Subbarao explained why India’s economic rise will continue in the post-crisis era.

A standing-room-only crowd packed Lewis Auditorium in Cornell’s Goldwin Smith Hall on August 28th to hear Dr. Duvvuri Subbarao, Governor of the Reserve Bank of India, give a talk entitled "India in a Globalized World: Some Policy Dilemmas." The talk was given as part of the Einaudi Center's Foreign Policy Distinguished Speaker Series.

Subbarao began his talk by claiming that he knew the answer to the most important question, when the global economic crisis would be over. Since the crisis began when he started his term as Governor and since people in India associated the crisis with him, he joked that the crisis would conclude when his current three-year term was up in 2013.

Subbarao proposed to examine the macroeconomic situation facing India’s economy. “All emerging economies were impacted by the crisis, but India’s was impacted less than many others,” he said. Whereas in 2008-2009 India had room for moderate growth, today’s high oil prices and inflation constrain growth. India is now more vulnerable to conditions in the global economy than during a previous “Demographic Sweet Spot” at the beginning of the growth period in 1991 where both exports and savings were high and there was more political support for a policy response, he said.

Subbarao went on to examine three dilemmas faced by the Reserve Bank of India. The first dilemma was how India could manage growth-inflation dynamics. Through slowing of investment, moderation of consumption, and deterioration of net exports, India’s growth has declined in the post-crisis period. Wholesale Price Index (WPI) and core inflation have started moderating since December 2011. Increases in food, commodity and oil prices, coupled with demand pressures and India’s fiscal deficit, have contributed to this inflation. Although actions by the Reserve Bank of India have succeeded in lowering the rate of inflation, Subbarao said it is still above “acceptable” levels.

The second dilemma addressed by Subbarao was how to manage short term tradeoffs that benefit the domestic economy without damaging the long term sustainability of the external sector. He identified the main challenges to growth of the external sector as the high level of current account deficits (CAD), the type of flows financing the CAD, and the exchange rate volatility. “The 1991 reforms were by far the most extensive reforms in the external sector,” he said. “20 years thereafter, the external sector has been robust. In fact, the external sector has been the buffer against all other macroeconomic pressures.” Slowing exports and risk aversion among
investors in global markets have caused a decline in CAD. Ideally, the Reserve Bank of India wants capital flows that are equal to the CAD, Subbarao said, but their variability makes them too much or too little. This validates what he described as, “Subbarao’s Law of Capital Flows: You never get capital flows in the exact quantity and/or at the precise time you want them.”

The third and final dilemma discussed by Subbarao was how best to manage what he described as, “The political economy of fiscal consolidation.” A fiscal deficit is problematic to the health of India’s economy because it crowds out the private sector and threatens debt sustainability, while the growing interest burden reduces discretionary public expenditure and exacerbates inflation if the economy is operating at full capacity. Much of India’s fiscal deficit is structural, and the fact that much of it goes to subsidies presents a significant political challenge to reducing this deficit.

Subbarao then moved on to a topic he didn’t really want to discuss but that everyone wanted to hear about; comparisons between the economies of India and China. Whereas China’s economy is a demand constraint economy, he explained, India’s economy is constrained by supply. China needs to develop domestic demand, but India needs to build its export sector. China needs to shift its balance from investment to consumption, and India vice-versa. Outside their double-digit growth rates occurring at the same time, Subbarao said, most comparisons between the two economies weren’t really valid.

Subbarao concluded his talk with the contention that India’s growth story was still credible. “India has such poverty that we need to grow at ten percent per year for the next 15 years just to catch up,” he said. However, he cautioned, “India’s growth is not inevitable, and both the public and private sectors need to do all the right things to achieve it.”

After summarizing his prepared remarks, Subbarao responded to questions from the floor. One audience member asked Subbarao to explain why India’s economy was now growing at such a higher rate than during its colonial period and the first 40 years after independence. He answered that the colonial period has been characterized as having had a “Hindu rate of growth,” with a fatalistic acceptance that economic growth is preordained and that nothing the administration did would improve it. India then hit what he called a “Demographic sweet spot” in which productivity grew concurrently with a decline in population growth, which made per capita income rise. The benefit of this growth has gone to lower income groups and has improved both their standard of living and has fueled domestic demand.

A student in the audience asked, “How much should the central bank intervene against unemployment?” Subbarao answered that unemployment is notoriously hard to measure in India since agriculture represents 15 percent of the GDP but 60 percent of the population is employed in the agricultural sector. He continued to say that the challenge is to find jobs for those in India’s current demographic “bubble” so they can create a demographic “dividend.” With a rise in agricultural productivity leading to less employment in the agricultural sector, he said, the service sector won’t be able to absorb this additional labor so India must create manufacturing jobs for its current rate of growth to continue.

Professor Frederik Logevall, Director of the Einaudi Center, then exercised his “moderator’s privilege” to ask Subbarao to give the “pessimistic conclusion” to the topic of his talk. Subbarao
answered that even with a decline in the growth of the global economy, the domestic ingredients are intact for India’s growth story to continue.

Dr. Duvvuri Subbarao assumed office as the twenty-second Governor of the Reserve Bank of India in September 2008. Prior to this appointment, Subbarao served as Finance Secretary to the Government of India from April 2007 to September 2008 and as Secretary to the Prime Minister's Economic Advisory Council from March 2005 to March 2007.

As a member of the Indian Administrative Service (IAS), Subbarao has been a career civil servant. Over the years of 1974-98, he worked in various positions in the state Government of Andhra Pradesh and in Government of India.

Subbarao was a Lead Economist in the World Bank (1999 - 2004), where his responsibilities involved advising developing countries on public finance management. He also task managed a flagship study on decentralization across major East Asian countries which was acknowledged as innovative policy work.

Subbarao received BSc (Hons) in Physics from the Indian Institute of Technology, Kharagpur and MSc in Physics from the Indian Institute of Technology, Kanpur. He also has an MS in Economics from the Ohio State University (1978) and was a Humphrey Fellow studying public finance at MIT during 1982-83. He earned his PhD in Economics from Andhra University for his thesis on "Fiscal Reforms at the Sub-national Level" (1998).

Subbarao came into the Reserve Bank just a week before the global financial crisis erupted in full in mid-September 2008. He led the Reserve Bank’s effort to mitigate the impact of the crisis on India and was actively engaged in the G-20 effort to coordinate an international response to the crisis. The challenges ahead for the Reserve Bank, as he sees them, are to bring inflation down, support the growth momentum of the Indian economy, take financial sector reforms forward and deepen financial inclusion.

Subbarao maintains a strong commitment to academic pursuits, and has written and lectured extensively on issues in macroeconomic management, public finance and decentralization.

The Foreign Policy Distinguished Speaker Series features prominent leaders in international affairs who can address topical issues from a variety of perspectives. The Speaker Series is part of the Foreign Policy Initiative at Cornell led by the Einaudi Center to maximize the intellectual impact of Cornell's outstanding resources in this area.