure side?

CHELLIAH: Not expenses.

KAPUR: Not on expenses.

LEWIS: How large is your committee? About how many?

CHELLIAH: There are four people besides me. One is the director of this institute, and then the people who have worked, served on the board of the . .

[End Tape 1, Side B]
[End of interview]