Speech

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Introduction of Raghuram Rajan, ETH Zurich

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Chairman of the Governing Board
Swiss National Bank
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Ladies and gentlemen

I am very pleased to welcome you all to this year's Karl Brunner Distinguished Lecture. This occasion marks the 30th anniversary of Karl Brunner's death. In the Karl Brunner Lecture Series, the Swiss National Bank pays tribute to academics whose research is of particular relevance for central banking. Today we are celebrating the outstanding contribution made by Raghuram Rajan, the Katherine Dusak Miller Distinguished Service Professor of Finance at the Booth School of Business at the University of Chicago. We are honoured that Dr Rajan has accepted our invitation to deliver this lecture.

Raghuram Rajan was born on 3 February 1963 in Bhopal, India. He started his career with a bachelor's degree in electrical engineering from the Indian Institute of Technology Delhi. Following the decision to leave the sphere of electromagnetic fields and waves in favour of the oscillations of the economy and financial markets, Raghu joined the doctoral programme at the Massachusetts Institute of Technology (MIT), where he received a PhD for his thesis 'Essays on Banking'. Four years later, at the age of just 32, he became a full professor of finance at the University of Chicago.

Exceptional academic

Raghu is an exceptional academic. He has done pioneering empirical and theoretical work across a remarkably broad field of topics. His main interests, however, lie in banking, corporate finance and economic development, and especially the role played by finance in economic development. In his paper entitled 'Financial dependence and growth', co-authored with Luigi Zingales, he found evidence of a positive causality between the level of development of a country's financial sector and income growth. According to Google Scholar, this paper has been cited more than 9,000 times. This is on a par with Milton Friedman's influential 1967 presidential address to the American Economic Association on the concept of the natural rate of unemployment.

Raghu's trademark is his willingness to challenge the accepted wisdom of the day. The best-known example of this took place at the Jackson Hole symposium in 2005. There he warned of an upcoming meltdown in the global financial system, with substantial negative consequences for the real economy. Three years later, the global financial crisis broke out. And it was largely caused by the very factors that he had identified.

For Raghu, financial markets play an important role for economic growth in the long term. However, financial markets have a tendency to deviate from fundamental values. Financial regulation has therefore been a concern of his since well before the crisis. What are his recommendations in this regard? To be effective, regulation must avoid being procyclical, that is, over-regulating in a bust and de-regulating in a boom. Rather, regulation must be comprehensive and contingent. Consider two types of such regulation. First, instead of being required to raise permanent capital, institutions should arrange for capital to be infused when they are in trouble. One example of contingent capital is for banks to issue debt that automatically converts to equity under specified conditions. The second type of regulation is aimed at ‘too big to fail’ institutions. Instead of limiting their size and activities, a more sustainable form of regulation requires these institutions to develop a plan that would enable them to be resolved over a weekend. Both of these measures proposed by Raghu have become fundamental elements of banking regulation in Switzerland since the financial crisis.

Impressive policymaker

I have known Raghu for many years. From my personal experience I can say with conviction that he is not only an exceptional scholar but also an impressive policymaker. His career as a policymaker began at the International Monetary Fund (IMF). In the aftermath of the 1997 Asian financial crisis, the IMF wanted to strengthen its financial expertise. Anne Krueger, then the IMF’s First Deputy Managing Director, asked Raghu if he would be interested in becoming the IMF’s Chief Economist. Raghu replied: ‘Anne, I don't know any macroeconomics’. However, this claim was neither convincing nor credible for the IMF’s Deputy Managing Director, and so at the age of 40, Raghu was appointed as the IMF’s Chief Economist. He was both the youngest-ever person to be assigned the position, and the first from an emerging-market nation. During his tenure at the IMF he pushed the research department to focus on financial-sector issues and explore ways of integrating them into the IMF’s macroeconomic models. This was long before modelling the financial sector more effectively became a high priority both in academia and central banking.

After his three-year term at the IMF, Raghu returned to the University of Chicago. In 2012, he went back to India to serve briefly as Chief Economic Advisor to the Finance Minister. In 2013, he was appointed as Governor of the Reserve Bank of India (RBI), and in 2015 as Vice-Chairman of the Board of Directors at the Bank for International Settlements.

With hindsight, Raghu himself acknowledged that putting an academic in the Governor’s job at the RBI was ‘like letting a kid loose in a candy shop!’. Which is not to say that the job was always easy or enjoyable. When he joined the RBI, inflation was at double-digit levels, the rupee was in free fall, capital was fleeing, and growth was weak. Raghu did not waste any time. In September 2013, on his very first day in office, he gave a press conference outlining a number of planned reforms. Investors and markets were soon convinced that the RBI would follow a stability-oriented monetary policy.

However, there were also occasions when Raghu’s comments had surprising consequences. For instance, during a press conference in 2015, when asked whether he was dovish like Janet Yellen or hawkish like Paul Volcker, he replied ‘My name is Raghuram Rajan and I do what I do’. Of course, the next day this James Bond-ish remark made headlines in the financial press.

When his three-year tenure ended, inflation was near the five percent inflation target, thereby improving conditions for ordinary citizens. Interest paid by the government had been reduced and bonds with maturities up to forty years were being issued for the first time. The value of the rupee had stabilised, foreign exchange reserves were at a record high, and India was the world's fastest growing major economy.

The three pillars of society

Let me finish by saying a few words about one of Raghu's latest publications. Next to an impressive list of about 90 peer-reviewed papers on specific economic and financial topics, Raghu has also written four books with a broader perspective. In his book, *The Third Pillar: How Markets and the State Leave the Community Behind*, which was published this year, Raghu emphasises that society is supported by three pillars: the state, markets and the community. Society can prosper if it achieves the right balance between the three pillars. Raghu argues that today, these pillars are seriously out of balance. While states and markets have expanded their powers, communities have been left powerless in dealing with the consequences of technological change and globalisation. As a result, people turn towards populist politicians. Their solutions, however, undermine the liberal market democratic system that has brought about prosperity. The appropriate solution to many of our problems consists of returning power from the state to the community. Communities should be able to develop policies to address their own needs. This makes them less receptive to populist solutions. Raghu's view reminds me of the political system in Switzerland. Here, political decisions are taken at the lowest possible level of governance, closest to the people concerned. This decentralisation fosters citizens' engagement in their communities.

Today, Raghu will speak about an issue that is more narrow in scope, but which is of great importance to central banks, not least to the Swiss National Bank. His speech is about the spillovers of monetary policy beyond a country's border. This topic has attracted a lot of attention in the past few years following QE and other unconventional monetary policy measures adopted by central banks. Who better to speak to us on this subject than Raghu with his profound knowledge of capital markets and his experience as the central bank governor of a country highly exposed to monetary policy decisions taken elsewhere?

Ladies and gentlemen, please join me in welcoming Raghuram Rajan with a big round of applause.