Board Meeting of February 18, 1999
Statement by Ruth Bachmayer

India - Country Assistance Strategy - Progress Report
India - Andhra Pradesh Power Sector Restructuring Project

First of all, I commend management and staff for updating the Board on developments in India through the CAS Progress Report which is being presented to us today.

Despite its still high growth, India seems to be in a difficult position, given the fragile political structure and the difficult external environment. It seems that for political reasons, because of opposition to economic reforms as well as loss of competitiveness of the Indian industries and "crowding-out" of Indian exports by products from countries that have heavily depreciated in the past 15 months, growth may not be sustainable in the near future. Nevertheless, in spite of these possible developments, we support the view that the major components of the current CAS for India still hold.

Also, the fiscal situation is deteriorating rapidly, both on the level of the central budget and the state level. We are very concerned about the fact that non-developmental expenditures as a percentage of the total budget have apparently increased sharply as compared to the previous year. Opposition against expenditure cuts seems to be very strong and we understand that non-developmental expenditures may be more difficult to curtail than spending on development.

We would appreciate more information by management on what the central government and the states are planning to do with respect to budgetary and tax reform and the improvement of revenue collection, and what the prospects of the public administration reform both on the central as well as the state levels are. From notes under paragraphs 20 and 56 on Uttar Pradesh and on subnational lending, we understand that the fiscal situation of some states is unsustainable, and we wonder what tradeoff between fiscal implications and worsening of poverty it may cause in the coming period.

In the context of pervasive poverty in the Indian society and of the recent external political circumstances, the budgetary reform and the expenditure cuts call forth two serious questions:
1. The first question regards the increase of military expenditures: it is crucial that India shifts the structure of budget expenditures in the direction of battling sweeping poverty, illiteracy and basic human needs. We strongly suggest that management launches a Public Expenditure Review to analyze and discuss with the Government where priorities could be reoriented mainly towards poverty and development related issues.

2. The second question relates to poverty, inequality and human development indicators. Quantitative information on these elements is very modest in the CAS Progress Report, and we wonder whether management has more data on these areas.

My last remark on the CAS Progress Report relates to the notion in paragraph 3. on India’s experience during the Asian financial crisis. As the report mentions, the Indian economy has been largely insulated from the immediate impact on the East Asian financial crisis due to a combination of several elements of monetary and capital markets policies. Together with some other countries, the Indian experience could provide an interesting example of how, for instance, moderate capital controls that are consistent with general principles of a market economy, may be used, at least temporarily, to protect countries with weak financial systems from financial crises and provide them with more time to strengthen their domestic financial systems. Yet, capital controls should not be seen as an alternative to financial sector reforms. We were pleased to learn from the Progress Report, that the Indian government and the Reserve Bank of India are serious about the financial sector reform. Having learnt from the East Asian crisis, we would, however, appreciate if more attention could be devoted to this area in the next report on India.

**Andhra Pradesh Power Sector Restructuring Project**

In principle, we welcome the overall focus and structure of the project. In our view, it would also be important to give a signal to those states of India, whose governments show a clear commitment to reforms, that they can rely on the Bank’s support. Andhra Pradesh seems to be the leading state in the strong commitment to reforms and based on these merits would deserve support.

Although the project is in line with the Bank’s strategy outlined in the CAS and aims to mitigate major fiscal imbalances and to support reform, we do not see its direct link to the support of basic human needs projects. We, therefore, wish to be recorded as abstaining.

We have, nevertheless, a couple of comments on the proposed project and the series of APLs to finance the power sector restructuring program of Andhra Pradesh.

1. Even though the government of Andhra may try to find social consensus regarding the power sector reform, we are under the impression that the social impact of the project – in the terms of redistribution of income and wealth among various social groups – is rather understated in the report. The elimination of subsidies and the necessary tariff reform will
have an uneven impact on various social groups and should not contribute to an increase, rather than a decrease in inequality.

2. Clear links in the project between the savings on the expenditure side of the budget and the progress of social reforms, the alleviation of poverty and improvement of health and education are missing. In our view, this would be particularly relevant in connection with the previous comment. We believe that progress in these areas could also be used as conditions for the later APLs.

3. We miss in the project a more detailed elaboration on how the project contributes to the improvement of the environmental impact of the power sector, as environmental improvement is one of priorities set in the CAS for India.

Finally, given the great overall loan volume planned for the restructuring program we would like to get clarification from Management how in case of approval of the first APL the Board will be involved in the subsequent APL decision stages.