Indivjal Dhasmana | New Delhi November 09, 2012 Last Updated at 00:38 IST

It is very important for the RBI to focus on inflation: Gita Gopinath

Interview with Professor of Economics, Harvard University

Gita Gopinath, professor of economics at Harvard University, estimates India's economic growth at 5.5 per cent for this fiscal. She tells *Indivjal Dhasmana* in an interview that even Centre's revised fiscal deficit target of 5.3 per cent of GDP is optimistic. Well-known for her work on sovereign debt defaults in Europe, Gopinath says that it will take a couple of years more for the euro zone crisis to be over and one has to watch about fiscal cliff in US. Edited excerpts:

Q. After the RBI kept the key policy rate intact, differences cropped up between the Finance Ministry and the central bank over the monetary stance. In a debate over growth versus inflation, which side would you take?
It is very important for the RBI to focus on inflation. It has had some success in bringing down inflation to 7.81 per cent. Without help from the fiscal side, inflation control should remain a priority of the RBI. Besides, a large part of the slowdown in growth in India is due to an uncertain policy environment and lack of implementation of reforms. To blame slowing growth predominantly on high interest rates would be wrong.

Q. What is your projection of India's economic growth this fiscal?
I will say 5.5 per cent.

Q. Since September this year, the government has taken a slew of reform measures and steps like diesel price hike for fiscal correction. Do you think it will spur growth?
I think these are good signs for growth. The concern that remains is that reforms are undertaken only when the economy appears to be close to the brink of a crisis, such as the recent risk of a downgrade of India's sovereign rating to non-investment grade. This is disheartening. Reforms in India need to take place on a consistent basis and especially when the going is good. I will not describe these recent reforms as major, but given the policy inaction we have witnessed over the last two years it is a positive sign. Ultimately, major reforms such as full deregulation of fuel prices, attracting large investments in infrastructure and labour market reforms will have to be undertaken, and that, too sooner rather than later.

Q. How important should India take warnings by credit rating agencies about cutting its sovereign ratings? Economists like Joseph Stiglitz have raised questions over the credibility of these ratings agencies themselves.
Credit rating agencies are infamous for being wildly off on their risk projections. That said, it is one thing to be downgraded from AAA status to AA+, and a completely different thing to go from investment grade to non-investment grade. In the first case, markets can ignore the rating changes to some extent, which they have in the case, for instance, of the US. If you go from investment grade to non-investment grade, that is a very distinct change. On the other hand, most investment banks have strict rules that limit their exposure to non-investment grade bonds and this can trigger a larger negative response from investors.

Q. Finance Minister P Chidambaram has announced a fiscal roadmap. According to this, the Centre's fiscal deficit will now be cut to 5.3 per cent of GDP in the current financial year, against the Budget Estimate of 5.1 per cent. Do you think it is feasible in the current circumstances?
At this point, everybody is happy that the government is demonstrating a lot of intent. There was some concern that even that was not there. So, the fact that they are at least showing intent is a positive sign. But, in terms of actual implementation and whether something will come out of it, one has to wait and see. The promises contained in the Fiscal Responsibility and Budget Management (FRBM) Act have not come to fruition, so there is reason to be cautious in one's optimism about containing the fiscal deficit.

Q. Is the government target of reining in the Centre's fiscal deficit at 5.3 per cent of GDP realistic?
It is an optimistic number, given the fact that previous targets have not been met.

Q. Next year will be the last budget of this government. Do you think it will be an election budget and the fiscal consolidation process will be thrown out of gear?
I think there is a real risk of that. If the current round of reforms somehow manages to boost growth relatively quickly, the government may be able to claim that it knows best and push through other tough measures. But if growth remains weak — the more likely scenario — then I don't think there will be an appetite to take on serious fiscal cuts, and I am concerned about that. This is typical — in a pre-election year budget, tough decisions are not taken.

Q. Many analysts say that anti-corruption movements which are going on in India will further delay decision making. Your take?
I don't think you can fault the anti-corruption movement for the inability of the government to undertake reform. The government needs to be viewed as being efficient and transparent in its decisions. The recent Cabinet reshuffle has tried to address some of these concerns.