

Will the Renminbi Eclipse the Dollar?¹

1. I have great pleasure in welcoming Arvind Subramanian, Senior Fellow at the Peterson Institute for International Economics, Washington DC. He will shortly be speaking to us on ‘Will the Renminbi Eclipse the Dollar?’ based, I believe, on his latest book ‘Eclipse’.

2. It will be presumptuous on my part to introduce Arvind. Some of us are privileged to know him personally, and almost everyone here knows him by name and by reputation.

Stature and Reputation

3. Over the last few years, all of us have seen Arvind grow in stature and international recognition as a leading expert on the global economy. He has been widely acclaimed for his sharp mind, lateral thinking, and prized communication skills. I know for sure, because at the peak of the crisis, he was among the first, possibly the very first, to raise the issue of the need for EMEs to have a minimum amount of reserves for ‘self-insurance’. It is not surprising that Arvind was called upon by the White House to brief President Obama before his visit to India last year.

Eclipse

4. While Arvind’s achievements to date have been truly impressive, his recent book “Eclipse: Living in the Shadow of China’s Economic Dominance” has catapulted him to the top league of thought leaders on the global economy.

¹ Welcome remarks by Dr. Duvvuri Subbarao, Governor, Reserve Bank of India at the talk by Prof. Arvind Subramanian, Senior Fellow, Peterson Institute of International Economics on October 7, 2011 in RBI, Mumbai.

5. Since its release, barely three weeks ago (September 16), Arvind's new book has made intellectual waves. It has been reviewed, critically acclaimed, discussed, debated and analyzed in virtually every major publication of intellectual repute. At a time when there is a new book on China practically every week, for a book to attract this sort of notice and praise is truly remarkable, and a tribute to Arvind's solid scholarship, incisive insights, and analytical skills. The very exclusive Foreign Policy magazine has selected Arvind as one of the top 100 global thinkers. Of course, I am not surprised. This recognition is a definitive acknowledgement that he has clearly transcended the boundaries of a single discipline of economics, and turned into an influential public intellectual at the global level.

6. I have not read Arvind's new book. But having been Governor for three years now, I know that one of the exclusive privileges of being the Governor is to be able to talk about books without having read them. However, I have read about the Eclipse, and so let me go on with my own understanding of Arvind's thesis in the book.

7. Arvind thesis comprises three points:

- (i) As measured by an index made up of the share of world GDP, trade and investment, China will overtake America as the world's dominant economic power sooner than people think. By 2030, China's share of global economic power will match America's in the 1970s and Britain's a century before.
- (ii) The three forces that will dictate this race to the top by China will be (a) demography, (b) convergence, which is the scope for 'catch up' and (c) 'gravity' which is a measure of the trade potential of a country.
- (iii) This projected rise of China to the top is imminent. The world should prepare for this through policies for reconciling China's rise with continued openness in the global economic order.

8. Arvind's conclusions are clearly contentious and contestable. However, in the best practice of intellectual integrity:

- (i) He clearly lays out his assumptions about US and Chinese growth rates.
- (ii) I believe he actually makes very conservative estimates above China's growth rate relative to its stellar performance over the last two decades.
- (iii) He also argues out clearly why China will overtake America in the twenty-first century faster than America overtook Britain in the nineteenth century.

Arvind's Arguments

9. Arvind's arguments and conclusions are persuasive for many reasons.
- (i) China has put out dazzling growth performance over the last two decades. We may dispute the fine numbers, but there is no doubt that what China has achieved by way of lifting hundreds of millions of poor people out of poverty is by far one of the most spectacular economic achievements in human history.
 - (ii) Last year, China overtook America as the world's largest manufacturer, and overtook Japan as the world's second largest economy.
 - (iii) The Chinese growth model and the Chinese way of doing things have won grudging admiration, even if not legitimacy.

Questions

10. At the same time, there are several questions concerning whether China can sustain its performance and come out on top. Let me list a few important ones.
- (i) Can the China growth engine maintain its momentum? Is the so called 'Chinese model' of export thrust, domestic investment binge and suppressed domestic consumption sustainable, especially in a large, heterogeneous country with a population of over 1.5 billion? In particular,
 - (a) Will the external environment sustain the export momentum?
 - (b) Can a country continue to invest 50% of GDP year on year without hitting against immense overcapacity, diminishing returns and a staggering non-performing loan problem? In short, will China not hit a brickwall?

- (ii) Second, can China make the strategic adjustment, what they call ‘rebalancing’, from external to domestic demand, and from investment to consumption in an orderly, calibrated way?
- (iii) Another set of questions relates to what happens after China exhausts the scope for ‘catch up’ growth as it already seems to. Will it not get locked into a middle income trap because of ageing population and rising real wages? Will China be able to innovate new sources of growth to keep moving up the value chain to escape the middle income trap?
- (iv) Fourth, a political economy question is whether China can rise to dominance even as it continues under an authoritarian regime? The Chinese success so far has, of course, given near legitimacy to China’s authoritarian model. Will continued authoritarianism be a plus point for China’s inexorable rise to the top or will it be a drag? Will the regime implode under its own weight? Or as some analysts argue, will China’s growing prosperity itself open up an avenue for winding down the authoritarianism, and provide a roadmap towards democracy?
- (v) Finally, a question more relevant here in the Reserve Bank is ‘what of the renminbi, in particular its potential international status? Quite independent of any currency in view, we in India have held that for any currency to be a global reserve currency, it has to fulfill certain attributes:
 - (a) the currency must be freely convertible both on current and capital accounts;
 - (b) its exchange rate must be determined by market forces of supply and demand;
 - (c) a significant portion of the world trade must be invoiced in the aspiring reserve currency;

- (d) in order to enjoy the exorbitant privilege of issuing the reserve currency, the issuing country must accept the ‘exceptional responsibility’ of maintaining sufficient liquidity in the currency;
- (e) its financial markets must be open, deep and robust;
- (f) the policies of the country must inspire trust and confidence.

China and India

11. I believe I have raised a lot of questions. But let me conclude with some thoughts on India-China comparison which has almost become a national obsession.

12. For us in India, China means many things - an object of envy, a challenge and an inspiration.

13. Note that in 1700, India, with a population of 165 m, was the world’s largest economy, followed by China with 138 m people. Even a century later, in 1820, as Industrial Revolution was gathering pace, India and China accounted for half of world GDP. The pecking order completely changed after that. China and India got relegated to the bottom of the league of nations. And over the last 25 years, we are fighting our way back up.

14. But China is ahead of us by miles. China is already a low middle income country, whereas India is still a low income country and home to the largest number of poor people in the world. As recently as 1990, India was 30 places ahead of China in the global competitiveness index. We are now 30 places behind China. As recently as 2000, there was at least one Indian university/institution in the top 100 global institutions while China had none. Today China has five and India has none. As measured by patents registered or research publications, China is moving up, and India is moving down.

15. I am making this comparison not so much in despair, but to trigger some introspection about what India should do to regain the glory that we enjoyed as the world's pre-eminent global power 300 years ago. China has demonstrated what is possible. To that extent China is an inspiration. The task for us in India is to match up to that record, or even surpass it, but by doing it the Indian way.

16. I am sure listening to Arvind about China's rise to the top will answer many of these questions and also provide us answers for our own way forward.

17. Please join me in welcoming Arvind Subramanian.