Press Release

Concluding Statement

Respected Governors, Mr. John Lipsky, Mr. Martin Wolf, Mr. Jaime Caruana
Respected Deputy Governors,
Eminent Academicians,
Distinguished Veteran Central Bankers,
Distinguished Top Management Representatives of the Multilateral Institutions,
Enlightened Participants,
My esteemed Colleagues from the Reserve Bank of India; and
Ladies and gentlemen,

As stated by an elder “whatever begins, also ends”. The time is now approaching for us to end these one and half days meeting of intellectuals. During this brief congregation of fertile minds, we learned from each other. We agreed with others. We agreed to disagree with others. Therefore, at the end, it is appropriate to do a brief review of the outcome of this conference.

Towards that objective, I will try to sum up the salient points that emerged from the four technical sessions and the two panel discussions. At the outset, our Governor indicated why central banking could change in important ways after the crisis, and how seeking solutions to the many challenges would be important for enhancing the contribution of central banks to the society at large in more effective ways and thereby regain greater credibility. Setting the tone for the conference proceedings, reflecting in essence the expectations from the deliberations to follow, Governor outlined five key challenges of significance to all central banks in the current context: (a) managing national monetary policy decisions in a globalizing environment, given the growing complexity in the interactions between external developments and domestic variables, (b) redefining the mandate of central banks, given the pre-crisis attraction of inflation targeting and the post-crisis debate on the role of central banks in relation to asset prices, (c) the responsibility of central banks towards financial stability, particularly beyond the conventional Lender of the Last Resort (LOLR) function, (d) managing the costs and benefits of regulation, in view of the difficulty in drawing a fine balance between regulation and financial innovations, and (e) the autonomy and accountability of central banks, particularly in the context of fiscal exit plans of countries as well as possible alteration to the mandates of central banks.

It was indeed an honour and privilege for the Reserve Bank of India to have **Nobel Laureate Andrew Michael Spence** grace this conference and also deliver the keynote address. In his enlightening remarks, he outlined four clear roles of Central Banks which are more or less established: (a) managing inflation, (b) managing shocks - both external and internal, (c) managing volatility – with skill and judgment, and (d) achieving a level of autonomy while acquiring credibility. He supported further extension of the role to cover financial stability, particularly given the challenges from asset prices, leverage and regulatory gaps. He suggested the extension of the role because, he felt that that: (a) central banks have the comparative advantage on macro-prudential issues, (b) they have the information advantage, and (c) there is a general concentration of analytical talent in central banks. He wondered whether national Governments will delegate that much of extra power to central banks.

The **first technical session** started with the paper by William Poole, which questioned the role of discretion in the conduct policies. His aversion to policy discretion was evident from his concluding remarks that "…we should not be dependent on the expertise of policy makers and the timeliness of congressional action to stabilize the economy".

The **next paper** by **Mr. Benjamin Friedman** highlighted an "unholy domestic trinity". He noted that in today's world, with financial institutions and financial markets as they are, a country cannot have these three policies together (cannot not because doing so is impossible, as with the "impossible international trinity" but because doing so leads to disaster): (1) a monetary policy oriented largely or even wholly around targeting price stability; (2) financial regulation based largely or even wholly on free-market principles; and (3) an energetic and effective lender-of-last resort policy.

The **third paper** by **Mr. Lars Svensson stressed** the relevance of "flexible inflation targeting" even after the global crisis, which is particularly important in the context of the apprehensions expressed in some quarters about inflation focused monetary policy involving possible neglect of asset price bubbles and financial stability objective. Svensson elaborated as to why "asset prices" and "financial stability" should not be explicit objectives of monetary policy, but how both are important from the stand point of the constraints they could pose for the monetary policy transmission process.

The **second session** that aimed at unraveling the challenges posed by increasing globalization to central banks, started with the paper by **Mrs. Irma Rosenberg** on a topic of immense direct policy relevance to most emerging market economies, *i.e*, **the impossible trinity**. Rosenberg explained the unpleasant trade-off associated with 'impossible trinity' and noted that "…the choice of monetary policy and exchange rate regime is neither simple nor clear cut". She concluded with the observation that "…since almost all advanced countries have chosen a monetary union or a float, there are good reasons for believing that other countries, when their capital flows are free and their financial infrastructure is complex and rich, will do the same."

Cost of delayed fiscal exit has been a general concern world over, and in this context, the paper by **Mr. Stephen Cecchetti, Mr. M.S. Mohanty and Mr. Fabrizio Zampolli** cautioned that the fiscal problems of industrial economies could be much larger than the official debt figures seem to suggest now. This could is on account of two factors, namely (a) pressure on revenues associated with possible permanent loss of potential output, and (b) rapidly aging population and the large and growing unfunded related liabilities. They emphasised that fiscal problems of industrial countries need to be tackled relatively soon and resolutely, which could otherwise complicate the task of central banks in controlling inflation in future and might ultimately even threaten the credibility of monetary policy arrangements. The market assessment of sovereign risk, though, seems to be changing, unlike the pre-crisis perception that sovereign papers carry no risk.

Since the global crisis has generally been viewed as the result of weaknesses in the regulatory and supervisory systems, the focus of the **third session** was to deliberate on options and challenges to fix them. The paper by **Mr. Stephen Roach** highlighted the need for both a new approach to regulatory oversight that incorporates "macro-prudential regulations" and a major reworking of the mandate of monetary policy to include financial stability. He rejected the idea that post crisis search for remedy should include only regulatory measures. To quote Mr. Roach, "…regulatory action can send an important message to market participants. But the policy rate is a far more powerful enforcement mechanism." Moreover, a financial stability mandate could also help in adding clarity and direction to the "current *ad hoc* approach to evaluating hows and whens of the exit strategy".

Financial innovations clearly contributed to the crisis and the excesses in an inter-connected financial system generally went unnoticed. The risk of excessive regulatory response to the crisis stifling innovations has been a general concern. The paper by **Mr. John Lipsky** provided valuable insights and direction on the current debate on the subject. He cautioned that "without a renewed effort to foster financial innovation in the global economy, all countries – including emerging market economies – will underperform their potential".

The **Fourth** technical session was devoted to examine whether financial stability should be an explicit objective of monetary policy, and whether the absence of such a mandate contributed to the crisis. **Mr. John Williams** explained how the Bagehot of the 21st century looked like in the US when the Fed responded to the sub-prime crisis. There are, however, limits to the Bagehot prescription, *i.e.*, LOLR cannot address the insolvency problem. Williamson emphasized that "…issues of insolvency cannot be solved by central bank liquidity policies. These are properly the domain of the fiscal authority".

Another dimension of central banking activities which gained prominence after the crisis is the size and composition of the balance sheets of central banks. The paper by **Mr. Krishna Srinivasan** outlined the key policy actions central banks had to adopt "nimbly, decisively and creatively" to alleviate the financial crisis, and examined their effectiveness. In designing the exit strategy, he stressed that three aspects may have to be given particular attention; first, careful and consistent communication, second, unwinding should not compromise central bank independence, and third, international spillovers of differentiated exit should not be ignored.

After the technical discussions, which deliberated extensively on the key challenges for central banks and options to deal with them, it was time to elicit the views of Central Bank governors who face the real challenge on a day-to-day basis and deliver without the benefit of hindsight. In the two **panel discussions**, with **Mr. Martin Wolf** as the moderator, Governors of eight central banks offered their candid views on ten important issues, with the flavour of country-specific positions nicely interspersed with their own global perspectives.

The theme for the first panel - domestic monetary policy – covered five important issues, namely (a) the implications of the crisis for inflation targeting; (b) the role of asset prices in monetary policy formulation; (c) the role of central banks in managing crises; (d) the role of central banks in regulation; and (v) exit from the crisis measures.

Governor Christian Noyer of Bank of France advocated that financial stability should be the second pillar of strategy. Financial imbalances are better addressed by macro-prudential policy and there is a need to better understand the interactions between monetary and macro-prudential policy.

Governor Glenn Robert Stevens of Reserve Bank of Australia put forward the argument that notwithstanding the questions raised about the utility of inflation targeting in the current crisis, it would be wrong to abandon it completely. Instead, it would be useful to develop a more realistic model explaining the interactions between the financial sector and monetary policy.

Governor Tarisa Watanagase of Bank of Thailand outlined the need for focusing more on supervision rather than regulation. Financial stability should be part of central bank's mandate so as to maintain sustainable growth and prevent boom-bust cycles. More corrective efforts are required in areas such as risk awareness, risk management, moral hazards associated with policy response to crisis and the right kind of policies for creating right incentives.

Dr. Subbarao, Governor, Reserve Bank of India, was emphatic that a lesson from this crisis is that pure inflation targeting does not work, because price stability, though necessary is no guarantee against financial stability. He also explained why India has not adopted explicit inflation targeting, even though price stability is clearly one of the overriding objectives of the Reserve Bank.

The theme for the **second panel discussion** - International Monetary System – covered five key issues, namely (a) Exchange rate policies and reserves accumulation; (b) Management of capital flows; (c) Future of the global reserve system; (d) Reform of the International Monetary Fund; and (e) The potential for developing regional monetary arrangements.

Governor Mark J Carney of Bank of Canada emphasized that the important issue right now is that of adjustment mechanism between surplus and deficit countries rather than a single currency dominance or the issue of reserve currency.

Governor Miguel Fernandez Ordonez of Banco de Espana highlighted that we must recognize the significance of unprecedented coordinated action led by G20 in avoiding another great depression, and in view of the expected difficult years ahead, we must sustain the global approach despite domestic differences in policies.

Governor Atiur Rahman of Bangladesh Bank underscored the point that the international system should reorient itself to take into account the concerns of low income countries. In this regard, he emphasized the role of discussions of India with other Asian countries in forums like ACU, SAARC FINANCE etc.

Managing Director Daw Tenzin of Royal Monetary Authority of Bhutan emphasized the importance of reserves in case of small economies like Bhutan. He viewed that crisis gives an opportunity to redefine market discipline and consumption patterns. He noted that IMF should focus on the issues relevant to emerging market economies.

Dr. Subbarao, Governor, Reserve Bank of India was categorical in his remarks that the International Monetary System was inadequate to prevent a major structural problem, that is global imbalances, which had to manifest in the form of some crisis or the other at some stage. He noted that even though India did not contribute to global imbalances, it has to face the consequences.

Where, then, do we stand at the end of the conference? And, what are the key findings that could shape the future course of policy actions in central banks? In the first session, there was no consensus on the role of monetary policy for directly doing anything about asset prices and no single view was expressed on whether financial stability could be an explicit mandate of monetary policy. LOLR and regulation were generally seen as potential instruments to safeguard financial stability, though not enough. The second session did not offer any clear direction to resolve the impossible trinity, implying that countries have to adopt their own approach. In the third session, the need for macro-prudential regulation as a necessary, if not sufficient, next step was recognized. How financial innovations, with appropriate precautions, could contribute to high global growth, more particularly in emerging market and developing economies, was explained. LOLR cannot solve insolvency problems, was a key message from the fourth session. The debate on what could be an appropriate Bagehot rule for the 21st century will continue. It was also viewed in this session that different dimensions of central bank independence may come under threat if high debt levels of the governments persist over protracted periods of time.

There were few specific issues highlighted by our Deputy Governors and Executive Directors. In the context of the Impossibility Trinity dilemma, **Deputy Governor Mrs. Shymala Gopinath** viewed that besides capital flows and exchange rate, the impact of capital flows on asset prices should not be ignored, particularly when the role of monetary policy for asset prices has become a key issue in policy debate. **Deputy Governor Mrs. Usha Thorat** raised the issue as to whether capital controls are relevant for EMEs, and whether post-crisis stricter capital requirements could limit the role of credit in promoting growth and development in EMEs. **Deputy Governor Dr. K.C. Chakrabarbarty** made two points of general relevance to all central banks: (a) whether LOLR provides liquidity support or solvency support is difficult to know, and there is no clear framework for this, and (b) despite the debates on exit, it is difficult to predict what could be actual exit path in any country; this suggests that it will be an evolutionary process, which has no precedence. **Deputy Governor Dr. Subir Gokarn** noted that for growing and globalizing EMEs, challenges for central banks will be there even without the crisis. Expansion of mandate has to be seen in relation to both accountability and capability. India has not adopted inflation targeting as yet, despite the pre-crisis trend, Executive Director, Mr. Deepak Mohanty raised the issue as to whether flexible inflation targeting could lack credibility. Executive Director Mr. Harun Khan wondered whether India's SLR requirements implicitly lower the pressures on LOLR function.

One **Key Message from this Conference** is that given the known challenges, despite lack of consensus on many critical issues, every central bank has to move in the direction of taking right steps that it may feel as appropriate, without waiting for the global system to move. It would be wrong, however, as noted by Mr. Stephen Roach, to presume that "best global policies are the sum of the best national policies". In a globalised world, thus, national policies alone, despite being the most appropriate, cannot prevent a crisis unless some of the global challenges are addressed collectively at the global level.

Let me convey our sincere thanks and gratitude to our Governor Dr. Duvvuri Subbarao. Governor was intimately associated with the planning of this Conference for the past six months. Amidst his preoccupation with both 'crisis management' and 'recovery management' efforts, he associated with every minute detail of planning this major and memorable event. All of us in the DEAP's team, owe a debt of gratitude and highly grateful to you, Sir, for this wonderful opportunity and for your invaluable presence and contribution to the past two days proceedings.

Our Senior Deputy Governors, Mrs. Shymala Gopinath, Mrs. Usha Thorat and Dr. K.C. Chakarbarty have always been with us guiding the process, from the conception phase and at various stages during the Conference planning process. From their rich and vast experience, we got very useful suggestions to smoothly conduct this mega affair. We are grateful to them.

Deputy Governor Dr. Subir Gokarn, has been a source of strength behind the organization of this Conference, and closely monitored the tying up of all arrangements. I need to thank and express our gratefulness to

Executive Director Mr. Deepak Mohanty for ably supervising the whole process. We thank him for his guidance and encouragement.

I would like to thank all the Contributors of Papers for the rich collection of papers and high quality contributions. Notwithstanding my unreasonable demands on them to quickly give the papers for circulation, most of them have given the papers within the stiff deadlines imposed on them. I apologize to all of them for insisting on timely submission. I will also fail in my duty, if I do not put on record our deep appreciation for the Chairmen, Co-chairpersons, and Discussants for their very valuable contributions. It is this intellectual treasure, left with us by the Chairpersons, Lead Speakers, and Discussants, which will keep the memories of this Conference alive for a long time with all of us.

Several Departments of the Reserve Bank of India collaborated and assisted us at various stages of the conduct of this event. In particular, Mr. J.B.Bhoria, RD, Mumbai Office, Mrs. Grace Koshy, Secretary and CGM, Ms.Alpana Killawala, CGM, Department of Communications have been of great help to us. I wish to place on record our sincere gratitude to all of them.

Getting to this point in the program and to this stage of the Conference has involved the commitment, collaboration, co-operation and goodwill of numerous individuals within and outside the Reserve Bank of India. We have been fortunate enough to be backed by a team of very motivated and dedicated colleagues from the Research Department who worked day and night and did their job exceeding well. I bow my head to all them in not only appreciating but also expressing my sincere gratitude to them for helping me and the top management in successfully organizing this conference.

Coming to others, who made this conference possible, we owe special gratitude to the officials of the Ministry of Home Affairs, Government of India and Government of Maharashtra, Mumbai Police Department for providing us mandatory clearances and providing us an invaluable and impregnable security cover.

I must thank the anchor Ms. Lobo, and the major service provider Mr. Neil Banks for arrangements at various stages. The Hotel Trident Management and Staff deserve our gratitude. I would like to thank the Members of the media, for enthusiastically covering the event. We are very much indebted to several individuals who may not be here but who have made significant contributions through the provision of various services.

Ladies and gentlemen, as some learned man said “Great is the art of beginning, but greater is the art of ending”. Let us make this end a new beginning. Let us agree to disperse today, with an understanding that we all will meet again in some other forum to discuss new concerns and to find new solutions. In any case, we plan to have our next International Research Conference in 2012. Till we meet again, good bye to all and wish you all a pleasant and safe journey back home. We shall now draw the curtains on the conference and stand in honouring our National Anthem.

Let us stand in respect of the National Anthem of India.