

India's Reforms Through the Lens of Dr. Rangarajan

A book review of *Forks in the Road: My days at RBI and Beyond* by C. Rangarajan

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Recent crises in most of the economies in the world, and especially in India's neighbourhood, remind us of the difficult times that the Indian economy had passed through during the 1991 balance of payment crisis. While the present crisis is leading some economies to default on their payments -- some approaching the IMF for aid, and a few others going for bilateral aid -- India came out of the crisis less scathed.

Since then, with a wide range of reforms, the Indian economy has not looked back; despite a black swan episode in the form of Covid-19, and even with intermittent shocks such as Y2K and the 2008 global financial crisis, India has become a 'bright spot' in a troubled global economy. It remains one of the fastest growing large economies in the world. This suggests that, in the three decades since the 1991 crisis, India must have put in place prudent policies, that made the economy less vulnerable to shocks compared to other economies.

It is important to put in one place all the policy changes that have been implemented since the 1991 crisis. However, as the reforms happened in many spheres -- fiscal, monetary, financial, external, trade, regulations, banking, technology, statistics, etc., - it is quite a task to document and discuss all these changes in one place or by one individual.

We are glad that now, after three decades, we have a volume that narrates the journey of India's regime changing economic reforms, and also how the Indian economy has performed through these reforming years. This could have been possible perhaps only by two individuals -- Dr. C Rangarajan and Dr. Manmohan Singh. The volume under review is written by Dr C Rangarajan, and dedicated to "*Dr. Manmohan Singh, whose vision and courage opened up new vistas and opportunities for India.*"

"Forks in the Road: My days at RBI and Beyond" was supposed to be a (long-awaited) memoir. As noted in the introduction, however, Dr. Rangarajan consciously made it more into a chronicle of events and the processes behind those events, rather than focusing on personal elements and

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anecdotes. (Only in chapter 13, 'Raj Bhavan Days', does the book highlight a few very interesting anecdotes).

The major part of the book covers Dr. Rangarajan's days at RBI - first as Deputy Governor and later as the Governor. Out of 16 chapters, excluding the concluding one, 12 chapters focus on his RBI days, while four chapters cover his contributions as Governor of 4 Indian States, his contributions to fiscal policy as the Chairman of 12th Finance Commission, his time as a member of Rajya Sabha, and his long innings as Chairman of Economic Advisory Council to the Prime Minister. The chapter on 'Advice to Government' covers his contributions to public policy as Chairman of various committees, ranging from savings/investments, financial inclusion, petroleum taxation, Jammu & Kashmir, HIV AIDS in Asia, sugar, National Food Security Act (NFSA), poverty estimates, etc.

This review does not aim to summarise the book. Rather, an attempt is made to highlight the critical role Dr. Rangarajan has played in a few major policy decisions, that have permanently changed the shape and destiny of the Indian economy. Here Dr. Rangarajan cautions, especially to fellow economists, that policy recommendations and decisions are the result of a confluence of analytics flowing from theory, data, and -- importantly -- judgement, and not about being slaves to one or the other school of thought.

On monetary policy, Dr. Rangarajan's major contributions start from his association with the famous Sukhomoy Chakravarty Committee, which -- the book says -- in some sense paved the way for smooth transition for RBI and monetary policy in the post-1991 period, with an array of proposed reforms in all the aspects that are under RBI's preview. The introduction of Open Market Operations (OMOs), the historic agreement between RBI and Government of India to dismantle the automatic monetization of ever-growing fiscal deficits, and the adoption of the monetary targeting regime are the outcomes of the Chakravarty committee.

In all writings on inflation and monetary policy, Dr. Rangarajan has focused on the money supply growth, and his beliefs on stability of demand for money are well-known. Indeed, Dr. Rangarajan is a staunch believer that inflation can be managed only by managing money supply growth. The book quotes Milton Friedman's famous statement -- "inflation is always and everywhere a monetary phenomena". Indeed, those who have read Dr. Rangarajan's recent (post-Covid) writings would know that he attributes the current bout of inflation in the global economy to excessive money supply growth, leading to sharp interest rate hikes by the advanced economies.

In the last chapter on 'Some Ruminations', Dr. Rangarajan highlights excess liquidity as the root cause of inflation in India as well. He disagrees with some of his critics about whether the policies pursued during his Governorship can be termed 'monetarist' (p.112), arguing that pure monetarists believe in fixed rate of growth of money supply, while RBI was following a flexible money supply targeting, and this has actually laid the foundations for what we follow now as flexible inflation targeting.

While the relation between money supply and inflation are empirical issues, and these relations are time varying (whether to target M1 or M3), one aspect that is important to highlight is the way RBI under Dr. Rangarajan had a great co-ordination with the Finance Ministry under Dr. Manmohan Singh. It is no wonder this book is dedicated to Dr. Singh; if one wanted to understand why this co-ordination between fiscal and monetary authorities is very important for macro stability, one may want to read the books published by successive RBI Governors. Indeed, only after many years are we now seeing better co-ordination between fiscal and monetary authorities.

The outcomes of such smooth relationships are clearly visible in how India managed the 1991 crisis, as well as the Covid and post-Covid crisis, in ways that resulted in macro-financial stability. After reading this book, and also looking at recent developments, one can easily conclude that fiscal-monetary co-ordination is a public good.

On the question of rules versus discretion, which is a major area of research in monetary economics, the book (p.212) makes it very simple, concluding that rules cannot be too rigid, while discretion reduces accountability. The book ends by saying “...in the final analysis, we need both rules and discretion.”

On banking and the external sector, RBI under Dr. Rangarajan has introduced various reforms to make both interest rates as well as exchange rates increasingly market determined. There was considerable opposition for these policies, and even a bomb threat! In the words of Dr. Rangarajan “...the shift to a market-determined average rate system was nothing short of a silent revolution.” (p.134). Statutory Liquidity Ratio (SLR) was brought down drastically, from 38.5% to 25%. Cash Reserve Ratio (CRR), that was at 15%, was also brought down substantially, with a long-time goal of bringing it down to 3%.

The episode of exchange rate devaluation, that had a code name ‘Hop, Skip and Jump’ (p.56), is a must read for all students of public policy as well as policy makers. The way RBI jumped the decision before the then-Prime Minister thought otherwise, in retrospect, worked out well for the external sector. In addition to these changes, other reforms on the external sector brought stability on the Balance of Payments (BoP). Indeed, the IMF, which was forcing India to go for full capital account convertibility, now has different thoughts, and appreciates the way India has managed its external account and its stability. The foundations for this were laid in the early 1990s.

Another aspect of the external sector that needs to be highlighted is the RBI’s conscious decision, since Dr. Rangarajan’s period, to reduce the proportion of external debt in the overall public debt. This is a major reason why India is largely immune to various global shocks, even in recent times. Now the Government says India has a very low share of external debt and is thinking to borrow from abroad. But this is a hard-earned distinction, all due to the efforts of RBI for over three decades, under successive Governors; it was rightly criticised by all the former Central Bankers, and it appears that idea is shelved for now.

There is one full chapter on social responsibility of banks. Dr. Rangarajan talks about how the Rural Infrastructure Development Fund (RIDF) is established for enhancing rural credit. On

financial inclusion at the grassroots level, it was during Dr. Rangarajan's period that the foundation for SHG-Bank credit linkage was built, by providing Rs. 10,000 as Community Investment Fund (CIF). This has paved the way for making National Rural Livelihood Mission (NRLM) a movement in the rural areas, contributing significantly to people's livelihoods.

The book also talks about the autonomy of central banks, mostly keeping in view recent developments (p.214). Here the book argues that there is a need for clear demarcation of who will have final say and in what areas, and cites the new monetary policy framework as a good example for such arrangements. Dr. Rangarajan suggests "*...when all is said and done, a spirit of dialogue and accommodation must prevail.*" -- a sage's advice.

This advice was clearly displayed, now looking to Dr. Rangarajan's contribution beyond RBI, when Dr Rangarajan could work with seven Chief Ministers (in four states) without much tussle. If one has to understand this smooth bonhomie between Governor and CM, we have to look at what is happening in some states at present. Indeed, as Dr. Rangarajan says, "*A public spat between a Governor and a Chief Minister is undesirable. Whoever starts it makes a serious mistake.*" (p.244). The book cites some interesting anecdotes while he was the Governor of undivided Andhra Pradesh, including part of a ceiling falling on him (p.240), and one Chief Minister wanted to meet him at 11.13 AM, as he considered that an auspicious time!

One major contribution of Dr. Rangarajan, referred to only in passing in the book (p.236), is his contribution to the statistical system, where he produced a two-volume report of the National Statistical Commission. It appears that he is not fully satisfied with the way successive governments have implemented his recommendations, including the setting up of the National Statistical Commission. The committee suggested that this be a constitutional body, while the government created it through an executive order; although there was an assurance that it would be made into constitutional body in a year's time, this was in 2005!

We are still waiting for the action taken report from the Ministry of Statistics and Program Implementation (MoSPI), even after two decades. Dr. Rangarajan's Committee on Poverty estimates is another example of a report or recommendations on which the government has not taken further action. This committee was asked to relook at the Tendulkar Committee poverty estimates. Now, it is still not clear what the official poverty line is, and hence what current poverty estimates are.

On fiscal policy, the 12th Finance Commission under Dr. Rangarajan has made many significant changes. One important aspect that may be highlighted is the 3% fiscal deficit target, as set in Fiscal Responsibility and Budget Management (FRBM) Act of 2003. Many think it has been influenced by the Maastricht treaty; however, it was Dr. Rangarajan who suggested this based on the household financial savings.

Another issue that 12th Finance Commission suggested was how to improve the efficiency of public expenditures. As there is much less support from the states for this, it was not addressed by successive Commissions. Indeed, the 15th Finance Commission did raise this issue more recently, but

shied away in bringing it in as part of devolution formula, possibly due to Covid. We do believe that public expenditure efficiency should become part of the devolution strategy in some form or another.

Dr Rangarajan ends the book with an interesting para (p.309), where he reveals the ‘rumor’ that he was considered for the position of Finance Minister; he says that it was not without foundation. This was in the later part of 2008, following the terrorist attacks in Mumbai. The journalist Puja Mehra wrote a book describing the time between 2008 to 2018 ‘a lost decade’ for the Indian economy. If there were no hurdles for Dr Rangarajan becoming Finance Minister in 2008, India’s destiny would have been quite different.

For instance, one major misstep that was made during the UPA-II is the introduction of retrospective taxation, and that was the beginning of the downturn of the economy. As written in the book, Dr. Rangarajan, as Chairman of PMEAC, says this was not discussed with the Council either by the Finance Minister or the Prime Minister. Later, Dr. Rangarajan did oppose this move. but by then the damage was already done. As he says in many places, “*...like many other things in life, this also a game of chance*” (p.241); in retrospect, his appointment as Finance Minister is a chance that not just Dr. Rangarajan but India has missed.

To sum up, as the book narrates, Dr Rangarajan’s contributions to public policy is wide-ranging, and has had a deep impact on the Indian macroeconomy and its stability. As he says, it was never a smooth ride, and there were hurdles all the way. In his words, “*...public policy in general, in particular central banking, is neither a science, nor an art, but a craft*”. Dr. Rangarajan’s contributions to central banking, monetary policy, external sector, fiscal policy, statistical systems, etc., are so significant that anyone who is going to read or write about independent India’s economic history would naturally, term the post-1991 years as ‘Rangarajan-Manmohan Singh Period’.

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