

A Practitioner's Policy Perspectives

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A long with the real pain that the global crisis has inflicted, another casualty is the professional competence and credibility of economists. Bankers and hedge fund managers may be reviled, but we know what they stand for and expect them to do what they did. We economists are supposed to serve a broader public good: our role is to protect the economy from the distortions, imbalances, and bubbles that are – and were most recently – followed by severe dislocation. So why did we not see the mess hurtling in our collective faces? If we did see the risks, why then did we not speak louder about the dangers? And, why especially did we not espouse and work to institute policies that would have prevented or limited the damage?

The fact that some saw it coming and did warn of the dangers is even more of an indictment since what is transpiring today could have been and was visualised and articulated. And yet the profession as a whole was either asleep at the switch or, worse, applauded the very dynamics that have proven so devastating. In a recent comment, Barry Eichengreen (2009) says that economists are subject to fads and trends because the penalties for departing from social norms are large. Hence, even though the tools and perspectives to question the prevailing normative view are available, the incentives to adopt them are minimal.

Monetary Policy in a Globalised Economy by Rakesh Mohan (*New Delhi: Oxford University Press*), 2009, pp xx + 328, Rs 795.

In this context, pragmatic policymaking is at a premium, not least to buck the fashions to which we fall victims. Rakesh Mohan sees such pragmatism as the key role of a practising economist. It is in the practice of economics that the rubber, so to speak, hits the road, the theories are tested, the validity of parameters is assessed, and the cold reality of politics is faced. He speaks of the recurring conflicts in objectives faced by policymakers. In resolving these conflicts, he questions and prods, often pushing back on views widely held by academic and other practising economists.

In his practice, Mohan reports, the Eichengreen challenge was always present. But because the risk of being marginalised is high, bucking the orthodoxy requires clarity of perspective and determined persistence. Both of these are amply in view in this book, which brings the speeches Mohan delivered as deputy governor of the Reserve Bank of India (RBI) from the early years of this decade, along with an extensive introduction and an “after word” that reports on the ongoing global financial and economic crisis.

The guiding thesis of the book is that the conduct of Indian monetary policy and the achievement of financial stability were

cast within broader developmental priorities and, as such, were subordinate to them. Thus, the political process reached two crucial determinations:

- Fiscal policy was to be a developmental tool.
- “Inclusion” was a priority.

Macroeconomic Stability

A developmental fiscal policy had far-reaching implications for the pursuit of macroeconomic policy and stability. Sizeable and recurring budget deficits became the norm, with few checks until the Fiscal Responsibility and Budget Management (FRBM) Act came into place in 2003. The Indian achievement is that macroeconomic stability has been maintained despite the large budget deficits. Although inflation has, at times, threatened to flare up, it has remained largely contained, especially when viewed against the experience of other developing nations. Moreover, India's current account deficit has been stayed in a relatively narrow range, rarely exceeding 2% of the gross domestic product (GDP), and always significantly smaller than the fiscal deficit. In practice, therefore, Indian households have entrusted their considerable savings to the government for investment in their futures.

Monetary Policy

In this setting, Mohan concedes that the RBI has essentially played second fiddle. Monetary policy has been dominated by fiscal considerations, although he speculates that this is changing as the FRBM is enforced. External stability has required that even as the capital account has been

gradually liberalised, restrictions have been used to prevent sudden and large capital movements. The RBI's role has been to maintain the "grains of sand" in the wheels that interface India with international finance. Mohan views this balancing of gradual liberalisation while yet restraining the full operation of market forces as a valuable achievement.

Although by his own account of fiscal dominance there has been limited basis to practise inflation targeting in India, Mohan's has been one of the sceptical voices in this regard. That scepticism has gained ground internationally as the ongoing crisis has unfolded. The elegance of one objective – an inflation target – for the central bank notwithstanding, the notion that a central bank can restrict itself to that single objective has increasingly been questioned. In various forms, central banks are engaged in supporting economic activity. And in tracing the sources of the current crisis, critics are bolder today in asserting that the run-up in asset prices (the asset price "bubble") should have drawn quicker attention with measures undertaken to deflate that bubble. While the critics of inflation targeting acknowledge that a central bank cannot pursue a multitude of objectives, practitioners, such as Mohan, think that a pragmatic balance can be achieved.

Financial Stability

If Mohan reveals his political predilections, he comes closest to doing so in endorsing the notion of "financial inclusion". In this, he appears to be guided by the literature that access to financial services can be a spur to growth. A policy and institutional framework that creates such access for the poor is, therefore, desirable since it addresses both growth and equality objectives. As a consequence, he sees India's large financial apparatus through this lens. While ready to question orthodoxy in most contexts, he does not here explore alternative approaches to achieving inclusion nor to the possibility, as famously proposed by Joan Robinson, that finance follows enterprise.¹

Within the institutional framework that has thus evolved, with the very sizeable presence of public financial institutions, regulation and supervision of the financial

sector have evolved in ad hoc ways. The details are many, but the theme is one of restricting banks' risk-taking activities, guiding them instead to transfer household savings to finance governmental activities. As with the restrictions on the capital account, these restraints on banks, Mohan suggests, have been a pragmatic approach to maintaining stability. He does acknowledge that India and the world are changing in ways that the restrictions that currently serve both developmental and stability objectives will increasingly need to accommodate more varied Indian needs and international trends and thus will, in the future, require more sophisticated approaches to achieving financial stability.

For students of the Indian economy who also seek a special understanding of India's monetary and financial policies, this book will be an invaluable guide. It presents a careful and current account of developments with an analytical eye, placed in the context and language of ongoing international policy debates. For readers seeking to assess the pulse and rhythm of India's ginger steps from the safety of domestic finance to the choppier waters of international finance, the book offers a calibrated prognosis. The discussion of broader international debates – on such matters as global imbalances –

appears throughout the book and always provides a helpful summary.

A book that is derived from speeches is hard to pull off. This one comes close. The sequencing is thematic and the cross-referencing is judicious and useful. But, in the end, speeches do not make for a snappy discussion of key policy trade-offs. The edge is lost in the effort to be comprehensive and fair. A follow up should be the next project. I look forward to a more pointed but yet pragmatic perspective on the policy debates with, perhaps, a more personal angle and more vigorous questioning of long-held beliefs, predilections, and premises that have informed Indian policy. Who better to deliver such a follow up than one embarking on a new career as a professor?

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NOTE

- 1 A "Finance Follows Enterprise" perspective would view education and decentralisation as the primary motors of inclusion, with finance playing a facilitating role. See Mody (2005).

REFERENCES

- Eichengreen, Barry (2009): "The Last Temptation of Risk", <http://www.nationalinterest.org/Article.aspx?id=21274>, From the May/June 2009 issue of *The National Interest*.
 Mody, Ashoka (2005): "Quest for Inclusive Growth: Continuity and Constraints in Indian Economic Policies", *Economic & Political Weekly*, 10 September.



CALL FOR PAPERS

Institute of Development Studies Kolkata is planning to organize a national conference on **Gender, Empowerment and the State** to be held on **10 and 11 December 2009**.

This conference proposes to explore conceptual and empirical issues in defining and measuring empowerment, how the issue of gender is incorporated in State policies, the extent to which women are targeted in different schemes and programmes, and to what extent the State has succeeded in empowering women. Papers are invited on any of the following themes: (1) Conceptual and empirical issues in defining and measuring empowerment; (2) Role of the State in empowering women; (3) factors inhibiting participation of women in Government schemes; (4) Gender sensitiveness of Governments programmes and policies; (5) Targeting of women in Government programmes; (6) Means to increase participation of women in Government programmes; (7) Any other issues.

Authors are requested to submit 300-word abstracts by 11 September 2009 to **Dr. Zakir Husain (dzhusain@yahoo.com)**, Institute of Development Studies Kolkata, 1 Reformatory Street, Calcutta University Alipore Campus, 5th floor, Kolkata - 700 027. For details please visit our website www.idsk.edu.in. Shortlisted authors will be invited to submit full papers by 23 October 2009. The papers may be subsequently published in an edited volume. Outstation participants will receive AC III-tier rail fare and local accommodation.