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India is yet to solve fundamental problems on fiscal side: Eswar Prasad, Brookings Institution

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ET Now Nov 28, 2014, 04.17PM IST

In a chat with **ET Now**, **Eswar Prasad**, Sr Professor, Cornell University & Sr Fellow, Brookings Institution, shares his macroeconomic outlook. Excerpts:

ET Now: Global investors see much more enamoured India once again. In fact, even though the macro fundamentals have not really changed sufficiently as to warrant this kind of enthusiasm, is that a danger of hubris overtaking us once again?



Eswar Prasad: There is certainly a risk when international investors pile into one country with so much enthusiasm, but one has to recognise that we are still in a very low interest rate environment in the advanced economies. Although there is some notion of the US beginning to raise interest rates perhaps some time in 2015, but if you think about international investors looking for a place to get better yield, then they can get in the advanced economies.

In China growth is slowing down, and other big emerging markets like Brazil, South Africa and Russia are facing very difficult economic circumstances. So India looks like the one bright spot and certainly with the inflation falling, the current account deficit coming under control and Prime Minister Modi beginning to embark on a fairly broad reform agenda, there is a sense that for India there is nothing but upside.

There is certainly the risk that if a lot of money comes in on the assumption that there is nothing in India but upside and then the Fed starts entering its interest rate tightening cycle, which leads to a pullback from the emerging markets, that is going to make things a little difficult for India. But still with the rupee, where it is right now with a higher level of foreign exchange reserves that was the case about a year ago, and with the economy beginning to generate some momentum, India is a lot less exposed than many other emerging markets.

ET Now: How do you see the economy today? Is the improvement in our macro fundamentals real and sustainable or is it contrived and temporary?

Eswar Prasad: My hope is that it is something more durable. Certainly if one looks at the inflation picture, which looks a lot better than anyone had expected a few months ago, part of that is due to base effects which the RBI itself has recognized are going to disappear.

If you look at the fiscal position, it is certainly improving in some dimensions, but again there has been a bit of a halt with revenues not coming as strong as one might have expected. I do not think we have solved the fundamental problems there as well.

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And then as one starts looking at other issues of macro reforms on subsidies, on infrastructure, on labour laws, on all of these, there is certainly a positive momentum, but we are a long way yet from saying that India has a durable recovery or is on a path towards sustained high growth.

ET Now: There has been a talk of a Modi dividend. Has the dividend played itself out completely and how long will this change in sentiment alone see us through?

Eswar Prasad: Now Mr. Modi has certainly been very reluctant to lay out a very broad and sweeping agenda and I, among others, felt that that would have been useful that he could have started out by laying out a broad agenda and by beginning to pluck some low-hanging fruits in terms of reforms.

ET Now: Yes, the Modi government does seem to be opting for slow and gradual reforms rather than any big bang reform yet. There are many areas where we do need root and branch reform. So is this a luxury that we really cannot afford?

Eswar Prasad: The masses have to be convinced that this is in their interest. So getting governance right dealing with the corruption problem, there is some logic to making sure that those elements are in place before you embark on very broad reforms because in a country like India or for that matter China, there is always the concern that economic reforms, although they might benefit everybody in the long run, in the short run the benefits are largely going to go to the political and economic elite.

Bringing the masses on board, convincing them that the reforms are going to be in their interest even in the short run, there is a lot to be said for that. Now having said that there is still the issue that unless some of these reforms are put in place fairly quickly, all the other aspects the macroeconomic stabilisation and so forth will not really put India on a high growth track.

ET Now: So could there be a case for a stimulus -- either monetary or fiscal -- to get us out of this low-growth trap?

Eswar Prasad: My sense is that the focus on macroeconomic stabilization, ie. bringing deficits and the level of public debt under - apart from inflation -- under control, is really the best contribution that the macroeconomic policy can play in terms of boosting growth. That is because ultimately even though fiscal and monetary policies might provide a short-term boost to growth, unless the structural problems in the Indian economy are sorted out -- that lead to higher productivity growth, better allocation of resources to the financial system -- we would not have really a strong and durable growth.

So my sense is, rather than relying on short-term macroeconomic stimulus, we really need to focus on the structural reforms and taking the eye of structural reforms while focusing on macroeconomic stability might not serve the country that well either.

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