Asia Society India Centre Questionnaire

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1. What is the biggest factor that explains India's economic growth and stability in the face of global economic crises? To what extent does this apply to other emerging economies as well?

India has had a generally cautious approach to financial development. Its monetary policy has always had three objectives: price stability, growth and the maintenance of financial stability, even if they were not articulated in this fashion. Liberalization of the financial sector has been done in a measured fashion, particularly the incremental opening of the capital account, so that it has been in step with developments in the real sector. India has also used its own counsel in developing its financial sector strategy rather than following fashions of the day. When conventional wisdom said that desirable exchange rate strategy was either a full float or a fixed currency board type exchange rate India followed strategy of maintaining a managed float that was flexible enough to respond to market fundamentals; when the monetary policy fashion was to do inflation targeting, India combined the price stability objective with the promotion of growth and maintenance of financial stability, while using a number of different policy instruments; when the international trend was to confine central banking to monetary policy and to separate out financial regulation in separate institution, India continued with a unified central bank and financial regulator in the Reserve Bank of India. With this cautious independent development approach it has succeeded in liberalizing the financial sector while achieving growth with financial stability, during a period when more than 100 countries have suffered severe financial crisis because of excessive or premature financial liberalization.

2. What lessons can emerging economies learn from what you termed a "North Atlantic" Financial Crisis, particularly since some of these economies in Latin America and Asia have suffered depressions in the recent past?

The emergence of financial crises has been well studied in the past and lessons learnt have quickly been forgotten repeatedly. A key advance indicator of a looming financial crisis is the overall increase in leverage in the financial sector. Because financial intermediaries have to be much more leveraged than their counterparts in the real economy, the incentive structure is geared towards an increase in leverage, which then provides increased returns to equity in the sector. It is public money that is then typically put at risk. The lesson is that financial regulation and supervision has to be active and intrusive. Financial regulators have to regulate and supervisors have to supervise. Monetary policy making should not be blind to developments in asset markets, which are most prone to bubbles in the

presence of accommodative monetary policy along with high levels of leverage. Inflation targeting should be tempered with considerations related to the maintenance of financial stability. Regulators also have to be vigilant in understanding and monitoring financial innovations so that they are productive in promoting real economic activity and do not become weapons of mass destruction. Finally the maintenance of fiscal responsibility is a necessary condition for financial stability and growth.

3. How do you see the changing path of the private sector in India with respect to "social enterprises," such as corporate social responsibility and microfinance, affect governmental policy? What do you see as the responsibility of the private sector in sustaining growth and maintaining stability?

The primary responsibility for sustaining growth and maintaining stability rests with the government. It must create conditions and incentive structures that are conducive for the private sector to save, invest, innovate and grow in such a way that growth is inclusive and widespread. The best that the private sector can do, while it maximizes profits, is that it ensures fairness in its operations and also exercises responsibility as a corporate citizen in the communities that it operates in and in the country at large. It can also make a great social contribution by minimizing or eliminating the typical negative externalities caused by industrial pollution and excess energy usage. There is also need for more discussion on who the stakeholders are in a private company: should the company be only responsible to its shareholders or equally to its workers, creditors and the communities in which it operates? However, the primary social responsibility for ensuring the supply of public services rests with the government, and the private sector should not be saddled with such responsibilities.