*An Interview with Dr. D. Subbarao**

Central Banking (CB): You are a highly-respected civil servant who has spent a significant portion of your career in various government departments. How does heading the Reserve Bank of India compare?

Duvvuri Subbarao (DS): As a career civil servant for 30 years, I have worked at the district level, the state level and the national level. I also worked at the World Bank, and now towards the end of my career it is a privilege to come to the Reserve Bank of India.

I've also been fortunate to work for a long period in the area of public finance. The Reserve Bank is different from what I did before as a civil servant in terms of work content and accountability mechanisms.

Work content is of course the quintessential central bank work which is a much narrower canvas than many of my assignments as a civil servant. The responsibility is of course much larger, and accountability as the Governor is at an individual level as opposed to accountability at an aggregate level in civil service jobs.

In a typical ministry, a civil servant would be responsible to the minister and the ministry itself would be accountable to the government. As the Governor, I am responsible at an individual level and I am hoping that my experience in the real sector would be an advantage in my current position as Governor.

CB: And do you think that experience has proven useful so far?

DS: Yes, I would think so. As we went through the crisis and distress signals kept coming, I had a good understanding of what

* Governor, Dr. D.Subbarao in conversation with Central Banking Publications, London, (published on July 2, 2009).

was causing the distress. That made me better equipped to respond to the crisis.

For example, in the wake of the crisis exports were hit: in India certain sectors are more export-centred than others, for example, textiles and gems and jewellery. Similarly, there are certain geographic locations that are more reliant on exports than others. My experience in the real sector made our responses better, more grounded in these realities.

CB: Do you have a clear agenda for what you want to achieve during your first three-year term?

DS: India achieved growth of 9 per cent over the four years to 2008, and the crisis clearly came as a setback to us. Last year (2008-09) the growth rate was 6.7 per cent. This was certainly better than most people had expected, but evidently lower than trend growth. For me, the single most important objective is returning the economy to a high growth path.

CB: So that would imply that you believe growth of 9 per cent to be achievable in the medium-term?

DS: Yes, of course. The challenge for the Reserve Bank will be to create the stage for a 9 per cent growth in an environment of price and financial stability.

CB: Do you think that concentrated wealth could hinder medium-term growth as a recent Asian Development Bank (ADB)-sponsored report has found?

DS: I have not seen the ADB report but I do know that reducing disparity across regions has been one of the key objectives of the Government. At the heart of the 11th Five-Year Plan is inclusive growth, and that aims to address precisely the issue of narrowing disparities.

CB: So you'd broadly concur with the finding that concentrated wealth could hinder the achievement of trend growth of 9 per cent?

DS: I know that higher growth in India cannot be meaningful unless the gains of growth are distributed more widely.

CB: If there were three things that you could achieve in your first three years, what would those three be?

DS: First, I would like the Reserve Bank to acquire greater proficiency in managing monetary policy in a globalised context. India is going to become more and more integrated. And we are going to be impacted by what's happening around the world.

Second, we have to make the Reserve Bank more transparent. We need to improve communication at both technical and non-technical levels.

Third, at a very personal level, I would like to de-mystify the office of the Governor. What I mean by this is that I want our staff to understand that even Governors do not know everything, that they have to make judgement calls in a context of uncertainty when the pros and cons of their actions are not completely clear. I want them to understand that they will serve me better by disagreeing with me and telling me what to do rather than trying to outguess me. I want them to understand that the Governors do not know everything and that they should feel free and comfortable about speaking up.

CB: The Reserve Bank of India is now in its 75th year. How does the Reserve Bank plan to mark this anniversary?

DS: Our plans are still somewhat fluid and I expect that we will look ahead as we look back. It's my privilege to be heading the Reserve Bank at such an historic moment. First of all, I want to say that the Reserve Bank has earned an enviable reputation for competence, for its professionalism and its integrity.

We will of course be having events to commemorate the anniversary. But what I do want to do is to use the jubilee as an occasion to have the Reserve Bank understand that they must make a difference and I want the people of India to understand that the Reserve Bank does something that's important in their daily lives. I want our staff to understand that they can make a difference.

CB: Looking back on the Reserve Bank's first 75 years, are there any lessons from history that the institution could usefully apply in the current circumstances?

DS: I'm afraid I'm not a student of history but 75 years is a long time and there are certainly lessons from our experience. The central bank has performed the role of being an effective counterpoint to Government, which often has to concentrate on short-term objectives. On its part, the Reserve Bank has been able to take a medium-term view and what is prudent and optimal comes out of this synthesis. We should continue to do that.

The Reserve Bank has had a culture of gradualism, moving forward decisively but only after weighing carefully the pros and cons. It's like crossing a river by feeling the stones metaphor.

Moving forward, we need to understand that monetary policy is going to be more difficult because of the increasing forces of globalisation. As I mentioned earlier, we need to acquire greater proficiency in that.

CB: Where do you believe your views differ from those of your predecessor, Y.V. Reddy? Where are the similarities?

DS: Dr. Reddy is an eminent economist who has served the Reserve Bank with dignity and distinction. He's a difficult act to follow.

We are similar in that our aims are to keep the economy on a high-growth path with price stability and increasingly, financial stability.

However, the difference between him and me will be the specific circumstances that we encounter when we try to deal with that mandate.

Dr. Reddy has had to deal with two episodes of inflation, one demand driven and the other supply driven. He has also had to deal with a flood of capital flows. I have had a baptism by fire, taking over at a time of crisis, where I've had to act quickly. It has been a steep learning curve.

CB: Do you feel that the Reserve Bank of India's relative scepticism towards inflation targeting has been vindicated by recent events?

DS: Yes, to a large extent. Because, in India, inflation is influenced by a number of factors besides excess demand in the context of easy liquidity. We're an import-dependent economy that is reliant on importing commodities. So, import prices can drive up inflation. Capital flows could impact inflation. Decisions by other central banks could also cause inflation, especially in a globalising world. In a crisis such as this, inflation could also come through the trade channel. Also, India is largely an agricultural economy, even though agriculture now accounts for less than 20 per cent of GDP. So, our agriculture prices are vulnerable to monsoon and adverse weather conditions, and beyond the pale of monetary policy action. Because of this, inflation targeting is neither possible nor advisable for the Reserve Bank.

CB: You've said that you're unconcerned that there is a threat of serious deflation despite wholesale prices being in negative territory. Can you go into a little more depth on why you hold this view?

DS: WPI inflation went into negative territory two weeks ago and remains there. Given the talk about deflation around the world, especially in the advanced economies, there has been some concern in India whether what we have is a structural deflation. It is important for the central bank to communicate the message that this is not structural deflation and that what we are seeing is purely statistical in its nature.

The WPI went into negative territory because a year ago, at this point of time, the administered oil prices were raised. Our negative inflation does not reflect a demand constraint. Far from it, we are a supply-constrained economy not demand constrained.

Negative inflation has also triggered speculation about further rate cuts. I want to reiterate here that the Reserve Bank looks at a number of indices, including the WPI, the four indices of the Consumer Prices. We also look at the inflation expectations survey that we do. So I want to reiterate that the current temporary negative inflation is not structural in nature, but rather it's only statistical.

CB: In an article written for The Banker, published 5 January, you wrote: "It was not supposed to happen this way. The de-coupling theory was supposed to kick in." Why did it not?

DS: The de-coupling theory held that because of the substantial rise in foreign exchange reserves, the improved policy framework, robust corporate balance sheets and a relatively healthy banking sector, emerging economies could steam ahead on their own even if advanced countries went into a recession.

The reality turned out to be otherwise. We've seen in the last several months capital flow reversals, sharp currency depreciations, and a widening of spreads on both corporate and sovereign debt. The de-coupling theory was never totally persuasive in a globalising world and its credibility has been seriously dented by the events of the past few months.

We should now have a modified de-coupling theory, which is that if the downturn in advanced economies is relatively mild, then the emerging economies could do enough through policy responses to insulate their economies. But if the downturn is severe, they will be impacted, of course differently in different economies.

Again, India has not been able to de-couple through this crisis, not so much because demand collapsed, but because we have been impacted through the finance channel and through the confidence channel. Because capital flows, which have been larger than our current account deficit over recent years, have substantially declined in the wake of the crisis.

CB: Do you think that scenario would change if domestic consumption in the likes of India or China was boosted?

DS: I can't comment on China. But as far as India is concerned, our consumption at 57 per cent of GDP is relatively high for an economy of our per capita income level. So the important thing for India is to increase investment, especially in infrastructure, and not so much consumption. I admit that private consumption has to go up as indicator of poverty reduction, but what is more important is that investment increases.

CB: Could you clarify your position on the stability of the current international monetary order?

DS: I have studied the debate about the dollar as the reserve currency, whether there could be alternatives to that, what are the implications for the world economy and for emerging economies. At this time I'm not sure if there is a currency that can replace the dollar. In any case, replacing the dollar can't happen by fiat. It has to happen on the strength of that alternate currency. But I do want to say that in terms of the international monetary order, we are facing a situation where finance is globalised, but we still have regulation at the national level. We need to look at the implications of this for monetary policy, especially for countries with fixed exchange rates and for emerging economies.

It's also important to focus on global imbalances. If we accept, as seems to be the current consensus, that these imbalances were one of the structural causes of the crisis, and given that you cannot have a world without imbalances, what can we do to ensure that the world is in a better position to minimise imbalances, and to the extent that they exist, to manage them.

CB: What do you think is the right forum in which to conduct this debate?

DS: Several international fora are appropriate. There is the IMF, the BIS's bi-monthly meetings and the very effective G20. Important topics such as this must be discussed at all these fora. And I believe that they are likely to be discussed for much longer than we think before we reach an agreed view on a minimum acceptable programme.

CB: The first official summit of BRIC leaders recently took place in Russia. How do you view the relationship between yourself and your Brazilian, Russian and Chinese counterparts?

DS: As a first point, BRIC is a Goldman Sachs acronym that emerged out of some similarities between the Brazilian, Russian, Indian and Chinese economies, which are growing rapidly and have an increasing influence on global growth. Since Goldman Sachs came up with that, these economies have had different developments, including in terms of the impact that the crisis has had on each of them. It has been useful for central bank governors and finance ministers to meet at international fora to have a shared understanding on some of the issues that are common to us, such as a common minimum programme on regulation, the management and the governance of Bretton Woods institutions.

CB: I see your point about BRIC being a construct of Goldman Sachs, but I've also heard people say that if it didn't exist then somebody would have to invent it.

DS: I would think that there are enough similarities that it is worthwhile discussing policy responses together. Not on all issues. But to the extent that we are seen as large, high-growth countries, and as contributors to incremental global growth, we have issues in which we have a common interest. It is not as though we must have a common view on every issue that emerges in international fora. But I believe that the consultation has so far been value adding.

The four of us saying something collectively has absolutely more clout than if we say the same thing separately. Even if there is an understanding that we have differences, is itself value adding.

CB: Is there anything else that you'd like to mention?

DS: One issue that has come up in India in the context of the crisis is why we are not doing everything that other central banks around the world have been doing. Our response has been that even as the origins of the crisis have been common, the evolution of crisis and its impact has been different across countries. Countries have had to respond to the specific situation in their countries. In the advanced economies, the transmission of the crisis has been from the financial sector to the real sector. In contrast, in a number of countries including India, the transmission of the crisis has been from the real sector to the financial sector and iterations thereon. While we have studied and reflected on the responses of other countries, our policy action has been tailored to the Indian situation and aimed at minimising the impact of the crisis. This has meant both conventional and non-conventional policy action.

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