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Interview: Montek Singh Ahluwalia, India's Minister of Planning

'Fiscal targets are useless without growth'

Ahluwalia says that surplus in important, but without investment cuts. This is what ensures long-term expansion.

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Special envoy to New Delhi

It is not enough to meet fiscal targets by cutting investments. Montek Singh Ahluwalia, India's Planning Minister, a country that grows 8% per year, questions the quality of fiscal adjustments and the imposition of primary surplus targets. "These targets can lead to the slashing of expenditures that are important in the long term," the minister said during the interview.

In a replay of the debate between Minister Dilma Rouseff (Predient Lula's Chief of Staff) and then-(finance) minister Antonio Palocci, Ahluwalia is disputing with his Finance Ministry colleague, P. Chidambaram. Chidambaram's dharma (duty) is to cut expenditures, while the Planning Ministry struggles to spend. Ahluwalia is close to India's Prime Minister, Manmohan Singh, who will visit Brazil on the 11th.

Both are Sikh and have worked together many times since 1979. Ahluwalia left the International Monetary Fund in 2004 for the Indian government after an invitation from the prime minister. In the IMF, he was director of independent evaluation – a kind of Fund Ombudsman. For him, Brazil is on the right track, but fiscal austerity is not enough. "It has become obvious that fiscal prudence alone does not ensure growth. It is one thing to have deficits in order to increase subsidies, but it is quite another to have them to build roads, bridges, schools…" India has a fiscal deficit of 8% of its GDP, and a gross public debt of 70% of GDP.

Brazil and India have similar characteristics. You have adopted a Fiscal responsibility Law.
Yes, we followed your example and adopted in 2003 the Fiscal Responsibility and Budget Administration Act.

How is the law doing?
I am skeptical regarding the use of fiscal responsibility legislation as an instrument to ensure budget prudence. In the world, views have changed regarding laws for deficit control. One only needs to remember that there was much enthusiasm with the Maastricht criteria in the European Union, but countries, when faced with difficulties, did not hesitate do get rid of them. I do not advocate squandering resources.. Fiscal austerity is very important, but I do not believe that these laws ensure good behavior. There is the risk of cutting expenditures that are important for long-term development.

So, do you believe that there is space for an anti-cyclic fiscal policy?
Yes. In reality, there should be counter-cyclic policies and, in some cases, even pro-cyclic. The most common argument is that, when the economy is growing, fiscal policy should be contractive (the deficit should be reduced), so that there is space for fiscal expansion when there is a slowdown. However, one could also argue that, when things go well, many investors get psychologically optimistic with the economy and this is the time to increase the deficit and invest. There is also the problem of the quality of the deficit. One thing is to increase the deficit in order to increase subsidies, but it is quite another to have them to build roads, which will accelerate growth.

How big is India's public deficit?
The central government's deficit is expected to be 3.8% of GDP this year, while the consolidated public sector deficit is 8% of GDP.

Is there an explicit target for deficit reduction?
Our fiscal responsibility law stipulates that the current central government deficit decrease from 3.8% of GDP to 3% in two years. This means that the deficit must fall to 3.4% next year. There are questions about this target – it should not be established without a specific debt-stabilization target and projected growth rates. If we grow by 6%, we could have a 3% deficit. However, if we grow by 9%, as at present, we could have a higher deficit.

What drives India's growth?
From the supply side, its technology services and some industrial sectors, which have become much more competitive. From the demand side, growth is driven by consumption.

Does the IMF pressure India to reduce its public deficit?
The IMF does not pressure countries that do not need Fund loans. They do not bother us, and they do not bother China. They say: an 8% public deficit is too high. We say yes, we know, we would like to reduce it. That's it. If we had to call on IMF loans it would be different – then they would really be tough.

What about the risk rating agencies, do they pressure India to improve fiscal performance?
The agencies used to classify us as a risky investment (below investment rate). Now we are at the first level of the classification, which is investment grade. This comes with growth and the increase in investment. The agencies delayed in giving us the upgrade because they focus too much on the fiscal deficit, instead of looking at the whole picture.