

The Economic Club of New York

Raghuram Rajan

Katherine Dusak Miller Distinguished
Service Professor of Finance

April 3, 2019
New York City

Interviewer: Frank Brosens
Co-founder Taconic Capital

Introduction

Barbara Van Allen, President

I'm Barbara Van Allen, President of the Economic Club of New York. Our chair, Marie-Josée Kravis asked me to preside this morning in her absence as she's overseas. I'm very honored to be able to introduce our guest, Dr. Raghuram Rajan, who is the Katherine Dusak Miller Distinguished Service Professor of Finance at the Booth School of Business at the University of Chicago.

As I'm sure many of you know, he was Governor of the Reserve Bank of India, between 2013 and 2016. And also has served as Vice Chairman of the Board of the Bank of International Settlements between 2015 and 2016.

Dr. Rajan was the Chief Economist and Director of Research at the IMF from 2003 to 2006. He received a bachelor's degree in electrical engineering at the India Institute of Technology, Delhi. And his MBA from the Indian Institute of Management in 1987. Then, he went on to receive his PhD, actually, in 1991 from MIT.

Dr. Rajan's research interests are in banking, corporate finance and economic development. He's coauthored or authored several books and rather than go through all of those with you, let's just say, that this morning, you have in front of you, his most recent book, *The Third Pillar, How*

Markets and the State Hold the Community Behind, which was just published a few weeks ago.

Dr. Rajan was also President, of the American Finance Association in 2013. A member of the American Academy of Arts and Sciences, and the Group of 30. In 2002, the American Finance Association awarded him the inaugural Fischer Black Prize for the best finance researcher under the age of 40. The other awards he's received, of which there have been many, include the Deutsche Bank prize for financial economics in 2013. *Euromoney Magazine* Central Banker of the Year, and the *Banker Magazine's* Global Central Banker of the Year Award, most recently in 2016.

I want to say our format this morning includes opening remarks by Dr. Rajan, with his accompanying PowerPoint slides, which I believe all of you should have in front of you. Afterwards, Economic Club board member and co-founder of Taconic Capital, Frank Brosens, will join Dr. Rajan on stage for a wide ranging conversation, covering both the book and other topics that I know are on everyone's mind.

And Frank will be sure to save time for questions from attending members and guests, starting with the 2019 class of fellows, several of whom we have here, where are our fellows, to ask the first question, to round out the program.

I want to remind everyone that we do have media in the room, this conversation is on the record.

Please be assured, as always, that we will wrap up promptly at 9:00. Dr. Rajan, the podium is yours, Sir. (Applause)

Raghuram Rajan

Katherine Dusak Miller Distinguished

Service Professor of Finance

Good morning, and thank you very much for having me. Let me cut very quickly to what the book is about. It tries to do three things. At some level, it's a love letter to capitalism saying here's why capitalism worked. That's the first historical section of the book. It also gives the framework to try and explain why it's not working as well now. That's the three pillars I'll come to in a second.

The second thing it tries to do is talk about how the community is an important element of why capitalism worked. And it's going to be an important element of making it work once again.

The third element is, so what do we do, what kinds of policies can we implement. So, many people say each book should do only one thing, this tries to do three things, and that's probably too many. That's why it's a thick book. (Laughter)

I write a book every six or seven years, so I needed to put it all in the same place. So, let's turn to

the first page, what's the book about? I mean, the standard view of capitalism, and really, much of the debate in the 20th century between systems was about how much government, how much markets.

Governments to enforce contracts and property rights in the most thin version of governments and free comparative markets outside. And of course, in communist versions, the government takes over everything. But, I think these narratives and much of the fight in the 20th century missed the crucial importance of the community in making liberal market democracy's possible. And I'm talking about the community directly, in terms of providing sort of support to people, both before they enter the markets, and when they fall out. But also the community in the sense of becoming one of the building blocks of democracy, which I think is central to making capitalism work. And I will talk about that in just a second.

When you have this combination of democracy and capitalism, capitalism continues to work for the many and that creates its own support. The many work to support capitalism. That's why it seemed that the liberal market democracy that emerged post-World War II was a stable structure. It worked very effectively for at least half a century in creating growth and elevating many of the industrial countries.

The question is, what supports having the balance today. Why is there so much anger, movements from the left, movements from the right, against what we had and that's really what

the middle part of the book is.

Let's turn to the next page, the three pillars supporting society. This is more definitional. Just to make sure we're all on the same page. The state has a standard definition of the state, the executive, the judiciary, the legislature. It provides the usual things that states have done over time; security, justice, which allows markets to flourish, but what we must recognize is that capital systems are more complicated than that. The state does a lot more. The state over time in many countries provides what I call pre-market support that is basic education, healthcare, enabling people to participate in markets, enhancing their capabilities. Of course, it also, as a result of violent fluctuations in markets has come to provide what I call post-market support, which is when you fall off the safety net, that helps pick you up.

Markets offer productively in choice. The community is what I think of, primarily, is the proximate community, the neighborhood, the village, the municipality. We can think of more complicated communities, communities linked via the Internet, and so on. I don't focus on that in the book, but you can think of more modern communities, communities in cities linked through schools, through professional organizations and so on. But I focus on the proximate community because it also seems to me that is the basis for political action and that's important, the more I think about.

Turn to the next page. Sorry, given the limited time, I'm going to run through this. But, why do

we care about the community today? Why do we care about the proximate community? For many people in this room it's not clear what the proximate community is. Some people don't know their neighbors, live in fairly large anonymous buildings. But for much of the world it still is what matters. It's a source of identity and values. You identify with the community you came from. You think that is where, in a sense, you're values were formed. It fills in holes.

An example, during the Great Recession in southern Europe, many people who lost their jobs, ran out of unemployment insurance. Where did they go? They went back to their villages. They went back to their family. They stayed with relatives. The same thing happened here. A lot of basements were full of kids who had moved back into the house because they lost their jobs.

So, the point is, social relationships, the community, fills in holes left by formal relationships, either the market or the state. But there's more than that. Apart from preparing you for the markets, early life, which we will come to in a second, but also picking you up when you fall off, it becomes the basis for political organization.

Again and again, communities working to a democracy, basically keep capitalism fairer than it would otherwise be. There's an inexorable tendency of capitalism to close up, to be dominated by a few firms along with the state. This is something that Adam Smith worried about. This was the central point in the *Wealth of Nations*. It is something that you see again and again. And it's something that I think democracy is a big counter to, and I'll talk about that in a second.

Skip to the next diagram. This is really a diagram of how I think these things work. The blue arrows are what we've already talked about. The state providing property rights, legislation, etc., to the markets, the state providing security, justice, etc., to the community. And the markets providing productivity choice to the community.

What I also describe, are the other arrows. Which I think are important and often neglected. That is, in a country with an independent private sector, which generates profits competitively on its own, there's far less of a dependence on the state. And when there's far less dependence on the state, the private sector is much more independent and can serve as a countervailing part to the power of the state.

Example, the *Washington Post* and the *New York Times* have no problem complaining about the administration on a daily basis. You won't see that in other countries where the private sector depends on the government for advertisements, depends on it for tariff protection, depends on it for credit. Think about the private sector, in my own country, India, where many of these forces keep them pliant to government action.

Similarly, I think, on the other side, the community offers democratic oversight. And every once in a while it rises up against increasing collusion. You've seen this repeatedly in the United States. In the 1890s the populist movement led by the farmers was a protest against increasing collusion, increasing corruption.

Railroads used to buy up entire legislature, simply by the act of promising them free passes for the entire season. That essentially, the democratic action, the populist movement brought about antitrust. It was an attempt to curb the bar of the railroads, the ICC Interstate Commerce Commission, came in at that time. But also, it set the ground, the farmers were also very angry with the banks who were charging...the east coast banks were charging them, in their view, extortionate rates. And you can trace a direct line from the populist movement to it in the 1930s. It was a way of limiting the concentration of power.

Similarly, today, you see a movement against big tech. I see this as a direct line of the broader democratic community trying to impose some constraints on massive concentrations of power. So, this balance, reflected by this diagram. I won't talk about the values and norms, the last piece of it, but, this balance worked very well for many years.

What has upset the balance, typically, what upsets the balance, the next page, is great calamity. The Great Depression, in the 19th century, which we never remember, as well as the Great Depression of the 20th century, brought about massive changes in society, including the creation of safety nets. Social Security, as all of you know, came about during the second Great Depression, that is the one in the 1930s. But also massive technological change upsets society. And I would say that's the factor now that is really creating the imbalances.

If you turn to the next page. The ICT revolution, which has been going on for the last 45 years or

so, has done a number of things, but amongst the things it has done is disrupted markets. It's made trade much easier, but in a way that is very, very difficult for certain segments of industrial society.

Essentially, these global supply chains are now possible because you can monitor on a real-time basis what's happening in your Thailand factory. But you can also ship back and forth very cheaply, that's what the ICT revolution has done. But that means that you can produce anywhere in the world. You don't need to produce near where your intellectual property is created, near where the design is done, where the marketing and finance is done, because you can create a global supply chain and produce anywhere. What that has done is essentially hit production workers in industrial countries harder, while made it much better for the guys who create the intellectual property, the guys who market and so on.

So, this has had a great differentiated effect across communities. Some communities doing very well, New York, San Francisco, some in the middle doing very badly, the ones with the big producing down, who has left because they've gone to Mexico or China. That hollowing out is the middle class jobs. The well-paid production worker jobs has been happening for some time. But it's happening not just in manufacturing, but also in services and the bigger factors, not so much trade, but automation. Four jobs lost due to automation relative to one job due to trade.

But really, both of these factors are at work. What it does, and you see it across industrial

countries is with the disappearance of middle-income jobs. Many jobs low skilled, low pay, very high skilled, high pay, is it, creates an incentive for people to want to get that high skilled, high pay jobs.

Let me sort of skip over the superstar professions. We have increasing, just to say, that with the global reach, we have an increase in superstar nature of professions being really good, gets you enormous amounts of money. Those two women, Taylor Swift, today, makes \$172 million, the other woman, you may not recognize, Elizabeth Billington, the star of the London Opera in 1801, she made a \$1 million then, even though she was *the* diva of that time, filled the opera house. Why, the difference in pay, Taylor Swift gets downloaded 5.5 billion times. Elizabeth Billington was seen by about 100,000 people in the entire season.

You have much greater reach today, therefore, incomes at the very top, for the very best, have increased tremendously. Something that is true of everybody in this room. So, what happens then, I'll come to that in a second.

But one of the things that happens, as a result of global markets, which is the next slide, is that governance, this pressure for governance to steadily move up. In the attempt to create the European common market for example, a lot of the governance has moved up from the countries to the European Union bureaucracy, because you want common rules, you want common standards. This sense of disempowerment at the country level, one reason for Brexit, they want

to take control back.

But this is an example with capital requirements. When banks were located in particular towns, capital requirements were largely set at the town level, town by town. As they expanded beyond towns to the state, capital requirements were set at the state level. As they expanded beyond the state to the national level, capital requirements were set at the national level. Today, capital requirements are largely discussed and set in Basel, because we have multinational banks.

The point is, governance is migrating upwards. Which disempowers the community, disempowers the local, towards the global. There are some places where this is needed, but other places, where this is sort of just an inexorable trend, regardless, with a need to harmonize.

The last point, which is that, the ICT revolution has disrupted the community. Because the returns to education have increased so much, there is tremendous pressure to get your kids the best education you can get. What does that mean? Well, typically your kids learn much better if they're surrounded by really motivated peers who are also very well prepared. Your learning depends on how good the other kids in your classroom are.

So, if you're an upwardly mobile couple trying to figure out where you want to keep your kids, you want them to go to the best school you can afford. In a city like this, it is the best private school. In the suburbs, it is the richest suburb you can afford, because that's where the

professional parents will spend more time on their young kids at an early age. Professional parents speak much more, children learn many more words in a professional family. They also get much better health, nutrition, much better work habits.

By age 5, my colleague, Jim Heckman, who won the Nobel Prize says that it's pretty much done. They're done for life, because they're set. That really is what the family and community does. That's why you want your kids to move to the best community you can afford.

What we've seen over the last 30, 40 years in the US, is that segregation is happening. We are seeing the succession of the successful, they are moving to the best community they can afford, knowing that the others cannot follow. What you see is, the United States, used to have a lot more mixed communities. These are now, actually separated out, many more rich communities, many more poor communities.

The succession of the successful, is yet another reason why the community has been weakened. So, I've talked about three reasons. One, weakened because the market and the state have taken off functions from the community. Second, weakened because different communities have been differentially affected by the global impact of trade and technology. But third, because of the high returns to education, we have had a separating out. The succession of the successful because we now have a real meritocracy, the only problem is that meritocracy has become a hereditary meritocracy.

The standalone, ivy league admissions, that we read about a few weeks ago, is just the icing on the cake. It's already a very skewed system. This is why we have widespread anger. Widespread anger because opportunity is no longer widely distributed, it's much more concentrated. People don't feel that their kids will have the same future they had.

It's not because anybody is willfully doing this, it is a consequence of the effects of technological change. The problem, and that's the last phase, is the trends are completely wrong. We essentially cannot afford the solutions that populists, nationalists argue for. Erecting barriers to trade is not going to help us deal with technological change, which is also eliminating jobs.

Moreover, as populations age, countries will have to think about whether they actually import people, so as to support the large unfunded entitlements they already have. Because somebody needs to do the work. We know that there's going to be a pyramid, an inverted pyramid going forward. You need to make it less inverted.

So, the high unfunded entitlements also suggest some amount of controlled immigration is needed in developed countries.

Finally, as populations age, where is the growth going to be, not here, it's going to be there in the young countries around the world. So, these suggestions by the populist, which typically imply constraints on trade, and if you are a right-wing populist, constraints on immigration seem to be

short-sighted, given that much of the industrial world will depend on the rest of the world to going forward.

So, openness is really necessary. How do we achieve that openness, while addressing some of the concerns that have arisen? That's the last part of the book, for which I don't have time, so I will stop here. (Applause)

Question and Answer Session

FRANK BROSENS: That was terrific. Having heard your comments, the question foremost in my mind is, how in the world did you have the good luck to manage to keep that magnificent head of hair. (Laughter)

RAGHURAM RAJAN: Well if you look closely, it's neither magnificent, it's thinning rapidly.

FRANK BROSENS: My wife thinks I look better this way. I think if she's telling the truth, she's probably the only one I know. I'm truly delighted to have the opportunity to interview Raghuram Rajan. In addition to everything that you heard from Barbara Van Allen, Raghu has been well-known for seeing around corners and identifying issues and risks that the world faces before anyone else and sometimes long before anyone else. I think he's done that again with this book.

In 2005 he famously gave a speech at Jackson Hole, titled, “Has financial development made the world riskier?” In the speech he identified “the emergence of a whole range of intermediaries whose size and appetite for risk could leave them exposed to certain small probability risks that their own collective behavior makes more likely”. Not just prescient but prescient for exactly the right reasons. And literally three years before.

His book in 2010, *Fault Lines*, was also prescient, focusing on widening income and equality as a growing and likely persistent problem. Which led to politicians, in his view, attacking the symptoms but not addressing the problems. That book won both the Financial Times and the Goldman Sachs Book of the Year Award, beating other small books like the *Big Short*, and a few others.

It really does bring me to the first question, which is, has your thinking really changed since writing *Fault Lines*, or is this just an evolution of your earlier views?

RAGHURAM RAJAN: I think in *Fault Lines* I worried at that time that the consensus on both trade and immigration would break down. That was one reason why I wrote it, saying, that’s not the problem. I was unfortunately, unpleasantly...watching what’s been happening, I worry that we’re attacking the system which actually has brought us so much prosperity.

At the same time, I think business as usual simply will not work. That we can close our eyes and

hope a little more stimulus, a little more growth will do it. The real problem is aggregate growth may look good. The point we were talking about, this looks, you know, 3.7% unemployment, low inflation. I mean, this looks so much better than the early 80s when you had the misery index going through the roof.

But the difference is, that, you have pockets of deep distress, still, in every country. Whether Jilly Jones are protesting in France, the little towns that growth has forgotten. But even in the United States, the little towns that growth has forgotten, and these guys are increasingly disconnected. You're getting second and third world regions, in a first world economy. Where growth is not going to reach, because the standard instruments we have for growth, low interest rates, some fiscal stimulus just don't penetrate. They don't have the capacity to take advantage of that.

That's the sense in which, I mean, from an abstract economic perspective, the focus on community is really a focus on place-based growth, local growth. And that's really, I want to....it's an attempt to change the dialogue, saying if we don't enable these communities to lift themselves, we are not going to get much. I mean, in many ways, this strikes me as a problem of development, that international economists have been dealing with, with so many years.

We have undeveloped places in the world, how do we get them out and the answer was never centralized policies. Because it rarely worked. In fact, very few instances where it really worked.

It was more countries sort of pulled themselves out with the help of the rest of the world, through
Create INSA-1. (?)

We have a similar problem in the industrial countries. Under-developed communities, which are
breaking down, and going further down. The real question, is how do we elevate them?

Otherwise, this anger is going to spread.

FRANK BROSENS: The big example, I guess, in our community that's been a big topic of
conversation the last few weeks is Amazon. I'm curious how that plays out?

RAGHURAM RAJAN: It's a very interesting situation. Because think of the administrations
main method to reach these communities, people are aware that there are dis-risk communities
and we need to reach them, it's the opportunity zone idea. Right. That we are going to give some
benefits to capital flowing into these areas. That's not a bad idea, but think about the most, sort
of ideal outcome of opportunity zones, it would be something like Amazon. Going into a
distressed area saying we're going to bring 25,000 jobs, each paying \$150,000 and the state is for
it, the mayor is for it. And of course the country more broadly is for it.

And yet, we see a push back in the community. Now, we don't know how widespread that push
back is, but it seems like really looking a gift horse in the mouth. Why are you upset that you're
getting \$150,000, 25,000 of such jobs? I mean, if you think through it, apart from all of the union

issues and this and that, that were going on, politicians, local politicians are not crazy. They're not going to say no, if they know that it's going to upset the constituents, which suggest that at least some people thought this was not going to be a win/win.

And one reason you can think about that, is , look how many people in that relatively depressed area could get those \$150,000 jobs, and the answer is probably some, but not a huge number. Many of them will come from outside.

Well, isn't that a good thing? A lot of rich people coming in, or well-paid people coming into the neighborhood, elevates local business, elevates local housing, elevates local rents, elevates local property taxes, not all to the good. And then, the question is, how do they affect the community? How does the inflow affect the community schools, does it pull away the best, which will be a problem, or does it bring smart Amazon kids into these schools?

The problem is, it wasn't completely clear whether this would be a benefit for everybody in the community. You needed much more of a dialogue to explain how this would not break the community into have's and have not's, and would actually elevate the community as a whole. And that's an example of what I mean, that what sounds like an unmixed blessing, on the ground turns out, at least in the perceptions of people, to be a lot more mixed.

This is the best thing anybody, I mean, people are killing to get Amazon to come to their states

and to their cities, and somebody said no. So, think about lesser investments and so on. It seems to me that we need more of a ground-up strategy, with the aid of the state, which helps people fix the problems that they really have.

Let me make one last point. One example I talk in the book is about a Pilsdon community in Chicago, which was literally a war zone. It had enormous number of murders. And they did something very local, which was, they decided the only way to get business was to fix the crime problem. Nobody was going to come in when there were 21 gangs and the murder rate was so high. So, they went at the crime problem. They identified three or four bars where all of the criminal element congregated. Got the city to shut down their licenses. They also decided to try and crowd out crime. A couple of ways, when an incident happened, they'd call into the police, multiple people would call in, so that nobody was identified as the caller and threatened by the criminals. They also went out into the streets and prevented, sort of, essentially made it much less possible for somebody to do crime in isolation.

Community action essentially brought down crime. And over time, once crime came down, this community started attracting Fospha(?) joints. In this community, at one point, getting a McDonald's was actually an elevation in the job environment. Now they're doing much better. And in fact they're suffering from the problems of success. They're getting gentrification. But that's a good problem to have.

FRANK BROSENS: Going back to Amazon, briefly. I've heard the arguments that in addition to the \$150,000 jobs, it was actually going to bring massive other jobs to the community in terms of drivers, restaurants, restaurant workers, etc. But it doesn't seem like that message was ever really communicated effectively. It may just be a function of bringing the community in.

RAGHURAM RAJAN: Right. Absolutely. It may be a dialogue that had to be had, but we need to have that.

FRANK BROSENS: You've talked about universal basic income and healthcare. And I'm curious, how that applies here and also in India, your country. How does it relate to Modicare, etc.

RAGHURAM RAJAN: It seems to me that if you go along this line that we as a society need to prepare our people to participate in markets. It seems to me that universal healthcare is a necessity. In today's world you need healthcare to participate. I'm not saying it should be privately provided or single payer, or whatever, I have no views on that. But it seems to me that, that should be a necessary aim because otherwise you can't participate.

I can understand the arguments for forcing people to pay for it, but there will be some people who cannot. What do we do about them? And do they have a right to participate in society. I'm firmly of the view that if you can afford it, as a society, it's a basic minimum in the premarket

provision to help people participate.

On the universal basic income, I'm much more skeptical. I'm skeptical because it seems to be that, that puts an enormous constraint on people participating in the market. Because it sort of is, in a sense something you do when there are no more jobs. And you can visualize no more jobs ever appearing. I'm talking about the version of universal basic income. On here's a living wage and you are paid it regardless of whether you work or not. That to me is what we do, you know, when the robots are doing everything. And none of us need work except for fun. At that point, it seems to me one can contemplate that.

Today, people are saying we need this because driverless cars are going to come. Well, maybe, maybe all of our Uber drivers will have to look for new jobs. But it seems to me that technology keeps creating the possibility of new kinds of jobs. Example, in healthcare. You know, it seems to me that we don't have adequate healthcare right now. But let's say we had an AI sort of background, which could diagnose, once it was fed in symptoms. Now doctors will tell you the hardest part is really eliciting the symptoms from a patient. Because there are so many roundabout ways to describe their problems and sometimes they hide their problems, because they don't want to talk about what's really going on.

So, you need a little bit of experience to elicit that. That's the human interface. And that's the human interaction which still really remains valuable even when machines are really important.

So, if we retrain that Uber driver into doing something like this, that's a job that the Uber driver doesn't need to know a whole lot of medicine, some, but not a whole lot. And there's a background sort of AI and then of course, behind the AI, there will be real doctors.

So, could we be eliminating the possibility of that when we pay these guys to stay at home and say no more jobs. And you remove the dignity from that person, or the dignity of earning a living. And are we ready for that? It seems to me it's a little too early. Just as a side note, universal basic income has been proposed ever since President Johnson, at least, there was a committee set up to propose universal basic income then, fearing that in a few years workers would become redundant because of technology. Well it hasn't happened yet.

FRANK BROSENS: So, kind of see whether technology as it progresses, see whether the jobs evolve. Keep the incentives there for people to work until you get to a point where okay, we're here.

RAGHURAM RAJAN: Absolutely. And it seems to me that it's hard to say that we're at that point now. I think we have lots of room to go.

FRANK BROSENS: Do you have a view on Modicare?

RAGHURAM RAJAN: Well I think this is part of the same issue. As countries get richer, there

is a demand for providing the basics of elements of life. And so we have Modicare, as you call it. I don't know whether somebody has really done the math to see if Modicare is affordable right now. At least at the level that they promise, and what the leakage is, what the incentives, etc. are. I think in India we have a tendency to start programs and say it's small, without recognizing that as it becomes successful the demand for it will increase. Today it's early days, but it will have a fiscal impact that needs to be thought through.

The flip side, the Congress is proposing a direct income transfer to the very poorest people in the country. And that's...it seems a very large number, 20% of the population. Now what is less clear, and I think they have said they will set up a committee to detail this stuff, is what are the programs this will replace, but there are lots of government transfer programs which are very inefficient. What programs does it replace? And to some extent how this can get rolled out.

I think it's early days to say anything about what the fiscal cost is and whether it is manageable. But I think there is a version of it which can be quite beneficial in empowering people with money, and allowing them to demand you the private or public service, without forcing them to be dependent on the public system.

FRANK BROSENS: I guess the fiscal issues also relate to monetary policy. If fiscal gets too wide, it creates some tension there. Monetary policy you've had a lot of news in India with Urjit Patel leaving in December. Governor Das loosening policy, I think he went from calibrated

tightening to neutral. Calibrated tightening is not a term I'd heard before. Some speculation that he may go to accommodative tomorrow possibly, and reduce rates further. I guess there are two questions there. One is, Central Bank independence, and is India losing that to some extent. And the second question is, what are the dangers of the current policy. Is the current policy right, and if not, what are the risks?

RAGHURAM RAJAN: I won't speculate on what policy tomorrow might be, but broadly, on the...first on the fiscal which will need correction post-election. We have an election coming up in the next few weeks. The fiscal is really very bloated. I mean, the headline number looks reasonable, but both the state and the central are actually spending more than the headline number. And there are all of these sort of unfounded liabilities and entitlement programs that are coming onboard. The next government will have to straighten out the fiscal reasonably quickly. Or generate growth so that fiscal looks more relative to the GDP. But that's something they need to take an axe to.

On the monetary side, I think in India when we started out fighting inflation, the big problem was food inflation. And food inflation, even though it's headline, it was actually persistent. And it seemed more a structural issue. The Central Bank was sort of ignoring that and saying, we're going to focus on wholesale price inflation which had very few sort of food elements and most of them imported. In that sense it was very convenient. Inflation was really low. But what people saw was consumer price inflation.

In order to tackle that, we moved our inflation focus or inflation target to consumer price, headline inflation. It did what it was supposed to do. We brought down inflation. The problem now is when you look at headline consumer price inflation, it looks really low, 2.5, 3%. Largely because food prices have collapsed. Food price growth has collapsed. The problem is core CPI inflation is still quite high, 5%. It's within the inflation target range, but it is higher.

If the Monetary Policy Committee was looking only at headline, and not thinking about how the drift of headline, whether it's going to move to its core or core is going to move towards headline, it would be justified in saying we can remain accommodated or get even more accommodative. Growth is not great, no matter what the GDP numbers suggest. There's some controversy about what the GDP numbers truly are.

But I'd say that there is some argument that can be made that way. However, if you think that headline is going to move towards core, over time, then you don't have that much room. Now, to your point about, is the Central Bank a little more pliant now. I mean there is some change as a result of the personality of whoever is appointed, and I think Mr. Das has been a fairly cooperative civil servant in his time in the finance ministry. He was the guy who was managing the demonetization. But, we'll see. My sense is, initially, governors try and please the government in part, but over time they find that this reduces the organizational sort of prestige, and they tend to develop a backbone.

FRANK BROSENS: Raghu is being modest I think. His effort from 2013 to 2016 in bringing inflation expectations down was a massive job and a massively successful effort. I guess the question is, if core becomes...starts to feed into inflation expectations again, the Central Bank can pretty quickly get behind the curve.

RAGHURAM RAJAN: It can. But I do think that there's now a consensus that a) we managed to bring inflation down, and that's generally quite good for the economy. So the old, what's a few percentage points in inflation. That has gone. So, I think so long as, I mean, people are driven by data because expectations are harder to pin down. If concurrent data about inflation starts moving up, especially with this post-target headline, I think you can see a change in Central Bank policy. Today, because it's low, you can still make the argument, ah it's going to stay low, so therefore we will be accommodative.

There will be inflation followers, rather than ahead of the curve, if that is the case. There's still some hawks in the committee. Vera LeCharia(?) from NYU is there, and ____, these are actually the most technically qualified members of the committee, and they're the guys who sort of, at this point are still the most hawkish.

FRANK BROSENS: Maybe we should open it up now to the audience. I'll take the first question from the fellow's table. And if you can, just state your name, your affiliation and make it a

question please.

QUESTION: (Not on microphone) Thank you very much for being here. My name is Anish ____ I work with ____ private equity. My question was on the impact of the ICT revolution in the community. You referenced here in the US that its led to the ____ successful. I'd be curious as to your view on the impact of ICT revolution on the communities in India.

RAGHURAM RAJAN: That's a great question. I think certainly the demand for high-quality education has gone up across the board in India. In India they succeed because the public school system was not great to begin with. There were very few middle-class people in what we call the public school system here. Instead the kids were in the public schools there, which are British public schools, another words private schools.

Of course the demand for high quality private schools there has increased tremendously. But it's increased at every level. You can see a desperation amongst the poor people to move away from the rotten public system into private schools, but the private schools they have access to are far lower in quality.

You can see it in people trying to get into...I mean the demand for undergraduate degrees across the world because India is not providing enough places is huge. But I think the other way it has affected people is through expectations. Within the traditional village community, everybody has

a TV set now. And they can see how people as well live, so the expectations have really gone up.

The biggest question in this election, before the recent skirmish with Pakistan, allowed the government to put national security as a big issue, was jobs. There are too few jobs for the aspiration levels of people. They desperately want better jobs to afford the lifestyles that they see. So, one part of it is the lifestyles. Of course, election results have changed as a result of ICT. There's a lot more direct use of social media, a lot more trolling, all the good stuff that you have here.

QUESTION: Abbey. Thank you for a fascinating discussion and a very interesting book. I'd like to turn our attention back to the book in the context of US domestic policy, including fiscal. We did see a very significant tax cut as it's being presented or discussed over the last couple of years. And it included the constraints on state and local deduction of taxes, the so called SALT. The argument was that, that was going to be an attempt to redistribute away from the communities that have done well, towards communities that haven't. The first part of my question is, are we actually seeing that something of a positive nature is taking place. The second related part of the question is, infrastructure policy. Clearly there has not been something done yet on the federal level with regard to infrastructure, but are we seeing that state and local communities are starting to build or rebuild infrastructure including a focus on broadband access.

RAGHURAM RAJAN: A great question. I think it's still early days to see whether that

distribution to other communities is working out. Of course, in order to take advantage of some of these tax changes you have to have some decent income. It doesn't help those guys who don't really have much of a job, in the first place.

But, on the infrastructure point, I think that's extremely important, because some of these communities, especially as far as broadband goes, they're simply not connected to the digital economy. I mean, one of the benefits of digital connectivity is work at a distance. So, you can still stay within your community and work in New York City, but for that you have to have reliable access. And if you look at the numbers, the US, probably because it's less dense than Europe, is far less well connected than Europe is. So there needs to be more work on infrastructure, especially things like broadband, but also actually a physical connectivity. If you want to start a business in your small town, you need to have the logistic connection. You can have access to an Internet platform which displays your wares, but you need to be able to ship it quickly and you need access to logistics and so on.

I think infrastructure is one way we could really help some of those distressed communities reintegrate back into the national economy.

QUESTION: Thank you professor. I studied along with Professor _____, my question is, in the last week when the Central Bank of India decreased the interest rate by 25 base points, my question is two-fold. One is, is it too late or too less, or in your view, is it helping the economy to

grow, or is it just an election gimmick. What's your view on that?

RAGHURAM RAJAN: You are talking about the last time the Central Bank cut interest rates. I think the malaise in the economy and some people may argue at the word malaise, right. We're growing at close to 7%. So this is something many countries would kill for, but it's still low, relative to the jobs that need to be created. And some of the private sector organizations, which have looked at jobs, say, we are far from creating the number of jobs that we need to create. An example, we have 39 million people, 29 million people applying for 90,000 low-level jobs in the railways. A huge demand.

The question is, is it inadequate demand, or is it inadequate supply for a variety of reasons we are more supply constrained. I think I am increasingly of the view, the problem is not so much demand, as it is, we need to remove the supply constraints. And that requires more government action rather than Central Bank action in trying to boost demand. Whatever Central Bank action takes place, does have some affect, alleviates some of the debt burdens to a small extent of the highly indebted, but also it alleviates, also helps as in prices. But it's less clear that it prompts the necessary economic activity because we're more supply constrained than demand constrained.

QUESTION: I'm talking about the timing of the interest rate decrease.

RAGHURAM RAJAN: You know, unless I have strong evidence I don't want to say that it's

politically motivated. I think, as I said, there is a reasonable case to be made that looking at current inflation, the Monetary Policy Committee would say, look it's too...we shouldn't keep rates so high.

FRANK BROSENS: What do you mean by government action?

RAGHURAM RAJAN: Look, there are lots of projects that are still stuck. There is some movement on highways, building roads and highways. But there are many others. There's this grand east/west corridor, north/south corridor, railways, roads, new cities, etc., And that has been much less movement...there has been much less...I mean it happens, but it is at a much more steady pace. And enhancing all of that would create more capacity and allow for more activity to be accommodated.

FRANK BROSENS: And to your point, there are a ton of workers that are ready, willing, and able to take those jobs.

RAGHURAM RAJAN: Exactly, so construction would really free up. Now to get construction really up and running in India, you need to fix the land acquisition laws. Land acquisition is really laborious, stands in the way of creating that infrastructure. We need an easier land acquisition process which is also seen as fair by people. And the land acquisition law that we have is just overly cumbersome. There's no way that it can be really put in practice.

The next government has to think about it. This government was going to do something about it, until they were accused of being in the hands of the big developers and they backed away from it. They haven't touched it ever since.

QUESTION: Arvind Sanger, Geosphere Capital: Raghu, you talked about the universal basic income that the Congress party has proposed. And you talked about the fiscal impact, and yet, if you look back at, first of all I was surprised to see Rahul Gandhi quoting you as one of the people consulted along with ___ I never thought the two of you would appear in the same discussion.

RAGHURAM RAJAN: The important word is consulted. (Laughter)

QUESTION: You talked about the fiscal impact or whether it's affordable or not, depending on what programs are removed, but the experience from the national rule employment guarantee scheme was the effect on inflation and the effect on discouraging rural labor in rural India. And this amount of money, \$6,000 rupees per month per family, would be adequate for families not to work. So you talked earlier about universal basic income problem being discouraging work which could drive, in this case, inflation. How do you think about it not from a fiscal standpoint but from an inflation standpoint?

RAGHURAM RAJAN: I think all of the points that you raised are extremely important, which is why, it's important to think this through. Politicians want to announce a headline number. But, after that it's very important that you detail it in such a way that it doesn't keep people from working. So, as you said, \$6,000 a month is a great number if you're living in Charkan. It's a terrible number if you're living in Delhi. So, there will have to be, in my view, some thinking through all of this, to make sure that you're not discouraging work. That what you're doing is creating capabilities and that you're substituting for programs rather than adding. If you add the whole plethora of programs that already exist, including subsidized food, and put this over and above that, then you get to the problem that I talked about with universal basic income. There is much less incentive to work. And that would be deeply problematic.

It needs to be thought through. I think there is a proposal to set up a committee, post elections to look at it in detail. That's my contribution, and figure out how it can actually work.

FRANK BROSENS: One last question. In the back, Patricia.

QUESTION: Patricia Duff. You really laid out a terrific path of what has happened so far. I'm wondering if you could just go into a little bit about how, what is the solution at the community level. Is this something that you must do from the mayoral level or is it something that you can create from the federal level so that you get more localism or whatever it is that you're calling these efforts to invigorate the economy at the local level?

RAGHURAM RAJAN: I think it's difficult to create localism from the center. And to some extent this was a problem with the Johnson administration, which tried to create community action, but mandated from the center. The problem there was that they didn't know how to work it through. And they wanted to bypass the local authorities, set up their own local champions, work with the unofficial, sort of activists. It was a mess. We didn't know whether to support local government, the activists, or somebody else.

But they were dealing with a different problem, which is that the community that they were most focused on, was really the depressed African American community. Which didn't have access to normal sources of bar. That's very different today than it was then. And so, I think you want to support local government initiatives which are focused on this, but you want to make available, both the powers as well as the resources to those entities, so that they can do what they need to do.

It is more a bottom up, rather than top down. I think there is some ways the central government can support, the federal government can support, and we need to think through that, but it has to be carefully designed. I guess both with the Indian sort of scheme and this scheme, a lot of it is about good policy. Right. Designing it properly so that it works as it should. That's something that I think we need to think through.

FRANK BROSENS: Thank you Raghu. Thank you all for coming. I think with that, I'm going to turn it over to Barbara. (Applause)

Barbara Van Allen: Just a reminder we have a robust schedule of events coming up this spring. A breakfast with Valdis Dombrovskis, the Vice President of the European Commission on April 11th, that's next week. A Diversity in Media Panel, How News Outlets are Building on Gender Representation. On April 16th we have a luncheon with Jeffrey Seller, who is the producer of Hamilton, on May the 1st. Also, just a few days later, May the 7th, we have Ajay Banga, the President and CEO of Mastercard at a luncheon. We then have Eric Rosengren coming in, the President and CEO of the Boston Fed, on May the 21st. And then Richard Clarida the Vice Chair of the Federal Reserve Bank will be here on May the 30th. So, please join us for some of these. And enjoy your day. (Applause)