

Comments by

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*India: Today's Fiscal Policy Imperatives Seen in the Context of
Longer-Term Challenges and Risks*

by Peter S. Heller
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I would first of all like to thank NIPFP and IMF for giving me this opportunity to participate in this interesting conference and interact with Peter Heller after a gap of several years. It has been my experience that he usually has an interesting and original perspective on conventional issues and this paper is no exception. The paper looks at the long term challenges facing India as a rationale for fiscal consolidation. I have not seen many papers that adopt this approach. The basic argument of the paper is quite straightforward. A large number of long term risks or challenges are facing India. To cope with these, the Government needs enough fiscal leeway. This is an additional case for urgent fiscal consolidation over and above the conventional arguments usually cited in this context. My comments on the paper are summarized below.

1. The paper provides a list of 12 long term challenges facing India. These range from current challenges such as the spread of HIV/AIDS, urbanization, and providing a viable social insurance system for a vast population to challenges like climate change, man-made disasters and national security. Each of us could come up with our own favourite list of the top 12 challenges. While some of these would be common to many lists, others may be less frequently cited. However we can take Heller's list as given and set them aside since the choice of specific items on the list do not affect the argument of the rest of the paper.
2. A more important issue is how to prepare for coping with major challenges facing a country. Heller's suggestion is that all new policies of the government should assess and indicate the fiscal implications of the policy. This is clearly a useful idea for fiscal consolidation. However, it is not clear why it should be applied only to new policies. Why not also assess the fiscal impact of existing policies? Moreover it is not clear how this exercise, while useful in itself, would specifically prepare the fisc to better cope with long term challenges; except in the generic sense that any measure that helps fiscal consolidation would better position the government to cope with shocks.

3. What would actually be useful to specifically prepare for key challenges, such as those listed by Heller, is to translate their fiscal impact into possible scenarios citing some actual numbers. So far not much of this has been done either in this paper or elsewhere as far as I know. This is a good field for future research.

4. Finally, it is relevant to ask what is the probability that the Indian Government will take the advice of the paper seriously to undertake fiscal consolidation in order to prepare for long term challenges. I am somewhat skeptical, because the government has not embarked on a strong fiscal consolidation program even to address the more immediate short term risks of large deficits and burgeoning public debt despite frequent alerts regarding this issue by policy advisors, academic experts, multi-lateral organizations and other stakeholders. Some of us believe that the burden of servicing a huge public debt, amounting to 75.5% of GDP, is already crowding out public investment directly through the budget and also crowding out private investment, at least among small and medium enterprises, via the financial sector. We see today the peculiar paradox of unsatisfied borrowers along side a large over-hang of liquidity. This is because risk - averse loan officers are reluctant to lend to small and medium enterprise private borrowers when the banks can make substantial profits through riskless lending to the government at fairly large margins over the borrowing rate. It is arguable that there is lost growth to the tune of 0.5% to 1% annually because of investment that has been crowded out. Even these immediate concerns have not led to a strong fiscal consolidation effort, presumably because of over-riding political compulsions which drive governments to spend beyond their means. It is therefore unlikely that the threat of potential problems 10 to 20 years down the road will galvanise governments into policy action for fiscal consolidation.

5. I have explained why I am not persuaded by the basic argument of the paper. At the same time, the paper serves a useful purpose because it points by implication to an important tension between the short political time horizons of policy makers and the long term perspective required for prudent macro-economic management.