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Rajan Channels Fischer With India Central Bank Overhaul

By Unni Krishnan and Sandrine Rastello - Sep 11, 2014

In his first year as [India's](#) central bank chief, [Raghuram Rajan](#) oversaw a recovery in the rupee from a record low, a revival in growth to the fastest in two years and a cut of almost 2 percentage points in the inflation rate.

Now comes the hard part.

As Rajan, 51, begins this month the second year of his three-year term, the former International Monetary Fund chief economist is seeking to focus the [Reserve Bank](#) of India's mission on [price stability](#), diversify its management and encourage staff to specialize their skill-sets.

To achieve this he'll have to win over unions opposing employment of outsiders, combat lawmakers looking to tighten oversight of financial regulators and convince a government seeking to boost growth to curb its [budget deficit](#). Rajan's efforts resemble those of [Stanley Fischer](#), who helped [Israel](#) weather the global economic crisis and stayed on at its central bank just long enough to enshrine policy changes into law.

"Rajan's done a very impressive job of restoring confidence in India," Philip Levy, senior fellow at the [Chicago](#) Council on Global Affairs, said in a Sept. 5 interview. "In terms of having the room to implement broader reforms that are going to make a real difference with the economy, that's a different skill-set, those are political skills, and Indian politics is a tricky business."

The RBI is looking to appoint a chief operating officer to look after its day-to-day functioning, while it discusses a new monetary framework with the government. The outline includes an inflation target and a rate-setting committee, according to a July report from the finance ministry.

'Disciplined, Pragmatic'

Fischer pressed for a similar structure when he headed the [Bank of Israel](#), saying that, on average, decisions made by a group of professionals are better than those made by an individual. The legislation was passed in 2010, after he said its approval would be an "important" consideration in

his decision whether to remain in office. Fischer quit in 2013 after confirming that the law was functioning properly.

Fischer, 70, is now vice chairman of the U.S. Federal Reserve.

“Mr. Rajan aims to build a bedrock of macroeconomic stability and simultaneously introduce various reforms that will help shift the economy onto a higher growth path,” [Eswar Prasad](#), who [authored papers](#) with Rajan and now teaches economics at [Cornell University](#) in Ithaca, New York, said in an e-mail. “This is similar to what Mr. Fischer accomplished in Israel, where his actions as a disciplined but pragmatic central banker helped revive confidence in the Israeli economy at a difficult time and stabilized its growth prospects.”

Top Rank

Rajan and his Israeli counterpart are among seven of 69 central bankers who won the top A rating from [Global Finance](#) magazine this year, compared with A- for the [European Central Bank](#)'s Mario Draghi and B- for [Mark Carney](#) at the [Bank of England](#). Rajan is also among [the 50 Most Influential people in global finance](#), according to a list compiled by Bloomberg Markets magazine for its October special issue.

Since taking office 12 months ago, Rajan has raised [borrowing costs](#) three times as he battles Asia's fastest inflation, boosting the rupee by 11 percent in the region's best performance. While India's economic expansion is forecast to accelerate to as much as 5.9 percent in the year through March 2015 from near a decade low, the rate is lower than the average 8.5 percent between 2005-2010. Consumer price inflation accelerated to 7.96 percent in July.

'Final Say'

A panel Rajan appointed has [proposed](#) targeting CPI growth of 4 percent plus or minus 2 percentage points, which would need lawmaker endorsement as the 1934 RBI Act says the federal government may direct the central bank on what it considers the public interest.

Parliament will have final say on any official target, a [finance ministry](#) official said, asking not to be identified as the talks are private. The government has also asked the RBI to wait for legislative amendments that permit a regrouping of RBI departments rather than going ahead with naming an interim COO, the official said.

“The RBI has held a lot of autonomy in India but it is not independent of the government,” said T.S.R. Subramanian, the nation's top bureaucrat from 1996 to 1998. “It has rarely been an uneasy relationship but, occasionally, it has not been a comfortable relationship.”

‘Areas of Tension’

While parliamentary approval for the RBI’s goals can help shield the central bank from political pressure, a single focus on curbing inflation could prove harmful, as it did in the euro region, said [Adam Posen](#), president of the Peterson Institute for International Economics in [Washington](#).

“Focusing solely on inflation or primarily on inflation is now too narrow once you have inflation down,” Posen, a former Bank of England policy maker, said in a Sept. 9 phone interview. “A large number of central banks where inflation is better anchored have backed away from that single commitment.”

Last month, Rajan urged cash transfers in place of subsidized food, fuel and services to India’s poor -- saying it would break a vicious cycle set by self-serving businessmen and corrupt politicians -- and in July said there were “areas of tension” in a March 2013 government panel report proposing to allow legal appeals on regulatory decisions.

Internal Obstacles

Some obstacles also come from within. An RBI union may threaten industrial action or even a strike if the new COO post is created, Samir Ghosh, general secretary of the All India RBI Employees Association, said by phone. Rajan’s restructuring blueprint has caused resentment as it seeks to include appointments from outside the RBI, which could impinge on promotional opportunities for existing officers, he said.

The suggestion for restructuring came from within the RBI and the organization is discussing the plan with various stakeholders, RBI spokeswoman Alpana Killawala said by phone in Mumbai on Sept. 3. Rajan declined to comment when asked about the proposals in Chicago on Sept. 5.

“While organization reform won’t be easy, that is no excuse for not trying,” Bejoy Das Gupta, Asia-Pacific chief economist at the [Institute of International Finance](#) in Washington, said in an e-mail. “At the end of the day, one wishes for a leaner and fitter central bank able to deliver effectively on its tasks.”

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