

## Book Review

### **I do what I do. By Raghuram G. Rajan, Harpers Collins Publishers India, 2017, pp. xvi + 325, Rs.699**

#### **Transforming a Fragile Indian Economy to Stable One: Role of Monetary Authority**

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The monetary authority must be independent enough in a developing economy so as the balance between growth and inflation rate can be maintained. The portfolio of the Governor of Reserve Bank of India (RBI) is therefore, a challenging one that requires an eagle's eye on various economic activities to cater to the development with justice; a primary need of Indian economy. Raghuram G. Rajan had been a Chief Economist of the International Monetary Fund (2003-2006) and had joined as 23<sup>rd</sup> Governor of the RBI on 4<sup>th</sup> September, 2013. A contestant in the race of being Nobel Laureate in the field of Economics in 2017, the star governor Dr. Raghuram G. Rajan shares his insights of functioning of RBI and intellectual moves taken during the critical conditions of Indian economy in his manuscript, *I do what I do*. At the time of his joining, India was declared a 'fragile' emerging market and international investors were losing confidence in Indian economy amidst high inflation, severe current account deficit, and in free fall of rupee. Being Governor of RBI, he believed that four messages i.e., building confidence of public, commitment of low inflation,

boldness, transparency and predictability of RBI needed to be spread to uplift the economy out of the 'fragile' status. When rupee was severely falling, Raghuram Rajan's intelligent move made \$26 billion inflow into India through three-year foreign currency non-resident (FCNR) deposits on the condition that rupee would swap into dollars at a cheap rate to uplift confidence in Indian currency across the globe and hence rupee started appreciating. This process of making Indian currency stable made him 'rock star' central bank governor. Since the rupee had been stabled, second mission was to disinflate the economy. During the period of his joining, India had highest consumer price index (CPI) among the large countries because of excess demand.

As stressed upon by Subbarao (2016), the succeeding governor Raghuram Rajan too highlighted that RBI's foremost objective is monetary stability along with inclusive sustainable economic growth. He believes that high interest rate to curb inflation by reducing demand is not a suitable option for Indian economy. Keeping high interest rates

to bring inflation down is not an intelligent action as it can affect demand severely and hence would lead to recession. So RBI has to follow a slow and steady path. Both RBI and Finance Ministry would desire to attain highest possible growth. This is possible only by sustained monetary stability i.e., by lowering inflation in the long run. The author has a view that high inflation can promote high growth in the short-run only.

In the new monetary policy framework recommended by Urjit Patel Committee (2016), the CPI has been targeted instead of wholesale price index (WPI). The WPI underestimates the inflation rate in the economy because consumers experience CPI rather than WPI. The inflation rate was in double digits during April 2012 to January 2014. In new CPI index, the food prices have a weight of 47.6 percent. In India, the author identifies that the food inflation is occurring because of i) shifting pattern of diets like protein rich products have been demanded more now; ii) high minimum support prices (MSPs) are reflected in food prices. As per Rajan's view point, these high MSPs have not been in the interest of farmers because the input costs are increasing in agriculture due to high inflation rates. Instead of announcing high MSPs, removing middlemen, introducing new technologies to enhance farm productivity, making agriculture market free, etc. will help to make agriculture profitable and reduce food inflation rate.

Another objective of RBI after monetary stabilization is enhancement of economic growth rate numbers. The growth

can be enhanced by empowering small and medium enterprises. The small and medium industries in countryside are less affected by global crisis than large industries. To finance these enterprises and remove poverty, we require easy access to financial resources. So this is possible only by financial inclusion and development. The financial inclusion is an essential building block for sustainable economic growth of India. The financial inclusion in India has been encouraged through effective initiatives like Pradhan Mantri Jan Dhan Yojana and Mudra Scheme. India is having one of the safest, cheapest, and alert banking networks across the globe. The payment banks, technology, banking correspondents, and mobile banking are playing an important role in achieving financial inclusion. Along with financial inclusion, consumer protection and financial education for their awareness are equally needed especially in the market of complicated products to retain the confidence of people.

To enhance the confidence of people, the RBI will have to reduce interest rates further. The RBI can reduce interest rates significantly only if people expect low rate of inflation in future. The author emphasizes that low inflation with low deposit rate is far better than high inflation with high deposit rate. The RBI has to balance the interests of both savers and investors. The savers interest can be protected in terms of positive real interest rates while a low and stable inflation would help in gaining the confidence of investors too. Stable prices and a positive real interest rate would also enhance

foreign capital inflows to India. The stability of currency would be achieved simultaneously with the stability of inflation rate as both go hand in hand. The RBI always tried to keep the policy rates in such a manner that promote growth consistent with inflation target zone. Further, the government should borrow less so that the burden of interest payments can be reduced and growth can be enhanced. However, in the last decade, an unsustainable increase in Indian current account deficit had been noticed. Indians had invested more in real assets like gold than deposits because of negative real returns on deposits. So country had to borrow from abroad for investment and imported gold payments. Thus, it is hard for people to expect low rate of inflation after the existence of high inflation rates for a decade.

### **PSBs**

The author mentions that credit market was at smooth pace without any distress before Global Financial Crisis. Most of the bad loans had been generated by public sector banks (PSBs) in 2007-09 due to corruption, weak institutions, irrational excitement, and weak legal system. The PSBs in 2007-08 had expected that high growth rate of economy would sustain and persist in future too; a time when banks had made a big mistake. As per the author, following are some solutions to improve performance of banks and smoothen industrial economic activity; i) change in banker's mindset, ii) strict laws and punishments not only against small borrowers but also against large borrowers, iii)

re-opening of bad loans, iv) providing flexibility not forbearance, v) establishment of investigative agencies, vi) more transparency, vii) better governance, viii) high credit risk premium, ix) infusion of better capital structures, x) quick response to bad loans by banks without any delay, xi) clearing balance sheets, xii) pre-lending assessment of project, xiii) post lending monitoring, xiv) continuous lending to even non-performing assets (NPAs) if they are viable, and xv) strengthening banks board by decentralizing. Thus, the privatization is not necessarily the only option to improve the performance of banking sector. The PSBs can also work efficiently through adequate monitoring, technology and information but without government influence. Healthy competition with fair government intervention is the driving force of an emerging economy which would help India to attain sustainable economic growth. Connecting asymmetric information like default with the unique ID would be a major incentive for people to repay. In this era of revolutions, oligopolistic banking system has been replaced with competition in financial markets. As the competition in the banking sector is increasing, it has emerged as profitable but also challenging in terms of risk for bankers. The financial risks are greater in these revolutionary and deepened financial markets. A diversification in investments can help to reduce the said risks. The PSBs, private sector banks, and financial institutions ought to be treated at par in regulatory treatment. The functioning of PSBs ought to be controlled by respective bank board than government.

The author states that steady liberalization of debt market is the best step in a developing country existing in the uncertain world. The debt market has been growing in India at a good pace because low and steady inflation expectations keep the interest rate low for government and borrowers. The financial innovations, infrastructure, more participation, liquidity, adequate regulations, and credit ratings are pre-requisites for broadening & deepening financial markets. Although Foreign Direct Investment (FDI) has been coming to India, but since India has been a current account deficit country, we have to borrow from abroad too. The borrowers should go for only hedged foreign borrowings because unhedged foreign borrowing is a great risk in case of rupee depreciation because borrowers would have to pay a great price.

Accordingly, the risk is essential for the growth of an economy but risk sharing needs to be done equally between the lender and the promoter which is not the case in the present scenario in India. In good times, promoter has been enjoying dividends whereas in bad times, lenders especially PSBs have been burdened with defaults (i.e., losses). The debts of 1.27 percent of GDP in 2013-14 were written off in last five years by commercial banks. Therefore the price of non-seriousness of lender has been paid by sincere savers and taxpayers of the country. Taking credit and investing in a project is a risky task but risk is a must to transpire innovations. However, strict laws against creditors discourage innovations all over the globe. A new bank-

ruptcy code has been enacted by Govt. of India for fairness and clarity of debt recovery and restructuring process. We have institutions like The Debts Recovery Tribunals under the Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002, Debt Recovery Appellate Tribunals, Joint Lending Forum, Participation of Constitutional Courts, Asset Reconstruction Companies, creation of CRILC (large loan database), Strategic Debt Restructuring (SDR) scheme, Scheme for Sustainable Structuring of Stressed Assets (S4A), Fraud and monitoring cell etc. for the resolution of the distress in the debt market. The RBI cannot micromanage every debt but it should recognise NPAs on time. When economy experiences slow growth, recovery of bad loan becomes even tougher. The RBI wants to capitalize public sector banks through government.

### **State of the Economy**

On the discussion of the state of economy in 2013, the author writes that India's slow growth has been the result of monetary and fiscal policies that have been used after Global Financial Crisis in 2008. Therefore, there is pressing need to introduce changes in monetary and fiscal policies. The fiscal consolidation is the key element to improve the situation. A government should always follow fiscal consolidation roadmap in emerging economies like India because disinflation policies here cannot be as strict as in the

developed countries. A tight monetary policy hurts the growth of an emerging and fragile country. So better is not to create a situation where India has to adopt tight monetary policies. A low and stable inflation is necessary for macro-economic stability. This is the impartial opinion given to government of the day by RBI. It is also suggested that public investment, productivity of agriculture, and exports should be enhanced while misdirected subsidies, current account and fiscal deficits should be reduced.

As per the author, Indian economy has been following a competitive, open, and efficient growth path; so the best of India is yet to come. The five pillars of RBI's financial sector policies include strengthening of monetary policy framework, improving and strengthening financial markets and banking structure, financial inclusion, and strict laws for debt recovery.

In a democracy, there is a vicious circle played by corrupt leaders, corrupt businessmen, and poor people. Idea of socialism has been replaced by crony capitalism with each passing day; inequalities, less transparency, and poor competition are obstacles in the path of sustainable economic growth. Among others, poor infrastructure, poor health and education services, poor law and administration, and non-availability of quality goods at ration shops are common features of Indian economy. So the RBI and government come out with the solution of all these problems in the form of direct benefit transfers (DBT). An era of financial inclusion has already been

started by opening bank accounts of all people under the Jan Dhan Yojana through which direct cash is coming into the accounts of poor. The DBT will help them to access the good quality of services privately. If poor people would optimally use these cash transfers by investing in education, health, and saving against uncertainties, it would lead them to economic independence. As suggested by him, Product, Place Price, Protection, and Profits are the five Ps of financial inclusion.

The author follows open economy macro models and argues that FDI is the best form of financing current account deficit. It will bring in new innovations, methods, and technologies. Industrial countries who want to follow inward looking policies these days are dominating in international monetary system. Thus, emerging markets have to strive to create open and fair global trade and finance. India has to invest in its institutions like research departments, universities, and think-tanks to make them strong for domestic-demand-led growth because global market has been facing recession. Working on production possibility frontier through innovations, competition of ideas, tolerance, effective communication, and mutual respect will lead India to sustained economic growth. The 'Make in India' is the best program that Govt. can initiate when economy needs strong industrial growth for sustainable economic growth. Indian planners need to generate domestic demand for domestic manufacturing i.e., Make in India and Make for India. Make in India means enhancing the production efficiency of

mining, manufacturing, services, and agricultural & allied goods. A strong transportation system to reduce transaction costs, adequate supply of energy inputs, electronic and financial linkages, competitive markets, safe workplaces, transparent legal system, improvement in human capital, and analysis of costs & benefits of regulations are pre-requisites for the success of 'Make in India' program.

### **Role of RBI**

Further, transparency, good governance, effective service, flexibility, communication, cooperation, and self-examination are obligatory in an institution like RBI. The Govt. wants to take away the powers (tools) of RBI through the Financial Sector Legislative Reforms Committee (FSLRC) report during United Progressive Alliance (UPA) regime. So he criticizes government's move and believes that RBI can fulfil its responsibility by using all its tools. A strong, trusted and independent RBI is in the nation's interest for ensuring macro-economic stability. To attain a stable growth rate, depreciated exchange rate and lower interest rates cannot go hand in hand. The RBI pays dividend to the Government every year. When Government demands special dividends from RBI, it should realise that they are not free of cost. The RBI gives special dividends to government either through printing new currency or selling Government bonds of same amount to public. Although, RBI cannot become completely independent but RBI's power to say 'No' to central and state Governments needs protection. The RBI Governor has to be continuously in

touch with the Government or Parliament for monetary policies and structural reforms the RBI has been taking. A Governor of RBI has huge responsibility for economic risk management of the country and so should not be downplayed. The RBI should explain the policies and threats of certain actions to public so as people support policies and reforms.

The author is of the opinion that increased liquidity through unconventional methods by developed countries has adverse spill over effects upon emerging economies. In 2007, the debt-fuelled growth proved unsustainable in U.S.A. An independent overseer should scrutinize the policies' domestic benefits and adverse effects on other countries. The Govt. ought to implement the policies that can support long-term sustainable growth, improve the tax collections, invest in innovations and information and technology sector etc. Cyclically sustainable regulations can keep the economic activities on smooth and stable path. Although expansionary policies were the cause of recession but the solution of getting out of it also lie in expansionary policies. It was not the right time to think about accumulated debt in recession rather it was necessary to stimulate demand and growth that prove sustainable.

The deregulation based policies have their own pros and cons. On the one hand, competition has been increased and consumers are blessed with a variety of products at cheap rates. On the other hand, income inequalities have widened to the extent that India has been reported as second most unequal nation

(Shorrocks et al., 2016). In most of the areas, labor has been replaced with capital in this era of high and advanced technology. The demand for skilled and talented workers have grown up and so have their incomes. It is difficult to improve workforce skills quickly and hence an easy access to credit has been provided to boost consumption of unskilled workers. These policies cannot reduce income inequalities but have reduced consumption inequalities.

The economic aid from developed countries to underdeveloped nations will boost growth and eradicate poverty only when it is accompanied with good governance and strong institutions. The author's work with Subramanian (Rajan & Arvind, 2005) reveals that there is no strong positive correlation between economic aid and long-run growth. A proper evaluation, experimentation, and supervision of the projects are required for which the country wants to get aid. The economic aid for education and health services will surely help to attain high growth rates. The aid recipient countries suffer from a 'Dutch Disease' which makes them uncompetitive. High wages funded by aid reflect in high costs of products. The exporters face competition in global market and have to shut down their factories because high-priced products are not sold in international market. In this way, aid recipient country has been thrown out of global competition. The governments, that do not do anything good for their people with debt as well as cannot repay it, must be declared 'odious' regimes by international commission (United Nations); a proposal with its own

consequences. Sometimes repayments depend upon further financing that would not be possible if debt of the country has been declared 'odious'. A high debt hurts growth in poor countries because the private investors in highly indebted countries are reluctant to invest. A dollar-denominated debt has been chosen over domestic currency denominated debt by investors because monetary policies of underdeveloped nations lack credibility. They fear that debt would be repaid by higher taxes, hence would reduce the profits. Debt forgiveness would be beneficial for the country only when it improves business climate with even regulations and generates resources to use them efficiently.

At the end of author's term as RBI Governor in 2016, economic position of the country had been far better than it was planned to achieve. There was stabilized currency, highest foreign exchange reserves, inflation within target zone, and positive real interest rates on deposits. The tag on the country had been changed from one of the 'Fragile Five' to 'fastest growing large economy' in the world and thus, the author succeeded in performing the major duties of the governor of the central bank of a developing country like India.

However, the author's contribution is on the simple operations and duties of a central bank governor like the manuscript by Subbarao (2016); a predecessor of him. Only, the experiences of the author on the functioning of RBI have been shared that do not justify the title of the book in any way. The author in his book

writes: “The title of this book reflects the serendipitous nature of public life. I enjoyed the give-and-take of press conferences after monetary policy meetings, especially because I knew most of the reporters. As one conference was ending, I was asked (yet again) by a familiar face whether I was dovish like Yellen or hawkish like Volcker. I understood what the reporter was asking, but I wanted to push back on the attempt to pigeonhole me into existing stereotypes. Somewhat jokingly, I started in a James Bond-ish vein, ‘My name is Raghuram Rajan...’ To my horror, mid-sentence I realized I did not know how to end in a way that did not reveal more on monetary policy than I intended. So with TV cameras trained on me, I ended lamely ‘...and I do what I do”.

It projects the picture of a moody speaker rather than the statement of an intellectual thinker. To sum up, this book by Dr. Rajan proves to be a journey through the rough and gloomy state of the almost shattered Indian economy to the ‘fastest growing large economy’ in the world. Role of RBI, banking systems, financial inclusion, monetary and fiscal stability, global financial crisis etc. are some of the important aspects covered by the author. Throughout his tenure of being Governor, the author had been optimistic and confident even in the most adverse economic times of country. Each problem has been explained in a lucid

manner and how a relevant and effective solution had been provided to it has also been elaborated. The scholars in the field of macroeconomic research in general and monetary economics in particular can learn extensively through this book since domestic and international economic instabilities have been wisely dealt with.

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