Social Sciences – Economics 2011

"I think the field of economics, the field of business is extremely exciting. Partly because we've seen that sometimes economies seize up, they don't work. And, the old answers we had explaining these kinds of things, we find they don't work so well. So there's an enormous amount of work to be done to understand what has happened and what kind of changes we need."

Raghuram G. Rajan

Governor, Reserve Bank of India, and Eric J. Gleacher Distinguished Service Professor of Finance, Graduate School of Business, University of Chicago

- B.Tech. (Electrical) from the Indian Institute of Technology, Delhi
- M.B.A. from the Indian Institute of Management, Ahmedabad
- Ph.D. in Finance from the Massachusetts Institute of Technology

Prof. Raghuram G. Rajan's work has analyzed the contribution of financial development to economic growth, and its potentially harmful effects of dysfunctional incentives that lead to excessive risk-taking. He presented convincing evidence of the possibility of a global financial crisis in 2005, well before the actual crisis occurred during 2008–09.

Predicting a financial meltdown

In the 1950s and 60s, the economies in the West enjoyed a tremendous growth buoyed by the end of the war, the reconstruction boom, and the resurgence of trade. By the 1970s, this rate of growth slowed leading to a massive slump in the western economies. To counter this, in the 1980s and 1990s deregulation of trade became the norm. This led to a rise in new entrepreneurial ventures.

As trade barriers came down, competition between companies increased. In order to perform better, they needed increased financing. This was provided by banks which became the cornerstone of the economy. Bankers went from being boring and safe to taking on increasingly risky ventures. A so-called 'bonus culture' where you were rewarded no matter what, rewarded them for actions that could destroy their own institutions or even the entire system.

Prof. Raghuram Rajan's work mainly focused on financial institutions and their role in the growth stories of nations. He pointed out that the structure of financial sector compensation was such that bankers were given huge cash incentives to take tremendous risks with other people's money, while imposing no penalties for any losses incurred.

As early as 2005, Prof. Rajan predicted a meltdown based on his extensive research of global financial systems.

In 2008, a catastrophic meltdown hit the global economy and most people were caught unawares.

Prof. Rajan has since suggested several safeguards to financial markets including a plan to create a form of financial catastrophe insurance that banks could buy into.