EASTERN

GLOBAL FINANCIAL CRISIS

Implications and Repercussions

M.N. Bhattacharjee, M. Dey, B. Wanniang
Sankar Sarma, L. Pathaw

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Global Financial Crisis: Implications and Repercussions

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Preface

Whether perceived as an aftermath of globalisation or not, the fact remains that the world is changing rapidly and so is India. India, with its high GDP rate, mobility and a demographic revolution of the young, is considered as one of the fastest growing economies today. A sizeable section of young Indians now believe that they are better off than their parents and that their children will fare even better even as the official data shows that the high growth economy has transposed 300 million into the middle class, and brought 250 million out of poverty since the 1980s. However, that still leaves another 550 million whose social indicators project that their conditions are far below the minimum comfort level, which should be a cause for alarm.

In an era that allows private and corporate sectors to reap unprecedented and enviable harvest from economic activity, there are claims that this has given rise to a boom in social sector spending despite comments by Nobel Laureate Amartya Sen that it would be 'stupid' to focus on double-digit GDP growth without spending more on the social sector. On the other hand, Jagadish Bhagawati, a potential Nobel Laureate, stresses that the second-generation economic reforms would accelerate growth to finance the target of social spending. Yet there is a school of thought that accuses the "Left" of ignoring the fast-paced growth and the boom in social spending by the government and so brands the "Left" analysts and economists as 'stupid' and 'scandalous'. Between 2004-05 and 2009-10, the accumulated social spending by the central and the state governments together has more than doubled from Rs. 1.73 lakh crores to Rs. 4.46 lakh crores [that is, from 5.33% to 7.23% of the GDP], which means that social spending has actually risen faster than GDP. It is argued that the rapid GDP growth has financed, not hindered, the rapid growth in social spending. Despite all these false claims, we still have more than 550 million languishing in pathetic living conditions with little hope for alleviation of their lot especially in view of the financial crisis looming large across the globe.

The Indian economy has strong links with the Gulf region. Of all the countries and regions, the Gulf is India's largest socio-economic partner and is vital to our future internal and external security, economic growth and prosperity. For instance, in 2009, the UAE was our largest trading partner and the number one destination of our exports, with Saudi Arabia being the fourth largest partner. More than 6.2 million Indians live in the GCC [Gulf Corporation Council) countries. The Indian Diaspora in the Gulf has been sending billions of dollars back to India for several decades. The Gulf region is the source of 80% of all our imports and this percentage is on the increase. More than 50% of all flights to and from India are between India and the six GCC countries. With the recent developments in the Middle East since late 2010, the political and economic equations are bound to take a new turn and consequently pose a question as to whether India would be able to maintain its growth rate in the backdrop of these developments.

International situations reflect on the political, economic and social aspects of any country and this includes India. The financial crisis of 2008 in the USA, which followed in other countries, had an impact on India too, though the magnitude of the impact was neither felt immediately nor to a great extent. However, the recent unremitting rising prices of all commodities, especially that of food, is indirectly linked to that crisis, and India is slowly but surely feeling the effects. Isn't the current crisis fuelled by the so-called global financial meltdown which is the inevitable culmination of the finance capital neo-liberal imperialist order where all aspects of economic governance are subordinated to finances' capital lust for the quickest possible gain? Does the crisis not expose the dubious mode of operation of modern capitalism under the neo-liberal order? When there is a boom, there are no regulations and the speculators reign. Often they create artificial boom by fraudulent methods, particularly the use of public funds for their personal or their cartel's gain. When the boom fizzles out, the governments rescue the collapsing institutions through public funds, but the people continue to lose through unemployment, loss of savings, wage cut, etc. Does it not also imply that the current rise in, and scale of, corruption involving huge losses to the public exchequer and, most dangerously, the institutionalization of corruption, have been paved the way by the management of the economy under the neo-liberal format?

It was the resolution of the Shillong College Faculty to provide a platform to discuss and deliberate on this aspect of global economy and, consequently, a National Symposium on "Great Depression of 1930s and

present Global economic meltdown – identifying the commonalities and lessons thereof" was organized. It was also thought necessary to highlight the emergence of new economic blocks like Brazil, Russia, India, China, Indonesia and others - a fact which has introduced an element of anxiety for the West which had been smugly complacent since the 1990s with fall of communism in the erstwhile USSR.

It was a matter of pride and honour for the organizers to have had as Resource Persons, Prof. C. P. Chandrasekhar of Jawaharlal Nehru University, New Delhi, one of the internationally-reputed and leading economists of our country and Shri Jitendra Choudhury, Honourable Minister of Industries and Rural Development, Government of Tripura, and a prominent political personality of this region, who raised the level discussion to new heights. The symposium was also significantly enriched by the participation of Shri Phrang Roy, IAS, former Vice-President, IFAD, Shri Conrad M Sangma, Honourable Leader of Opposition, Meghalaya Legislative Assembly, and Shri Pynshyngai Syiem, Parliamentary Secretary, Government of Meghalaya, besides other intellectuals and research scholars from universities and colleges across the country.

The Editorial Board is extremely privileged to publish here the contributions from the Resource Persons, all the papers presented as well as the report of the proceedings of the symposium. We sincerely hope that this publication will be of immense help to the students involved in research in relevant topics as well as the planners and policy makers to design more pragmatic strategies for the development of the region as well as the country as a whole with public welfare as the supreme goal. We, however, express our regret over the in-ordinate delay in the release of publication the reason for which was beyond our control and expectations.

February 5, 2012

Dr. M. N.Bhattacharjee
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Introduction

The basic feature of development in present world is to engulf the idea of reform and opening up to the world market. India has taken adopted the policy of globalisation, liberalisation and privatization of its economy since 1991. But it must be recognized that this idea of opening up accompanied with some dangers for this environment with all its components creates a "Graham's Law" dynamic in which perverse incentives drive good underwriting out of circulation and hence leads to growing inequality. The reforms requires that it should keep (1) public ownership predominant; (2) democratic voices of people at highest esteem; (3) the need for a trained and steeled leadership to guide the conduct of people; and (4) a philosophy of leadership based on scientific, materialist and dialectical concepts. The opening of the economy while having its good effects in some sectors has also made it open to fluctuation in the world market. More we open up our economy, less we are insulated from these fluctuations and hence more vulnerable. The recession in economy over last more than four years therefore is having its cascading effect on the India economy and every one, particular the weaker section, is feeling the pinch of it in one way or the other.

Everyone is feeling the impact of the economic crisis. But the disturbing trend is that the burden of current crisis is being shifted to the peasantry, rural labour and the working people. Trade liberalization has exposed the peasantry to the volatility of international agricultural prices and highly subsidized import competition. The lack of adequate social expenditure and the crippling of the public distribution have lead to the impoverishment of the rural poor. The global economic crisis - through domestic deflation, credit squeeze and sharp fall in crop prices - is certain to worsen the state of distress of people unless immediate corrective steps are taken.

In the backdrop of the unfolding crisis of world today particularly in the economic and financial sectors, there is a need for wider deliberation of people from walks of life, particularly the intellectuals, bureaucrats,

politicians, policy makers and others and hence to put forward alternative vision which may enhance the path the development and provide sustaining relief to people thus paving the way for egalitarian trajectory of development. We need to evolve strategies to combat the crisis and make the life of the people more comfortable and healthy. People must get involved spontaneously rather than being forced to participate in the development. For this path of development must be people oriented, inclusive in nature and must take into account the local needs and aspirations.

Our country is, at present, faced with series of economic difficulties that have a direct bearing on the people's livelihood and well being. The government at the centre as well at the state level has to address these issues urgently and squarely. Everyone must remain vigilant in defending the interests of the people and work for strengthening the economy of the country. Intense discussion on whether to sustain the present financial system by various "bail out packages" and wait for the next "bubble" to appear or to revive the real economy directly through fiscal stimuli and increasing the State participation will definitely result in positive outcome and intellectual forums and political groups may be motivated to work in harmony to create a better world for all of us.

The North-East region is again plagued with its own problems and dynamics which are getting multiplied everyday with this economic slow down. There is the additional problem that most of the mainland India people are ill-informed or have very limited knowledge about North-East. The Indian state the political elites have failed to socialize the North East with the pan-Indian mainstream society and culture. On the other hand, North East cannot expect to survive on central assistance and grants on this pretext or other. It will have to justify its claim or receiving its share of development. The economic melt down has affected the life of people of the region and more so the tribal societies. It is important that impact of the economic development on the life of people, with special reference to the tribal population of the region, be deliberated in a broader forum a pragmatic approach be taken where the societies can assimilate the economic and social changes so that people are able to lead their life with comfort and progressive ideas.

The considerations narrated above was deliberated and thoroughly discussed in the Symposium on "Great Depression of 1930s and present Global Economic Melt down - Identifying the commonalities and lessons thereof" organized by Shillong College Academic Society and Shillong

College on 25th and 26th June, 2010 and the present volume is directed to reflect on the discussions and other emerging issues base on observation and empirical data. The papers presented here not only discuss the problems and challenges but also suggest measures to face the challenges. The event was inaugurated by Shri Conrad K. Sangma, Leader of Opposition, Meghalaya Legislative Assembly. He reflected on the glaring irregularities of income and wealth distribution in India, which are due to the inefficiencies in management, and implementation of development programmes. He called upon the academician, administrators, policy makers and others to ponder over the problem with public welfare in mind and draw up sustainable strategies that will not be fluctuating with the speculative market. He also asked the student community to take lessons from the deliberations of the Symposium and improve their knowledge in the subject.

Prof. C. P. Chandrasekhar, Centre for Economic Studies and Planning, Jawaharlal Nehru University, International Development Economics Associates (IDEAs), Department of Economics, Jawaharlal Nehru University, New Delhi, delivered the Key Note address covering the various aspects of the crisis from the 1930s to the present day. Prof. C. P. Chandrasekhar began his lecture with the analysis on the Origin of the Depression of the 1930s, which has spilled over now as the Recession. In doing so, he related to the role of the Financial Sectors with special reference to the Banking system. He stated that the Banks perform two crucial functions of payment and settlement of transactions and are the principal carriers of risk. Failure of the banking system in performing these two roles has led to the depression earlier and at present recession. However, after the 1930 Depression, USA regulated the Banks and helped tackle this situation. In the post war boom and over the last 30 years the banking system has changed drastically and it has led to the liberalization of banks. These private banks provided credit and performed the role of payment or settlement of transaction and in the process earning high returns but they ceased to be risk carriers for they transferred the risk to the people (borrowers).

Thus, he stated and suggested that banks need structural regulations for it is this credit facility, which is the core cause of the recession much like the 1930 depression (indirectly referring to the household balance sheet where mortgage, credit etc. increased). He emphasized on the crucial role played by the credit policies of banks and financial institution as the main factors for the economic crisis. Shri Phrang Roy IAS (Retd.), former Asst. Vice President, IFARD, graced the occasion as the Guest of Honour

and commented on the relevance of the theme in the present day content, especially for the states in the NER. He also stressed on the urgent need of adopting sustainable development practices that combine modern knowledge and technology with traditional knowledge.

At the beginning of the Business Session Prof. C. P. Chandrasekhar again forwarded his learned and informative lecture on the sub-theme "Current Financial Crisis". He elaborated on the origin of the Great Depression of the 1930's analyzing its similarities and effects to the economic crisis in the present day context. In doing so he related to the crucial role played by the financial sector with special reference to the banking system. Crucial function played by the banks in term so credit expansion, investment, and policies etc. were stressed upon. He stated that the banking system perform two crucial functions, i.e. payment and settlement of transactions. They are also the principal carriers of risk. The failure of the banking system to efficiently perform these functions resulted in the great depressions of 1930s and the economic crisis of the present day. Emphasizing on the important role played by the Government to tackle the various dimensions of the crisis he stated that structural regulations of the banking sector are crucial to control economic fluctuations.

In Session II, the sub-theme was "Global Recession - an overall analysis" and the participants from various states presented five papers. The first paper was presented by Jasojit Debnath, on "Lessons Learnt from analysis of financial crisis" which was also co-authored by Prof. Sujit Sikidar. The paper focused on the Dubai Financial Crisis of 2009 and the Greek Debt Crisis of 2010 so that lessons can be drawn from the past crisis and preventive measures can be adopted for the future. The paper emphasised that currency management as well as debt management cannot be left to the free-play of the market forces. There is a need for a judicious balance of restricted capital account convertibility.

The second paper on "Understanding Impact of 2007 version of Global Financial Meltdown on Indian Economy" was jointly co-authored by Prof. Philip Mody and Prof. M. Mossang and analysed the historical background of the 2007 version of global financial crisis highlighting its positive as well as its negative impacts pm the Indian Economy. It emphasised that the lesson learnt from the global economic meltdown 2007 include the adverse impact of being engaged in excessive speculation, improper credit rating, granting high-risk loans, faulty government policies etc. the paper pointed out that the impact of the financial crisis had not been very severe in India as in other Asian economies mainly due to her

almost closed-economy like character. However, India have to be cautious about the global financial meltdown 2007 that had taken place in USA since it has affected Indian banks, the service and production sector, real estate sector, the IT sector, the stock market, exchange rate depreciation and economic growth. Therefore there is a need for the adoption of remedial and precautionary measures to avert any economic crisis.

The third paper of the session entitled, "Role of Indian Economic Policy on International Financial Capital - its efficacy in dealing Global Economic Meltdown", was jointly co-authored by Dr. M. Dasgupta and Prof. P. C. Marwein,. The paper attempted to analyse and compare the intensity of the two global meltdowns, i.e. the Great Depression of the 1930s and the Great Recession of 2007 and their impact on the Indian Economy. The paper highlighted that the imperialistic policy of the Government of British India during the thirties devastated the Indian economy while the country remained less affected during the recent economic crisis. This was mainly due to appropriate economic policy management and structural reforms, significant spending on infrastructure, efficient and productive capital management, maintenance of stable interest rate through effective control of inflation rate by the RBI etc. All these had provided a strong foundation for sustained economic growth. Further, strong regulations by the RBI on the flow of international financial capital has helped to maintain stability in the exchange rate to a considerable extent.

The fourth paper of the session entitled, "Economic Slowdown, Impact of Downsizing on HR: Antecedents and Consequences", was co-authored by Dr. Chimun K. Nath, and Prof. Rahul Dutta focused on the psychological well-being of employees who survive organisational downsizing and restructuring which remains a contemporary theme in the work environment. Using statistical data and hypothesis, the paper investigated the relationship among survivor attributes such as attitude, commitment and motivation after downsizing in selected manufacturing organisations. The results showed that survivors had high levels of motivation and moderate to satisfactory levels of attitude and commitment. A significant relationship was observed between survivor motivation and commitment. The paper also laid down specific recommendations to ensure improved survivor quality after downsizing.

The fifth and last paper of the session by Dr. Anurag Singh and Sonit Dutta entitled, "Global Recession and its Impact on Indian banking Sector" pointed out that a sound banking system is an important tool for

economic growth and stability. Emphasizing that the banking sector, which is the backbone of the Indian Economy, had also been affected by the global economic meltdown of 2007 but the magnitude was not very high. The paper also analyse the various measures adopted by the RBI and the government to handle the recession and suggested various solution for the overall development of the banking sector in India.

A brief review of the findings and policy implications of the session are:

1. An important lesson of the economic crisis is that the Government plays a significant role in controlling and preparing effective alternative measures to encounter any crisis in future.
2. Currency and debt management cannot be left to the free play of the market forces even in a liberalized market environment of the present day.
3. There is a need for judicious balance of restricted capital account convertibility as a means for higher and sustainable economic growth.
4. In a highly volatile economic environment a through knowledge about deciding the criteria, process and procedure is needed when downsizing is undertaken. The elements of downsizing such as differential treatment of employees during and after downsizing have to be managed with sensitivity to ensure positive economic outcome for the organisation.
5. There is greater need for liberalisation of foreign investment policies and providing access in agriculture and services that has so far been restricted.
6. Interest rate management, risk management, credit management etc. accompanied by sound economic policies to develop the rural economy are the policy implications to encounter economic crisis.
7. Increased participation of the Government in financial management and strengthening of the Public Sector Enterprises.

On the second day, i.e. 26th June 2010, the Business Session took the sub-theme "Global Recession & Tribal Economy with particular reference to North Eastern Region of India". The Resource Person for this session was Shri Jitendra Choudhury, Hon'ble Minister of Industries and Rural Development, Government of Tripura, who delivered a well-documented talk on the subject. He discussed on the various aspects of

globalisation and stated that globalisation presented both opportunities and challenges to the society. While referring to the tribal economy he pointed out that the process of globalisation has social, cultural as well as political impact in these economies. These economies are no longer isolated but are now affected by the interplay of market environment. In the process there is a need for proper implementation of government policies and programmes to develop the tribal economy in the North Eastern Region. An important policy implication that came out is that the natural resources of the region should be harnessed scientifically and development of transport and communication network should be augmented leading to a good link with the South East Asian countries and China.

He mentioned that globalization is not only an economic phenomenon and the process of globalisation was as old as human history and part of the global process. In this global process, there are opportunities and challenges, which may harm a particular society as well.

He pointed out that globalisation has social, cultural and political dimensions. While referring on the impact on tribal economy and life, he pointed out that nearly 87.19% of the tribal depend on agriculture. He referred to the declining cultivation from the 1961 census, where he mentioned that about 60.8% of tribal populations have their own farmland. But from 1991, it declined to 54.50% where most tribals had shifted their practice from farming in their own land. Thus, we see that an increase in agricultural and migrant labourers from 1961 onwards, e.g. Jharkhand, Chhattisgarh etc. This led to increased Land Alienation and this he attributed due to big projects and encroachment and mining policies. Citing the reports of Planning Commission and Government of India (1931-1990), he explained that large areas of land got alienated from the tribals and this he pointed out was mainly due to extraction of limestone, coal, forest resources, etc. Since many tribal communities in the North East still practiced shifting cultivation, coupled with blanket permit to extract forest resources, it has hampered the productivity of land. From statistics, he pointed out that soil erosion and other impacts of shifting cultivation had affected productivity and production.

Coming to the indiscriminate licensing following the emergence of the new economic policy since 1991, he pointed out that this had major effect on land alienation, which indirectly affected the employment scenario of the tribals. Further, according to him the tribal people have a close connection in the cultural front and the process of globalisation is having its impact on the identity and culture. There is fear of loss of identity

and this may adversely affect the society. He opined that one has to meet the challenges of the time. He advocated for radical land reforms. For this, he felt that appropriate political will and policy is the need of the hour. The resources need to be harnessed scientifically with better management and linking the northeastern region with the South Asian countries and China should be looked into.

The last session of the Symposium was on sub-theme, "Global Recession and Indian Economy" and altogether 6 papers were presented in this session. The presentations analysed the various aspects of the economy in relation to the global recession.

The first paper was presented by Dr. V. R. Kshatriya on "Global Economic Crisis: Lesson for management of people in India", he focused on the organisational perspective of profit making organisation which highlighted; many facts and data which show that the global crisis implication on organisations in India were positive, and had offered a lot of opportunities for them despite the negativity.

The second paper presentation was on "Economic Meltdown - its effect on Higher Education" by Dr. Brinda Bazeley Rymbai where she said that the impact of the economic meltdown has affect global higher education in may ways especially with respect to higher professional courses, research and teachers forcing India to come with stimulus packages, and U.S.A. and Europe with proposal and expectation to counteract the problems. A significant change is noticeable in universities everywhere, even in NEHU with respect to manpower generation and employability. Impact of the recession on Education, particularly on Higher Education, also came up in the presentations. It is a challenge ahead, with the global economic meltdown so as to bring equity and social justice.

The third paper was presented by Reshma Tiwari "Micro finance Industry Amidst Global Economic Crisis: Challenges Ahead" and highlighted that the global economic crisis created micro finance liquidity crisis and affected in decline in GDP, Exports, Outflow of foreign investment, mutual fund institutions experiencing liquidity constraints and stated the importance of local sources of funding, MFI's to improve quality and portfolio risk management etc.

The fourth presentation was on "BRICs - Shaping a new paradigm" by Mr. Surajit Sen, which showed that the BRIC countries economic position compared to the rest of the world is better in many areas and BRIC stock offers the most exciting investment opportunities. He also

referred to what Goldman Sach' (Economist) statement the BRIC's are the emerging market economies having a potential to become economic super-powers.

Ajay Mitra presented the fifth paper on "Sensex Volatility and Household investors". In his paper he stressed the need of increasing financial literacy, strict regulations with respect to fraud, protection of household investors in order to regain the confidence of household investors in capital markets.

The sixth paper of the session and also the Symposium entitled, "Current Global Crisis and Great Depression of 1930s" was presented by Mathur Barman. He gave a comparative analysis of the Great Depression of 1930's and the current Global crisis and suggested measures to cope with the crisis.

A brief summary of the policy implication and recommendation of the session are:

1. BRICS nations occupy a key role in the modern globalised era and the interplay between the BRICS economics and the G-7 is a critical aspect of globalisation and interdependence.
2. Micro-finance Institution should learn the lessons from the sub-prime crisis and improve their risk management practices.
3. Banking system should be centrally controlled by all advanced countries to protect the domestic and international economy.
4. Limited exposures to the complex derivative product.
5. SEBI should play more active role in protecting interest of the household investors.
6. Mass awareness campaign with the help of print and electronic media regarding pros and cons of stock market investment.
7. Strict regulations to avoid frequent scams and frauds.
8. There should be political coordination between all countries regarding policy regulations.
9. Public Funded Education need to be strengthened significantly.

The Symposium ended with a Valedictory Session in which Chief Guest Shri Pynsyngai Syiem, MLA and Parliamentary Secretary to the Government of Meghalaya, impressed upon the everyone to be aware of the changes in the economic conditions of the tribal population, especially in the North East, and how globalisation and the recession is effecting

tribal economy and hence the need for more pragmatic approach in protecting the tribal culture and traditions in this recession-stricken economy. He wished that the Students have taken note of all the major points and have benefited from the presentations and discussions in the symposium. He further wished that the message of the deliberations spread elsewhere also and people take interest on the cause of price rise, inflation and other related issues and hence work unitedly to reach to programme where everyone of us take part in the process of development and are able to end the era of speculation.

Dr. M. N. Bhattacharjee

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1

The Costs of 'Coupling' The Global Crisis and The Indian Economy[1]

C. P. Chandrasekhar

Introduction

A noteworthy feature of the current global crisis has been the failure of most mainstream analysts (unlike heterodox economists such as Patnaik 2008 and Kregel 1998, 2008, among others) to predict its onset, estimate its duration and severity, or lay bare the mechanisms that contributed to its unfolding. This weakness of telescopic and analytical faculty has been most evident with respect to developing Asia, especially China and India. Even as the global crisis and its effects were being recognised with a lag, Asian developing countries - and these two countries in particular - were seen as the potential shock absorbers in the global system, with predictions that their persisting expansion and relatively high rates of growth would prevent the global downturn from becoming a meltdown (Bergsten 2008, Kohn 2008). Elements other than the benefits of integration were being offered as explanations. Demographic features, potentially large domestic markets and "favourable" policy environments were typically offered as alternative forces driving growth (Goldman Sachs 2007). Such arguments were reinforced by econometric studies (e.g. Kose, Otrok and Prasad 2008) that found evidence of divergence of

business cycles across developed and emerging market economies in the period of globalisation. Decoupled giants driven by internal stimuli were seen to be obvious buffers against a global recession.

It is indeed true that despite the large gap between per capita incomes and levels of productivity in these two countries and in the developed capitalist economies (Table 1), their superior performance in terms of GDP and productivity growth over more than a decade has put them on a path towards economic convergence with the developed countries. But implicit in the perception of their role as shock absorbers is that this "trend divergence" in their growth performance also implies a substantial degree of desynchronisation of the business cycle in these two countries and in the developed industrial nations. It is the latter idea that the recent experience has challenged, revealing in the process weaknesses in the growth trajectory that could reverse the trend towards convergence with the developed countries, at least in the case of India.

Table 1. Selected economic and productivity indicators for United States, China, and India: 1995-2004

		Productivity growth			Productivity levels	
	GDP 2004	(% average annual change)			GDP (US$)	
Country	(US$)	1995-2004	1995-2000	2000-2004	Per employee 2004	Per capita 2004
United States	100	2	2.3	1.7	100	100
China	71	5.5	3.1	8.6	13	16
India	28	4.2	4	4.4	10	8

Notes. 1. Productivity growth is measured on the basis of GDP per employee.

2. GDP is in U.S. dollars converted at 1990 purchasing power parities.

3. China does not include Hong Kong.

Source. Conference Board and Groningen Growth and Development Centre, Total Economy Database (September 2006), quoted in National Science Board, 2008 and available at http://www.nsf.gov/statistics/seind08/pdf/c06.pdf

The idea of decoupling was strengthened by the ability of China and India to avoid major financial crises such as have affected a number of other emerging markets. It was argued that this was the consequence of a "prudent" even if extensive programme of global economic integration and domestic deregulation, which involved substantial financial liberalization but included some capital controls and limited convertibility of the currency for capital account transactions. Such prudence was seen to have ensured that China and India remained unaffected by the contagion unleashed by the East Asian financial crisis in 1997 and subsequently kept them protected from crises that could have cut short their high growth episodes (Cornia ed., 2006).

However, recent events have questioned the "decoupling" thesis. In this paper, I argue that the presumption that the Indian economy was on a robust growth trajectory decoupled in important ways from the international system is questionable. Rather, the recent boom was fundamentally dependent upon greater global integration, which also made the growth process more uneven and more vulnerable to internally and externally generated crises (Chandrasekhar and Ghosh, 2004, 2006). It is commonly perceived that this reflected the impact of trade liberalisation, but in fact changes in finance were probably more significant, in ways elaborated below. Essentially, recent growth was related to financial deregulation that sparked a retail credit boom and combined with fiscal concessions to spur consumption among the richest quintile of the population. This led to rapid increases in aggregate GDP growth, even as deflationary fiscal policies, poor employment generation and persistent agrarian crisis kept mass consumption demand low (Chandrasekhar and Ghosh 2007). The substantial rise in profit shares in the economy and the proliferation of financial activities (which together with real estate accounted for nearly 15 per cent of GDP in 2007-08) combined with rising asset values to enable a credit-financed consumption splurge among the rich and the middle classes especially in urban areas, which in turn generated higher rates of investment and output over the upswing. The earlier emphasis on public spending as the principal stimulus for growth was thus substituted in the 1990s with debt-financed housing investment and private consumption of the elite and burgeoning middle classes. The recent Indian growth story in its essentials was therefore not unlike

the story of speculative bubble-led expansion that marked the experience of several other developed and developing countries in the same period.

By the middle of 2008, this process too was reaching its limits. The dependence of GDP growth upon largely debt-fuelled consumption of a relatively small segment of the population rather than mass demand meant a more limited and ultimately more fragile domestic market. Export growth (in software, IT-enabled services and some manufactures) remained high but exports were not large enough to counter domestic decelerating tendencies. High rates of investment were driven by expectations of rapid growth of the domestic market as well as very substantial fiscal sops, but the latter could not increase beyond a point. As a result, Indian economic growth started decelerating early in 2008, even before the effects of global slowdown were transmitted through sharply declining exports. Real GDP growth, which was 9 per cent in the financial year April 2007 to March 2008, decelerated to 7.6 per cent in both the subsequent quarters. Industrial production peaked in December 2007, fell by 6.5 per cent in April 2008 and remained well below the earlier peak until January 2009. So the internal bubble-generated growth process had already begun to slacken when the impact of the global crisis created further adverse pressures.

The export slowdown

With the onset of the crisis, growing trade integration implied that one of the routes through which the real economy was affected was a deceleration in exports of goods and services, which had contributed significantly to the earlier boom. Trade to GDP ratios in India increased from 11 per cent in 1995 to 21.3 per cent in 2007. However, unlike China where much of the export expansion was on account of manufactures, export growth in India was principally due to services. In the merchandise trade area, India's export success was restricted to a few sectors such as garments, chemicals, pharmaceuticals and metals and engineering goods. While the first three categories of exports grew because of dynamism in the global market, the latter two were largely driven by increased demand from China in the period since 2002.

In services, however, India emerged as the largest exporter of computer and information services in the international economy in

2005, and its share in world exports of computer and information services was 17 per cent in 2006 (World Trade Organisation, quoted in Reserve Bank of India, 2009f). Services in general had come to dominate the Indian economy, accounting for more than half its GDP, contributing an overwhelming share to its recent relatively high rate of growth and even giving rise to arguments about services emerging as the Kaldorian growth sector in India (Dasgupta and Singh 2006). Services (excluding construction) accounted for 56 per cent of the increment in GDP at factor cost over the period 1996-97 to 2006-07 (computed from National Accounts Statistics data available at RBI 2008).

Within services, the share of software and IT-enabled services in the incremental GDP generated from services had been rising, with a significant share coming from exports. Gross exports of software, business, financial and communication services amounted to 5.3 per cent of GDP at market prices in 2007-08, with software services exports touching 3.4 per cent of GDP, compared to 14.2 per cent for merchandise exports.[2] Service exports were therefore not just important sources of growth but also of foreign exchange earnings, supporting the balance of payments and making up for the fact that liberalisation did not really trigger a merchandise export boom from the country. However, dependence on such services export-led growth was also a source of potential vulnerability, given the high degree of concentration of exports to a few developed countries: the US accounted for 61 per cent and the UK for 18 per cent of India's IT-BPO export revenues in 2006-07 (NASSCOM figures quoted in RBI 2009f). Moreover, since the mid-1990s, a rising share of remittances, which was the other major contributor to inflows on the current account of the balance of payments, came from the US, reflecting the growing number of short-term migrants on H1-B visas offering software and IT-enabled services on location. According to World Bank estimates, remittances to India had increased by more than a third to $52 billion in 2008 from its $38.7 billion level in 2007. According to a 2006 study by the Reserve Bank of India, region-wise, North America accounted for nearly 44 per cent of the total remittances to India, followed by the Middle East (24 per cent) and Europe (13 per cent). This reflects a shift in the sources of remittances away from West Asia to the US, as a result of the impact that the software services

export boom had on the nature of Indian migration to the United States and Europe. These regions have seen a significant increase in the number of short term migrants. In the United States, for example, the flow of software and IT services workers required to provide onsite services to clients of Indian firms under the HI B visa provision has increased substantially. Remittances from them could be seen as a form of income from trade in services, largely earned in the US and a few other developed industrial countries.

Given these forms of integration through trade, it was only to be expected that the global slowdown would directly affect exports and economic activity in India. Merchandise trade was the first to be affected. Merchandise exports from India grew by just 2.4 per cent during fiscal 2008-09 to $166.7 billion, as compared with a rate of growth of 28.9 per cent during the previous fiscal year. The deceleration began in September 2008, after a relatively robust 33.7 per cent increase during April-August 2008. Subsequently, exports declined relative to a year ago in every month with the highest decline in the month of March 2009 (-33.3 per cent). Import value growth too declined, influenced in part by the decline in world oil prices, but by less than the decline in export growth. As a result, the trade deficit for 2008-09 widened to $117.1 billion, 33 per cent higher than a year earlier (Figures from RBI 2009a). Over the first four months of fiscal year 2009-2010 exports had fallen by 34.1 per cent, offering little hope of recovery in the export sectors of the economy.

To some extent the implications of the widening trade deficit were mitigated by the neutralising effects of exports of services and remittance inflows, which continued to increase in this period. Therefore the current account deficit was significantly lower than the trade deficit, but even so it rose from 1.5 to 2.5 per cent of GDP during 2008-09.

A lag in the effects of the global crisis on net services exports from India was to be expected, given that contracts in software and Business Process Outsourcing services are typically signed for long periods such as two to three years. The effect of the crisis would be on the renewal of contracts and the signing of new contracts, and the initial impact on aggregate revenues would be proportionately lower according to the weight of legacy contracts in the total. The

lag was likely to be even longer in the case of remittances because workers who lose their jobs abroad and return home tend to bring their accumulated savings, and this windfall effect initially more than compensates for the fall in the value of ongoing remittances because of lower overseas employment. In addition, rupee depreciation over 2008 accompanied by growing interest rate differentials was likely to have encouraged larger remittances through rupee denominated non-resident accounts.

However, by early 2009 it was evident that these lags had been covered, as several software and IT services firms in India predicted lower revenue growth, cut back on recruitment and even started laying off workers (*The Economic Times* 2009; Indiatimes Infotech 2009; Business Intelligence 2009, Lakshman 2009). Meanwhile, since North America accounted for nearly 44 per cent of the total remittances to India, the severity of the recession in the US and developments with regard to use of H1-B workers and issue of H1-B visas would affect remittance inflows. World Bank (2008) estimates that remittance inflows to South Asia will be flat with zero growth in 2009, compared to the 16 per cent growth experienced in 2008. This will affect India too.

Also, by early 2009 the adverse employment effects of the merchandise export decline were evident. Quick official surveys by the Labour Bureau (Government of India 2009a, 2009b and 2009c) focussing on 8 sectors (Textile & Textile Garments, Leather, Metals & Metal Products, Automobiles, Gems & Jewellery, Transport, the IT/BPO industry and the Handloom/powerloom industry) have provided estimates of job loss as a result of the economic slowdown in the country. The surveys suggest that employment fell by 477,000 in October to December 2008 and then recovered by 277,000 workers in January to March 2009, pointing to a net job loss during this period. However, employment fell by a further 131,000 workers during April to June 2009. While employment declines were predictably higher in the export-oriented sectors, it is noteworthy that these surveys have found growing job losses in activities that cater dominantly to the domestic market as well. In addition to quantity adjustment in the labour market, workers' incomes were also hit, with reports of falling real - and sometimes even nominal - wages of workers in industry and services as well as reduced incomes of self-employed workers

who constitute more than half the work force by 2005 (NCEUS 2008). Agriculturalists, especially those producing export crops whose prices had collapsed, faced growing difficulties on top of their existing financial problems reflecting rising input costs and large burdens of debt. Small scale producers in all sectors were squeezed by the pincer movement of falling demand and credit crunch as even informal sources of credit dried up. Since these producers account for the bulk of employment in manufacturing and services and typically hire workers on informal casual contracts, their economic difficulties translate directly into reduced employment. Surveys of home-based workers reported rapidly declining orders and falling piece rate wages even in nominal terms, for work that formed part of wider production chains for both domestic and export markets (AIDWA 2009).

Two other effects of the crisis on general living conditions deserve to be noted. First, the state governments - who in India's federal system are directly responsible for much of the public expenditure that directly affects citizens, such as on health, education, sanitation and infrastructure - have found their tax receipts falling below projections due to the downswing. Since they face hard budget constraints and many of them are subject to stringent fiscal responsibility conditions forced on them by the central government, this has constrained their expenditure and reduced essential spending on basic services, not to mention development. Second, while aggregate inflation rates have been near zero for the year April 2008 -March 2009, the prices of food and essential medicines have continued to increase, even as unemployment has increased, wage incomes have stagnated or fallen and cash crop producers have faced falling prices.

Capital inflows and the financial sector

Employment declines in the non-export sectors suggest that the route by which the effects of the international crisis are being transmitted to India go beyond just external trade. One obvious alternative route is the effect of the crisis on cross-border capital flows, which had shown a dramatic increase in the preceding boom. Foreign investment flows rose sharply from $4.9 billion in 1995-96 to $29.2 billion in 2006-07 and then more than doubled to $61.8 billion in 2007-08 (Reserve Bank of India, 2009b). In 2007-08, capital inflows into India amounted to over 9 per cent of GDP even though

the current account deficit in the balance of payments stood at just 1.5 per cent of GDP (Subbarao, 2009). Thus, the accumulation of large foreign exchange reserves was the result of capital inflows that were far in excess of India's current account financing needs. The greater part of capital inflow was in the form of portfolio investment, which was stimulated by a continuous process of liberalization of the rules governing such investment: its sources, its ambit, the caps it was subject to and the tax laws pertaining to it (Chandrasekhar 2008). The process of liberalization also kept alive expectations that the caps on foreign direct investment in different sectors would be relaxed over time, thereby providing the basis for eventual foreign control. Those who acquired shares could hope to sell them later at a profit to firms interested in acquisitions. One consequence was the rapid expansion of private equity in India and a private placement boom, which was not restrained by the extent of free-floating shares available for trading in stock markets.

While financial liberalisation began early in the 1990s, the surge in foreign investment flows occurred much later. So liberalisation was a necessary condition for such inflows, but not a sufficient one. Until 2003, net inflows were relatively low, reaching a maximum of $8.2 billion in 2001-02 even though rules regarding foreign portfolio investment in the Indian stock market and external commercial borrowing by Indian firms were liberalised in 1993. Net capital inflows rose to $15.7 billion in 2003-04, partly encouraged by tax concessions offered to foreign investors in that year. Thereafter, for a variety of reasons, India was "discovered" by foreign investors and effectively became the target of a capital investment surge. Net foreign investment flows to India more than doubled from $29.7 billion in 2006-07 to $63.6 billion in 2007-08, before declining to $21.1 billion in 2008-09. And more recently there is evidence of a revival of foreign investment flows. This suggests that India was and is serving as a hedge for financial investors when uncertainties engulf emerging markets elsewhere in Asia and the world.

Capital inflows rose also due to large increases in commercial borrowing by private sector firms. As constraints on external commercial borrowing by domestic companies were relaxed and because interest rates ruled higher in the domestic market, large Indian firms at the margin took the syndicated loan route to borrow

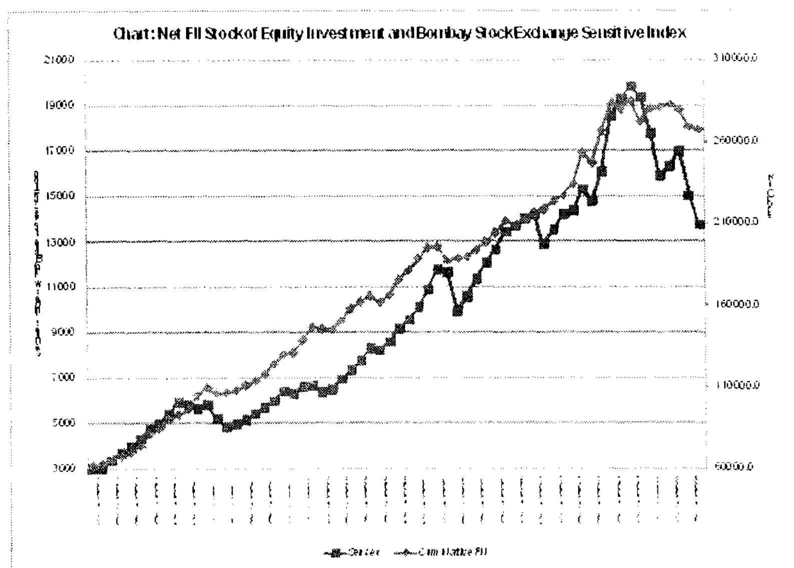
money abroad at relatively lower interest rates. They engaged in a version of the carry trade, borrowing money in foreign exchange from the international markets where interest rates were lower and making investments in India (in addition to leveraging investments and acquisitions abroad). Net external borrowing by India rose from $24.3 billion in 2006-07 to $51.5 billion in 2007-08, with the bulk of the increase in the form of short term borrowing. The stock of India's liabilities in the form of debt securities, trade credits and loans rose from $105.1 billion at the end of June 2006 to $175.6 billion at the end of September 2008 (Reserve Bank of India, 2009d).

A surge of external equity and debt inflows of this kind, combined with a much smaller increase in the current account deficit and a liberalised exchange rate regime, is likely to exert upward pressure on the domestic currency. This would adversely affect the country's export competitiveness and encourage further speculative inflows of capital. To forestall such effects, the central bank typically seeks to manage the exchange rate by buying up foreign currency and building its reserves, and this was in fact the policy of the Reserve Bank of India. As a result, India's foreign exchange reserves increased from just $76.1 billion at the end of March 2003 to $309.7 billion at the end of March 2008, essentially due to increased inflows of short-term foreign capital (Reserve Bank of India, 2009c). At more than 15 months' worth of imports, these reserves were clearly excessive and became a symptom of India's coupling with the world system through the capital inflow route.

Dependence on portfolio equity and debt inflows of this magnitude meant that if any internal or external development was seen to warrant pulling out of India, the exit could be as strong as the earlier inflow of foreign capital. The outbreak of the global crisis therefore resulted in a sharp outflow of capital, especially portfolio capital brought into the stock market by foreign institutional investors (FIIs). Needing cash to meet commitments and cover losses at home, these FIIs sold out in Indian markets and repatriated capital abroad - as much as $15 billion net outflow in the fiscal year April-March 2009, as compared with a net inflow of 20.3 billion during 2007-08 (Reserve Bank of India, 2009g).

One consequence of the capital outflow was a collapse of India's

stock markets, just as the earlier capital inflows had triggered a speculative bubble in both stock and real estate markets. They had caused an unprecedented rate of asset price inflation in India's stock markets and substantially increased volatility. FII investments were an important force, even if not always the only one, driving markets to unprecedented highs, with a high degree of correlation between cumulative FII investments and the level of the Bombay Stock Exchange (BSE)'s Sensitive Index (Sensex), as evident from the accompanying chart.



Source. Reserve Bank of India (2008, October 8), *Handbook of Statistics on Indian Economy* Retreived March 21, 2009 from Reserve Bank of India: http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%20of%20Statistics%20on%20Indian%20Economy.

Stock markets in developing countries like India are thin or shallow in at least three senses. First, stocks of only a few companies are actively traded in the market. Second, of these stocks there is only a small proportion that is routinely available for trading, with the rest being held by promoters, the financial institutions and others interested in corporate control or influence. Third, the number of players trading these stocks is also small. The net impact is that

speculation and volatility are essential features of such markets, for several reasons. Because an increase in investment by FIIs triggers a sharp price increase, it provides additional incentives for FII investment and in the first instance encourages further purchases, so that there is a tendency for any correction of price increases to be delayed. When the correction does begin, it typically would have to be led by an FII pullout and could then take the form of an extremely sharp decline in prices. In addition, the inflow of foreign capital can result in an appreciation of the rupee, which increases the return earned in foreign exchange. As a result, the investments turn even more attractive, triggering an investment spiral that implies an even sharper fall when any correction occurs. Finally, the growing realization by the FIIs of the power they wield in such shallow markets encourages speculative investment aimed at pushing the market up and choosing an appropriate moment to exit. This implicit manipulation of the market, if resorted to often enough, obviously generates a substantial increase in volatility. And in such volatile markets, domestic speculators also attempt to manipulate markets in periods of unusually high prices. All this said, the four years ending in early 2008 were remarkable because of the prolonged bull run in the Indian stock market.

After such a speculation-induced bubble, the reverse tendency of collapse in stock markets was triggered by the exit of foreign investors, who then responded to the stock market decline in a cumulative process. This affected not just stock market valuations but also the external reserve position and the exchange rate. By October-December 2008 the entire capital account turned negative, with a deficit amounting to an estimated 1.3 per cent of GDP. While this was mainly due to net outflows under portfolio investment, banking capital and short-term trade credit, there were also falls in foreign direct investment and external commercial borrowings inflows. Even inflows under short-term trade credit declined. This led to an overall balance of payments deficit for that three-month period of as much as 6.2 per cent of GDP. In the circumstances it was not surprising that India's foreign exchange reserves, which stood at $316 billion in June 2008, fell to $248.6 billion at the end of January 2009. This was a significant fall, but the volume of reserves still remained high, amounting to around 9 months' worth of imports (Reserve Bank of India, 2009c). Another consequence of the outflow of capital was a

sharp depreciation of the rupee, by more than 30 per cent vis-à-vis the US dollar in the year to March 2009, taking the currency's value to more than Rs. 51 per dollar. Although this decline has since been partly corrected the currency does remain vulnerable.

One indicator of that vulnerability is the movement of foreign exchange out of the country in the form of outward remittances under the liberalised remittance scheme for resident individuals. These remittances totalled $9.6 million, $25 million and $72.8 million in the three years ending 2006-07. But they shot up to $440.5 million in 2007-08 (Reserve Bank of India, 2009e). This is possibly indicative of speculative trends that could push down the value of the rupee. In the face of determined speculation even reserves in excess of $200 billion are no insurance against a large depreciation.

The crisis and credit-financed demand

A third way in which integration has influenced the way in which the global crisis has affected India is its impact on the role played by credit in financing private consumption and investment. Internal financial liberalization in India had resulted in a process of institutional change in which the role played by state-owned financial institutions and banks was substantially altered. As regulatory structures for private banks were dismantled over the 1990s, and private banks cornered the most lucrative clients, even public sector banks had to alter their strategies to seek new sources of finance, new activities and new avenues for investments, so that they could shore up their interest incomes as well as revenues from various fee-based activities. So banks linked up with insurance companies and entered other "sensitive" markets like the stock and real estate markets. This led to a relatively rapid transformation of banking in India, with growing exposure of commercial banks to the retail credit market with no or poor collateral, the associated accumulation of loans of doubtful quality in their portfolios, and a growing tendency to securitize personal loans.

Total bank credit grew at a scorching pace from 2005 onwards, at more than double the rate of increase of nominal GDP. As a result, the ratio of outstanding bank credit to GDP (which had declined in the initial post-liberalisation years from 30.2 per cent at the end of March 1991 to 27.3 per cent at the end of March 1997) doubled over

the next decade to reach about 60 per cent by the end of March 2008. Thus, one consequence of financial liberalisation was an increase in credit dependence in the Indian economy, a characteristic imported from developed countries such as the USA. This increase in credit could appear to be positive inasmuch as it reflected a greater willingness on the part of banks to lend: the growth in credit out-performed the growth in deposits, resulting in an increase in the overall credit-deposit ratio from 55.9 per cent at end March 2004 to 72.5 per cent at end March 2008. This increase was accompanied by a corresponding drop in the investment-deposit ratio, from 51.7 per cent to 36.2 per cent, which indicates that banks were shifting away from their earlier conservative preference to invest in safe government securities in excess of what was required under the statutory liquidity ratio (SLR) norm. (Data in this and the subsequent four paragraphs are from CFSA 2009.).

However, rapid credit growth meant that banks were relying on short term funds to lend long. From 2001 there was a steady rise in the proportion of short-term deposits with the banks, with the ratio of short term deposits (maturing up to one year) increasing from 33.2 per cent in March 2001 to 43.6 per cent in March 2008. On the other hand, the proportion of term loans maturing after five years increased from 9.3 per cent to 16.5 per cent. While this delivered increased profits, the rising asset-liability mismatch increased the liquidity risk faced by banks.

These changes do not appear to have been driven by the commercial banking sector's desire to provide more credit to the productive sectors of the economy. Instead, retail loans became the prime drivers of credit growth. The result was a sharp increase in the retail exposure of the banking system, with overall personal loans increasing from slightly more than 8 per cent of total non-food credit in 2004 to close to 25 per cent by 2008. Of the components of retail credit, the growth in housing loans was the highest in most years. As Table 2 indicates, the (new) private banks were the most enthusiastic adopters of such a strategy, followed by foreign banks.

This rapid increase in credit and retail exposure, with inadequate or poor collateral, would have brought more tenuous borrowers into the bank credit universe. A significant (but as yet unknown) proportion

Table 2. Personal loans as per cent of total outstanding credit of commercial banks.

	1996	2000	2007
State Bank of India and associates	9.5	10.7	22.0
Other nationalised Banks	9.1	10.9	15.8
Foreign banks	8.8	17.1	24.8
Regional Rural Banks	10.5	18.8	20.5
Private sector banks	9.7	7.9	37.3
All Scheduled Commercial Banks	9.3	11.2	22.3

Source: RBI 1997-2008.

of this could be "sub-prime" lending. According to one estimate, by November 2007 there was a little more than Rs.400 billion of credit that was of sub-prime quality, defaults on which could erode the capital base of the banks.[3] To attract such borrowers, the banks offered attractive interest rates below the benchmark prime lending rate (BPLR). The share of such loans in the total rose from 27.7 per cent in March 2002 to 76.0 per cent at the end of March 2008. This increase was especially marked for consumer credit and reflected a mispricing of risk that could affect banks adversely in the event of an economic downturn.

Additional evidence of mispricing of risk in the Indian financial system came from the exposure of the banking system to the so-called "sensitive" sectors, like the capital, real estate and commodity markets. This increased to 20.4 per cent of aggregate bank loans and advances in March 2007, with real estate contributing 18.7 of that figure, the capital market 1.5 per cent and commodities 0.1 per cent. Further, the off-balance sheet exposure of banks increased significantly from 57 per cent of total bank assets at the end of March 2002 to 363 per cent at the end of March 2008.

This increase was mainly on account of derivatives, whose share averaged around 80 per cent, and once again was led by private and foreign banks. Public sector banks followed, with their exposure rising subsequent to the amendment of regulations to permit over-the-counter (OTC) transactions in interest rate derivatives. Since the

current accounting standards in India do not clearly specify how to account for and disclose losses and profits arising out of derivatives transactions, the propensity of some players to use derivatives to assume excessive leverage made it difficult to gauge the actual market and credit risk exposure of commercial banks.

These changes in the financial sector point to two further ways in which the current global crisis can affect India. First, the credit stringency generated by the exodus of capital from the country and the uncertainties generated by the threat of default of retail loans that now constitute a high proportion of total advances could freeze up retail credit and curtail demand, as is happening in the developed industrial countries. Second, individuals and households burdened with past debt and/or uncertain about their employment would prefer to postpone purchases and not to take on additional interest and amortisation payment commitments. Thus, the off-take of credit can shrink even if credit is available, resulting in a fall in credit financed consumption and investment demand. Since growth in a number of areas such as the housing sector, automobiles and consumer durables had been driven by credit-financed purchases encouraged by easy liquidity and low interest rates, this would immediately affect the demand for housing, automobiles and durables. This, in turn would have second-order effects in terms of contracting demand for other sectors and economic activities. As a result, a wide range of industries, services and segments of the labour market are likely to be indirectly affected by the crisis.

If the growth slowdown persists or recurs with greater intensity with more severely adverse employment effects, defaults on the accumulated legacy of retail credit are likely. Combined with losses on investments triggered by the growing appetite for risky assets among scheduled commercial banks after liberalisation, this poses a real danger of insolvencies because of an increase in the proportion of non-performing assets in the Indian banking sector.

The Indian government's response

When the crisis first broke internationally, within official circles in India there was a perception that the Indian economy would be less affected and the Indian financial sector would be relatively immune to the winds from the international financial implosion. The presence

of a large nationalised banking sector and a somewhat more stringent regulatory regime for real estate lending by banks were seen to protect the Indian financial system from harmful contagion from abroad. However, as shown in previous sections, these expectations have been partially belied, with adverse movements not only in real economic indicators, particularly export production and employment, but also in financial variables such as stock market indices and currency values.

The initial responses of the government focused on the financial side of the current crisis, with three major components to the first stimulus package adopted in late 2008. These included measures by both the Reserve Bank of India and the government, aimed at reducing interest rates and increasing the access to credit of large and small firms, state governments and individuals. At the same time, access to credit from foreign sources was sought to be enhanced through measures that further liberalised the remaining constraints on external commercial borrowing. The ceiling on FII investment in rupee-denominated corporate bonds was more than doubled. The slogan appeared to be, "if domestic credit is unavailable or expensive, borrow from abroad." There were also measures aimed at getting state governments and an infrastructure investment fund set up by the central government, the India Infrastructure Finance Company Limited (IIFCL), to borrow more to finance capital, especially infrastructure, expenditure. Finally, there were attempts to spur the demand for automobiles and housing through various incentives to buyers and to banks to provide credit for such purchasse. So banks and financial institutions were encouraged to lend and different economic actors were invited to borrow and spend. This includes borrowing in foreign exchange to finance expenditures in areas like real estate which are unlikely to yield foreign currency revenues that can be used to meet future repayment commitments.

Even if they had worked, such policies would only have strengthened the very same economic tendencies that generated the crisis in the developed countries in the first place. In any case, and perhaps unsurprisingly, by April 2008 it was already evident that these monetary measures all proved to be lacking and did not ease credit conditions in any meaningful way. This was partly because of the liquidity trap characteristics of the situation as the most credit-worthy

potential borrowers were unwilling to borrow because of the prevailing uncertainties and expectations of slowdown, and partly because banks also suddenly became more risk-averse. This meant that all other enterprises, even those who desperately required working capital just to stay afloat, found it increasingly difficult to access bank credit even as they faced more stringent demand conditions.

In such a situation, reducing interest rates does not solve the basic problem of tightened credit provision, even though it may marginally reduce costs for those who are able to access bank credit. The real economy is unlikely to be revived through such measures in the absence of a strong fiscal stimulus. It is now increasingly accepted that there is no alternative to the standard Keynesian device of using an expansionary fiscal stance to create more economic activity and demand, and thereby lift the economy from slump. Even so, the Government of India took an inordinately long time to announce what turned out to be a relatively small fiscal package, involving less than 0.5 per cent of GDP of additional direct public spending. This was combined with various tax cut measures, with estimated revenue losses still less than 1 per cent of GDP.

Part of the reason why the fiscal stimulus in India was stronger than provided for was the presence of pre-committed expenditures in the form of implementation of the Sixth Pay Commission's recommendations that involved payment of huge arrears to Central government servants. As a result, the overall fiscal deficit (of central and state governments together) in fiscal year 2009-10 is likely to increase significantly, though a large part of it would be the result of tax cuts and subsidies and rather than direct spending. There are several problems with relying upon price-based fiscal measures. To begin with, tax cuts stimulate economic activity only if producers respond by cutting their own output prices and such price cuts in turn generate demand responses, or if they enable firms that would otherwise have closed down to survive. But neither is inevitable, nor even very likely given prevailing market structures in India. Across the world, governments are finding that in times of economic uncertainty, tax cuts are much less effective in stimulating activity than direct government expenditure. Similarly, measures that try to provide additional export incentives (such as interest reductions for export credit) to exporting sectors such as textiles, garments and

leather do not counteract the effect of big losses of export orders as the major markets start shrinking.

Therefore direct public spending would be a far more effective way of dealing with the current slowdown even in India. However, the fiscal stimulus provided thus far has been both small and also not directed towards forms of expenditure that are likely to have high multiplier effects. Some of the most critical areas of potential spending have been ignored or neglected, such as increased resource allocation to state governments, direct investment to ensure mass and middle-class housing, interventions to improve the livelihood conditions of farmers, expansion of the public food distribution system, enlargement of employment schemes and provision of social security. It is in this context that the talk of the need for "exit" from the spending thrust needs to be assessed. Combined with the loss of the once-for-all stimulus delivered by Pay Commission related arrears, this could dampen or subvert the recovery, especially in a year when the monsoon has been less munificent.

This inadequacy of fiscal and monetary policies to address the current economic problems in India is combined with the near absence of measures to regulate finance, especially to prevent excessive risk-taking that destabilises the real economy. The Indian government appears to be moving towards more financial deregulation and privatisation of existing public financial institutions. In particular, its strategy seems to be to further inflate the embryonic credit bubble to prevent growth from slipping sharply, in other words generating another speculative bubble to drive the real economy recovery, regardless of the possibility that this could pave the way for a financial meltdown that would that would subvert such a recovery. But such a possibility must be acknowledged. Even if it is not as yet in a debt-driven crisis, the Indian economy is substantially dependent on rapid expansion of private credit to sustain growth.

In addition, the strategy pushes infrastructural investment financed not only with domestic debt, but also with external commercial borrowing. This not merely adds to the debt spiral, but involves a currency mismatch inasmuch as infrastructural projects are unlikely even in the medium term to yield foreign exchange revenues that can be used to meet interest and amortisation commitments

payable in foreign exchange. On the other hand, with global interest rates being much lower than domestic rates, firms may not adequately take account of exchange rate risks and opt for foreign borrowing whenever available. This could lead to solvency problems if the rupee depreciates sharply, and strain India's foreign reserve position if the exodus of foreign capital continues. The reliance of the Indian state on encouraging more private debt-financed spending to trigger a recovery is indeed fraught with problems.

It also does not work. As of July 2009 the evidence suggests that the recovery in industrial growth is only marginal despite the government's efforts. Industrial growth during the first four months (April-July) of fiscal 2009-10 (relative to the corresponding period of the previous year) was at 4.6 per cent lower than the 5.6 per cent recorded during April-July 2008.

While the export decline noted above could partly explain this adverse turn, the substantial dependence of Indian manufacturing on the domestic as opposed to the export market implies that the fundamental problem facing the economy is a slackening of domestic demand. This domestic demand recession is surprising for a number of reasons. First, even though the government's crisis-induced effort at providing a fiscal and overall demand stimulus to the economy remained half-hearted, that effort came on top of the fortuitous stimulus provided by the implementation of the Sixth Pay Commission's recommendations, which included the payment of arrears that offered windfall gains to domestic consumers. Since, the beneficiaries of the Pay Commission's recommendations fall in the middle and upper-middle class categories, it is to be expected that their windfall gains and higher salaries would be directed towards demands for manufactures, besides luxury services. If despite that industrial growth has been indifferent or poor other factors must have neutralised the effects of this fortuitous stimulus.

Second, the effects of the crisis have been transmitted to India precisely at the time when the political business cycle would have worked to drive up economic growth. With India having gone in for a general election during April and May spending in various forms would have substantially increased. Not only would government expenditures been higher on average as incumbent governments seek

to push ahead with programmes and concessions to win over the electorate, but the recorded and unrecorded expenditures undertaken by the Election Commission on the one hand and the political parties and candidates contesting the elections on the other would have injected additional demand into the system. This too seems to have been inadequate to stall a recession.

While it is undoubtedly true that if these fortuitous stimuli had not played a role the manufacturing recession would have been even deeper than revealed by the extant numbers, the element of surprise is that those stimuli have not been able to prevent the downturn. The effects of the global recession have been significant. This in turn implies that all earlier talk of India being decoupled from the international system was exaggerated.

This experience has a larger lesson about the effects of liberalisation on manufacturing growth in India. While liberalisation did change the sources and pattern of growth in India, this was not because of a shift in favour of an export-based stimulus, but because of the expansion of new sources of credit-financed consumption that widened the demand and market for manufactures goods. What the current crisis has done is to challenge the sustainability of that form of growth.

Footnotes:

1. This paper draws heavily on research undertaken jointly with Jayati Ghosh. Comments and suggestions from Yilmaz Akyuz and Rammanohar Reddy on an earlier draft are gratefully acknowledged.
2. Figures computed from data reported by Reserve Bank of India at http://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/T% 2042 %20 [Trade % 20and%20Bal].pdf and Central Statistical Organisation at http://mospi.gov.in/qr_estimate_gdp_curr_prices_12march09.pdf, accessed 17 April 2009.
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2

Impact of Economic Crisis on Tribal Society, Degeneration of Traditional Institutions, Pattern of Social Change in Tribal Society

Jitendra Chaudhury

Commonnlaties between the 1930s and present global economic melt down

The sub-prime crisis in US and Europe developed into a global financial crisis by the end of the year 2008 and further detoriated in the year 2009. There are symptoms of the crisis blowing into a full-fledged economic crisis. There are various questions regarding the causes of the crisis, transmission process of the crisis and impact of the crisis for developing countries like India and China. There are also implications for regional or sub-national economic units like North Eastern Region of India.

Trade cycles are important features of industrialized economies. The trade cycles have not only a recurrent character but also seem to be unpredictable. The 'Great Depression' of 1929-33 led to the birth of an important branch of Economics, namely, macroeconomics with the publication of 'The General Theory of Employment, Interest and Money' in 1936 by J. M. Keynes. Often the global financial crisis of 2008 is suspected to be similar in its impact on output and employment to the 'Great Depression'.

In early 1930, credit was ample and available at low rates, but people were reluctant to add new debt by borrowing. By May 1930, auto sales had declined to below the levels of 1928. Prices in general began to decline, but wages held steady in 1930, then began to drop in 1931. Conditions were worse in farming areas, where commodity prices plunged, economic inequality and jobless growth restricts aggregate demand which in turn leads to financial and economic crisis. The financial crisis occurs because consumers are encouraged to purchase goods and assets through bank loans because they do not have sufficient purchasing power. As the quality of debt recovery is put into risk the banks ultimately face the problem of insolvency. As bank finances dry up, the industries find it difficult to carry on their business. They restrict output and employment. This has a ripple effect on other industries through fall in demand. This process ultimately ends up in an economic crisis. In such a situation encouraging employment generation programmes, investment in infrastructure, encouraging small and minor industries, rural development and expenditures on primary education and primary health care by the government rather than bailing out banks and financial institutions are likely to be supported by the Marxist point of view.

The prevailing global financial crisis came to its peak in October 2008. Economists differ regarding the span of this crisis. However, it cannot be denied that the roots of the crisis had implanted themselves earlier when loans were been given to the customers without verifying their repayment capacity and these loans were financed through securities which did not clearly indicate the quality of the role and risk involved. The phase of the financial crisis when the results became visible may have a span of one or two years. But the foundations were laid prior to that.

The second aspect to be recognised about this financial crisis is that it began from the United States but ultimately touched the financial system through the sale of securities of the mortgaged loans of the whole world. In India the nationalised commercial banks were not touched by these securities but certain private banks were contaminated through exposure to these questionable types of securities.

Other aspects of globalization:

Globalization as such is not a current phenomenon. In a sense,

it is as old as human history. It is a global process where billions of people of the world are involved. The process of globalization can therefore is supra-national in its strength and vigour. Therefore each nation and community has to create proper strategies for meeting the opportunity and challenges emanating from globalization.

Globalization can not be and should be understood as a purely economic phenomenon. Apart from the economic aspect there are social, political and cultural dimensions of the process of globalization.

In the purely economic sense, globalization is free trade of a country with the rest of the world. It also implies free flow of physical capital and finance capital. Of course, today the general meaning of globalization capitalizes on the economic aspects only, besides the political structure. But while analyzing the impact of globalization on the economy of indigenous society, the tribes of North East India, these four aspects of globalization have to be given their due importance.

In the social sense, globalization implies the capacity to adjust with other societies which have a won social structure. In the political sense, globalization may implies the dominance of hegemony over the so called less developed countries.

In the cultural aspect globalization may implies uniformisation of cultures in terms of food habits, dress codes, marriage practices, age old value systems and their traditional form of art & culture.

Major Features of Tribal Economy and life in India:

The country has 85 million adivasi, i.e., tribal population living in the Fifth Schedule areas of eight states of Andhra Pradesh, Chattisgarh, Jharkhand, Himachal Pradesh, Gujarat, Madhya Pradesh, Orissa, Rajasthan and Maharashtra and in the eight North-Eastern states. Their percentage to the total population of India is 8.1 with a sex ratio of 972 while that of the total population is 927. As per 1991 Census, 87.19% of ST population depended on agriculture, either as settled and shifting cultivators of agricultural labourers or as collectors of forest produce. These figures corroborate the close association with land and forests as a means of survival, livelihood and a social way of life for the tribal people. (K. Bhanumathi Samata, 2010).

A very significant and alarming trend that is visibly upsetting is the depreciation in the percentage of ST cultivators from 68.18% as per 1961 Census to 54.50% in 1991 Census and an increase of agricultural labourers from 19.71% to 32.69%. This clearly indicates the alienation of tribal lands for various purposes like construction of dams, mining projects, setting up of forest based and other industries, notification of wildlife sanctuaries, construction of government infrastructure and encroachments by non tribals. The official figures for land alienation in the Planning Commission report of January 2000, the area alienated from tribals in all the states is 9,17,590 acres and those displaced between 1951- 90 are 21.2 lakhs (39.4%). Almost 80% of the forest and mineral resources of the country are found in the scheduled areas the exploitation of which have been the primary causes of land alienation among the adivasis. These areas, particularly the Eastern and Western Ghats are the catchments to a number of rivers which form the life systems for the large 'development' projects built during the '60's and '70's. The diversity of natural resources available in these forests brought in two major stakeholders from the outside during this period - the non tribals who wanted to occupy the rich lands of the tribals and the state which launched its apparently public / national interest projects which were large scale, capital intensive and causing millions of people, mainly dalits and adivasis to be uprooted from their lands. They were based on the Nehruvian philosophy of development where the voiceless millions living in the midst of these resources have to forfeit their livelihoods for the progress of the nation. Thus the setting up of energy and hydro electric projects, public sector industries like mining, development of a network of roadways and railways in these scheduled and forest regions for the transportation needs of the industries and the expansion of government infrastructure were the important vehicles of economic growth undertaken by the state. By the nineties, the public sector has been heaped with the choicest of abuses and accusations for having failed to deliver any progress to the nation. The resources available in the scheduled areas were considered as having vast potential for exploitation and the new economic policy reflected a clear shift in the state's reverence for the private sector. The protective and welfare role so far played by the state suddenly began to shrink from the 1990's once the state decided to make accessible these natural

resources to global and private powers. The subsequent changes in policies and laws or where ever possible, contravention of laws by the state in the scheduled areas has been the immediate consequence thereby exposing the remote tribal in an unknown hamlet to the fangs of globalization.

Dependence on Indigenous form of Cultivation:

The shifting cultivation method is not of course restricted to the tribal folk of north east India only. Estimates of the actual number of shifting cultivators vary from 250 million to 300 million globally (V T Darlong, 2010). Taking the world population to be around 6 billion, the number of shifting cultivators is 3 to 5 percent of the world population. Therefore, in terms of population share, the number of shifting cultivators may not be very significant. But if one looks at the geographical spread of shifting cultivators then one finds that 45 percent of tropical agriculture area is under shifting cultivation. 1/3rd of agriculture in South-East Asia is under shifting cultivation. Moreover, 60 percent of Africa's food is produced through shifting cultivation.

The forest area affected by shifting cultivation in North East India

State	Forest Area Affected (sq. km.)	Percentage of actual forest area
Arunachal Pradesh	8,521	12.4
Assam	7276	27.9
Manipur	13846	77.4
Mizoram	12442	68.5
Nagaland	10641	74.1
Tripura	3315	62.3

Source: Shifting Cultivation In Search of Alternatives (2010).

The table shows that the percentage of actual forest area affected by shifting cultivation is highest in Manipur (77.4%) and lowest in Arunachal Pradesh (12.4). Nagaland, Mizoram, Tripura are in the next ranks and Assam has the fifth rank. Food cultivation is not only

economically unviable today but also a major contributed to deforestation and a threat to bio-diversity. Therefore, most of the experts on tribal economy are of the opinion that the shifting cultivators have to be shifted to types of occupations where there is better economic returns and lowest negative environmental consequences. If one assumes that a typical tribal household has three adult equivalents and also a adult requires five hundred grams of rice per day then the daily requirement of rice per household is 1.5 Kg. monthly requirement is 45 Kg. Yearly Requirement is 540 kg. A typical household can cultivate one hectare of land. Due to shortening of jhum cycle one hectare of land can provide 6.25X80 kg=500kg of rice per year. Which was 800-900 kgs in 1961-1970 period (Tawnenga, Uma Shankar and R S Tripathi, 1996). Therefore, at present a jhumia family can't meet the requirement of rice from jhum cultivation alone. This indicates economic non-viability of shifting cultivation in many parts of North-east India at present.

The tribal economy of North East India is mainly based on shifting cultivation. In shifting cultivation a particular plot is selected from the forest by the cultivators. Then the forest trees and shrubs are cut down. Then it is allowed to get dry for a few days. This activity is carried out in the months of December and January. From mid-February fire is set on the dried up branches and timbers. Then shifting cultivators wait for the rain. Planting of seeds consisting of various crops is done for mid-March to early-April. Some seeds are broadcasted also. From May to September weeding is done and also a lot of time is spent in guarding the crop from different types of forest animals. Harvesting of the crops in different phases is carried out from the month of September. There is also thrashing work in this period especially for the women folk. Harvested crops are also stayed in this period.

Environment and Shifting Cultivation

Shifting cultivation affects environment mainly through deforestation and soil erosion (M Datta and NP Singh, 2010) show that shifting cultivation is one of the causes of soil erosion in Tripura. This is showing in the following table:

Loss of Soil through Erosion under Different Use Practices

Land Use	Soil loss (t/ha/yr)
Shifting Cultivation (7 ha area)	5.1-83.3
Tuber crops on raised beds (bun)	40.0-50.0
Pineapple cultivation along the slope (first two year)	24.0-62.6
Homestead area	16.8
Mixed crop of maize and rice	19.7-21.0
Rice on slope	32.9-45.0
Bare fallow	83.8
Cropping systems	51.0-83.8
Planting grass cover	10.83
Natural bamboo forest	0.04-0.52

Source: Shifting Cultivation In Search of Alternatives (2010)

The above table shows that a seven hectare area under shifting cultivation causes soil loss of 5.1-83.3 ton per hectare per year. In sharp contrast a natural bamboo forest causes 0.04-0.52 ton per hectare per year soil loss. This soil loss causes a decline in net productivity of the following order as shown by Datta and Singh.

The Negative Impact of Global Financial Crisis on the Tribal Economy

If one studies the relation between global financial crisis and the tribal economy in a superficial manner then on may find a weak linkage between the global situation and the north eastern economy of the tribals. This is due to the fact that a very insignificant amount of commodities are sold to the formal market mechanism. But the issue has to be studied in terms of the linkage between access to natural resources, production of commodity using in the natural resources and marketing of products. In this manner if one links the different stages of value addition from collection of the natural resources to processing of natural resources and then finally marketing of this products then one can find out however global financial crisis

impacts the tribal economy in the first stage of value addition process. Unfortunately much of these collections either of timbers or non-timber forest produces operate through informal grey markets. As result data availability is very limited.

There is another aspect of globalization also the present global economic crisis has reduced the growth rate of GDP of the Indian economy by 2 to 3 percent according to experts. As result revenue collection of the government is likely to suffer. The public sector expenditures to improvement in human capital, creation of physical infrastructure and social amenities like providing safe drinking water, health centres and primary schools are likely to experienced a slow down. This also creates a negative impact on the tribal economy of North East India. However, some time must elapse before a proper assessment of the consequence of the present financial crisis can be made.

Cultural Dimensions of the Tribal Economy

The cultural activities are deeply rooted in shifting cultivation of the tribes. There are pujas to make the elements happy and bountiful. Selection of the jhum sites and beginning of shifting cultivation also lead to various religious and cultural functions. There are song and poetry for the nights spent in guarding the crop land. Sometimes they are love song. Similarly. harvesting, thrashing and storing are also woven with songs and poetry providing a cultural dimension to the fundamental economic activities of tribal societies. Therefore, one can imagine of taking away shifting cultivation from tribal society without taking away tribal culture and even in a sense the basis of tribal identity. In other words the challenge of transformation of tribal society cannot be understood without looking at the cultural, social and political aspects of tribal life.

Impact of Globalization on Tribals of Northeast India

It is true that the scheduled areas are a repository of rich natural resources and they hold most of the nation's wealth, whether physical, social, ecological, environmental, economic nor aesthetic. The resources have been sustained over the centuries and maintained with little destruction more due to the social and cultural practices of the forest dwelling tribal communities whose systems of livelihood ensure

minimum harm to the ecology. State perceptions of utilisation of resources are diametrically opposed to the Tribal worldview of resource exploitation and this divide has only widened further with the intrusion of globalization's market oriented philosophy of development. The experience of indigenous communities in other developing and underdeveloped countries outside India where ever globalization had descended has proved that indigenous knowledge systems, livelihoods, lands and forests have been brutally over ridden by these forces. Experiences of all these communities have been gruesomely similar - that state transferred control over resources from communities and even from itself to industries and private institutions, that resources were exploited not because there was an urgent and immediate need for their utilisation, that there was no long term or planned perspective to the utilisation of these resources, commercialisation and commodification of resources became the primary concern and not ensuring that the resources were available and sustained for optimal usage and for majority benefit. Their experiences have further proved that resources conserved for millions of years were depleted beyond repair within a short period of globalised economies and that it has led to aggravated poverty of communities living in the areas of these resources while the industries and private institutions prospered enormously. This aggressive nature of resource exploitation has led to civil wars, strife, famines, political disturbances and violence in otherwise peaceful communities before globalization took away their resources. Some of the Fifth Schedule areas in India have been witness to such destruction mainly where mining projects and dams were built.

Globalisation and privatization are the key focal areas of our new economic policy. This policy is being aggressively introduced in the tribal areas which are rich in natural resources in order to cater to the global corporate and private interests. As the tribal areas are safeguarded by Constitutional protections like the Fifth Schedule, there is a determined attempt to amend or violate the laws by the State itself in order to pursue its privatization policies. Hence, there is an urgent threat to the lands and natural resources of the tribal people as well as to their customary practices and traditional rights. Food security, potable drinking water and sanitation will be a serious crisis in the health and survival of tribal children as these resources

will become less accessible to tribal communities due to their commercialization.

Tribal children are forced to compete with a highly imbalanced and exploitative external society. Therefore, protection of the Constitutional laws is the first saviour of adivasi children's rights to land and resources as global greed exploits their natural resources will strangulate their lives in future. Primary education and awareness of legal and traditional rights is the most important vehicle of creating tribal assertion among the next generations of tribal. Assertion of tribal self rule, right to ownership and decision-making over natural resources and right to information are therefore crucial. Present global financial crisis shows how these problems are compounded when the centre is itself under economic stress.

Meeting the Challenges

To take advantage of globalization the tribal economy will require: a) improved human capital, (b) more access to physical infrastructure like roads and (c) better political governance & constitutional safeguards (d) cultural adjustments.

A view of human capital situation in the tribal societies in the North East India can be found from the following table.

Literacy rate of STs in States and India.

Sl. No.	States	1961	1971	1981	1991	2001 Total	2001 Female
1	Assam	23.58	26.02	----	49.16	62.5	52.4
2	Manipur	27.25	28.71	39.74	36.79	65.9	58.4
3	Meghalaya	-----	29.49	31.55	53.63	61.3	59.2
4	Nagaland	14.76	24.01	40.32	46.71	65.9	61.317
5	Sikkim	-----	-----	33.30	19 44	67.1	60.2
6	Tripura	10.01	15.03	23.07	27.89	56.5	44.0
7	Arunachal Pradesh	-----	5.20	14.04	56.62	49.6	40.6
8	Mizoram	-----	53.49	59.63	82.71	89.3	86.9
9	India	8.54	11.29	16.35	29.60	47.1	34.8

Source: Yojana vol 54, p-30, June 2010.

The table shows that in terms of literacy rate of Schedule Tribes, the STs in North east India are better placed than the all India level. Therefore, in terms of human capital they have a better status than the rest of the country. Therefore, one can expect that STs of North East India will be more capable in meeting the challenge of globalization in due course of time.

The Way Forward: North East India Perspective

The North Eastern region of India is rich in natural resources like bamboo, rubber, tea, horticulture, orchids, medicinal plants, flora and fauna and cultural diversities. In fact, out of the ten bio-diversity hotspots, one is north east of India, other two being Eastern Ghat and Western Ghat. The human resource is also considerable. North East of India is corridor to South-East Asian countries. It is a route China also. In spite of such resources North East of India in general and tribals in particular are economically one of the most backward regions of the country. This massive poverty in the midst of natural and human wealth is a great puzzle. Development of human capital and physical infrastructure, better governance and cultural flexibility and openness can lead to a more prosperous North East.

3

Sensex Volatility and Household Investors: A Study of the Market Crash and Global Financial Crisis

Ajoy Mitra
Ratul Bora
Sankar Sarma

Abstract

The influence of Global Events and FIIs on the movement of the Sensex became apparent after the 2004 general elections in India. Sensex provide dream run during the year 2006-2007 and surged by more than 50 per cent. But from January2008 after the sudden reversal of FII flows and certain global financial events triggered a panic reaction which resulted in very high volatility in the Indian capital market. During this period, the Sensex experienced the worst single-day decline in its history. In the nine months between January and September 2008, the index declined by about 40 per cent. And it all started because of the selling pressure exerted by the FIIs after the global credit crisis. Indian Household Investors are the worst sufferer because FII control in the companies that constitute the Sensex is very high. Data on the shareholding pattern show that the FIIs are currently the most dominant non-promoter shareholder in most of the Sensex companies and they also control more tradable shares of these companies than any other investor group. Household Investor in this country is and has been being grossly neglected, thanks largely to an unfriendly policy regime framed by apathetic officials. In developed stock market the household investors are

the 'backbone' of the bourses, has in effect been driven out of the capital markets not so much on account of lack of interest on his/her part but because of the volatility in stock market and global financial crisis.

Introduction

Sensex provide dream run during the year 2006-2007 and surged by more than 50 per cent. The market was on peak at 21,206 as on 10th January, 08 to 12,860 on 30th September, 08 and 7,697 on 27th October, 08. It was nearly 64% correction from the high and eventually resulted due to the high volatility witnessed for last few years. This type of sharp decline witnessed probably for the first time in the history of Indian capital market, which is greatly influenced by FII and some global factors. Other interesting features of Sensex volatility is that it down nearly 40% from January peak to September but in October it down another 40% from the close of 30th September, 2008. This paper aims to look at the stock market and the behaviour of household investors in view of the Sensex volatility in relation to the global financial crisis.

The current global financial crisis has its roots in the US, Europe and other advanced countries. Its proximate causes include sub-prime lending, faulty distribution models, unsustainable financial engineering and derivatives usage, faulty credit rating by agencies, a lax regulation and large global imbalances in those countries. But the fundamental cause of the crisis was the loose and excessively accommodative monetary policy followed by the US and other advanced economies from 2002-04.

Financial markets across the globe are in different arena today. Development of financial market and importance of the emerging market (especially BRIC countries, viz Brazil, Russia, India and China) has brought new opportunities and challenges for each one of the participants. One of major problem faced by household investors across the globe is the increased volatility in the various financial markets.

The Indian equity market faced one of its worst days on Friday, 24th October where the Sensex lost 1070.63 points or 10.96% to close at 8701. 07. It was the second largest fall for the Sensex in terms of points after the 1408 points fall on 21st January 2008. In

terms of percentage fall, it was the third after 12.77% on 28th April 1992 and 11.14% on 17th May 2004. On 27th October, 2008 the index closed 2.20% lower to 8509.56.

Household Investors across the world and across the markets have realized the need for a comprehensive strategy which would help in mitigating the impact of the volatility. Though, regulators are trying their best to bring down the volatility, but a household investors must take essential precautions to ensure one portfolio is insulated (as far as possible) from volatility stock. This paper also explains various risk management strategies that investors can make even without knowing the same. It is important to realize that the exact causes of volatility very difficult to determine but one should use different strategies to deal with it.

Background

The liberalization policies initiated in India in the early 1990s brought about radical changes in the conduct of stock market. Rising globalization, deregulation, and foreign portfolio investments made the Indian stock exchanges competitive and efficient in its functioning. With the rise of equity culture across the globe, even India which has a long history of stock exchanges, has witnessed a perceptible shift in the proportion of investor's participation in equity markets. The role of investors is the key to success of market guided economic system and since it is they who pump their savings into the markets, their investments need to be channelized to the most rewarding sectors of the economy. One of the most dominant investors groups that has emerged to play a critical role in the overall performance of the stock market are Foreign Institutional Investors (FIIs).

India has been in the forefront of utilizing technology to enhance its stock market performance. Both the stock exchanges' (BSE and NSE) web sites provide a real-time update of various indices, streaming quotes of stocks, the news updates, screen-based order matching system, and major development like "screen-based book building", where securities are auctioned through an anonymous screen-based system, and the price at which securities are sold is discovered on the screen. This perhaps eliminates the delays in risk associated with traditional procedures. Further reforms on practices like rolling settlements, trade guarantee, demat settlement and derivative trading

have certainly added depth (volume of a particular stock) and breadth (number of stocks traded) to the market. The liberalization of FII flows into the Indian capital market since 1993 has had a considerable impact on market practices, say analysts. And many of the moves to modernize the equity markets in the past decade may be attributed to pressure from foreign investors. For instance, FII investment in the Indian market only took off after paperless trading was introduced in the late 1990s. Earlier, most funds were scared to punt in the market because of fake shares and transfer. To make the process of share transfer and delivery easier and quicker, the regulator, SEBI introduced dematerialization of shares where the shareholders were compulsorily asked to trade shares in the demat form. Other market practices have also been changed at the behest of the foreign investors. The time period for settlement of shares was shrunk gradually from 15 days to a week, then four days and now three days, popularly known as T + 2 settlement. Any investor who now buys or sells shares, receives shares or money on the third day from the day of trade, compared to 15 days in 1995. The domestic market's peculiarities were also discouraged by foreign investors. Vyaj badla, a uniquely Indian hybrid of a futures market that was part of cash market, was banned in 1996, turning the bourses into full-fledged cash market. The removal of badla also curtailed a lot of speculative and circular trading. These investors were also prime movers behind the introduction of futures and options in 2002, which foreign funds needed to help hedge their cash positions. In 1997, mandatory conversion into corporate entities from proprietary firms contributed to increased transparency of broking firms as they had to abide by the stricter guidelines on minimum capital requirements. The reduction of the broking charges also added more depth and breadth into the bourses.

Why is Volatility Undesirable?

Increased volatility brings down the household investors confidence in capital market as speculators take the upper hand. This can either lead to the prevalence of Income Effect over Substitution Effect or investment in other physical assets. This is highlighted in the recent RBI annual report which gives the break up of the financial savings of the household sectors. As per the report only 6.3% of

household savings goes to shares and debentures (even in that 4.8% comes from mutual fund). This has been the case ever since 1990s Harshad Mehta scam devastated household investors' confidence. A look at similar figures shows that the proportion of savings invested in shares and debentures was much higher in 1980s till the investors' confidence was broken. Some big participants of stock market always playing with the household investors' confidence time and again, it happens in 1990s, 2000, 2003, 2005 and in 2008. The larger implication of volatility is that stock market can not fulfill the basic purpose and the set up of regulators like SEBI are put in questions. Thus volatility impairs the smooth functioning of the capital market and effect economic growth of a country. It also makes a financial market more institutionalized as household investors due to their low corpus, usually have lower risk taking ability. Economist, academicians and the financial press have highlighted that the Indian capital market are to be develop and it must be inclusive. But in a country like ours, the Average Indian has to invest in capital market, as he has to be a part of the growth story which the Corporate India, Politician, Economist and Media is experiencing.

Global Financial Crisis

The present global crisis coincided with one such economic cycle, but a highly complex and phenomenally large one in its magnitude, which was not witnessed since the global depression of the 1930s. Extremely loose monetary policy of the US and EU in the past few years, their aggregate demand exceeding output, their large current a/c deficits (which are mirrored in large surpluses in China and elsewhere), increasingly lax administration of their financial institutions and large Fed rate cuts in 2007 lending a strong boost to oil, commodity and asset prices together set the stage for the present global crisis. Between 1980 to1990, the US capital flow (both FDI and private portfolio investments) to emerging market economies was a maximum of $25 billion per annum. But between1990 and 2003, the US capital outflows to EMEs increased to around $200 billion per annum.

In 2007, the capital outflows spurted to around $600 billion per annum, only to crash soon. The effect of the sudden reverse flow

of capital (particularly of portfolio investments) was a particularly traumatic experience for the EMEs. It had severe implications for their monetary management and financial stability. The global crisis has a direct bearing on capital inflows into India. The rate of FDI inflow recorded an increase in 2008-09 compared to the previous year, the FIIs (net) recorded heavy stream of outflows from India in 2008-09 contrary to a healthy rate of inflow in the previous year. Also, during the period, both external commercial borrowings as well as short-term trade credit shrank substantially.

As a cumulative effect, India's real GDP growth declined from 9% April-Dec 2007) to 6.9% (April-Dec 2008); simultaneously, growth of India's industrial production dwindled from 8.8% to 2.8%; growth of its services sector declined from 10.5% to 9.7%; exports fell from 28.4% to 6.4%; imports plummeted from 40.2% to 17.9%; the Sensex fell from 16,569 to 12,366 and its rupee value depreciated from Rs.40.24 per US$ to Rs45.92 per US$.

Present Scenario and Strategies for Household Investors:

The market has been now moving in a manner which is making everyone think short term. The predictability of the market is one thing that is extremely uncomfortable in the interest of the household investors. For the last five years or more, the household investors were always complaining about the unpredictability of the market. Just before the market tanked in January 2008, there were few who had moved out of the market by choice before the black days began. At that time many analysist giving Sensex target of 25,000 to 30,000 for the year 2008 and electronic media also help to make dream for the same. But many of them never expected this type of fall in there wildest dream, all expected a lit bit of correction but 64% fall is too big to adopt or adjust as valuation look cheap and attractive of many blue chip stocks.

The position of the day trader, the day trader lives in a false hope of being smarter than the large operators and institutional investors. Large operators know that their ability to out-smart the small tiny traders and household investors. When small investors and

traders also starts getting an inkling of what the big operators are doing, then their strength and earning ability will go down. Now, ten months into the now acknowledged bear phase and still it is unpredictable in near future.

The market is likely to witness more pain, say many analysts, citing various reasons. One reason being put forward is that the previous three bear phase were all more than 18 months and we are only ten months into the current bear phase. This may be scientific reasons because the world has undergone a major changes every few years and the Indian market even more so. The bear phase of 1993 or of 1997 or of 2001-03 was probably in the period when India was still a nonentity as far as world business community.

The recent bad days for the market have been quite painful as is usual in any bear attack, and the household investors are now eagerly waiting for happy days to come back again. There are positive side too as the Indian economy has not turned negative in these ten months in comparison to other emerging economy. The fundamental of Indian story is still shine bright. Though some important factors which effect the Indian stock market:-

- Inflation @ 12.63% (Highest since last 16 years)
- Political Instability
- Indian Rupee Vs US Dollar (See-Saw)
- International Crude price ($147 to $60)
- GDP growth rate - slowdown / downgrade
- Slowdown of Global Economy
- Higher Interest Rate
- Negative Sentiment of Overseas Market
- IIP Index

Now-a-days Indian market follows the trend of the global markets, accordingly market conditions also not good and very volatile. In the current scenario, household investors should do well if they remain invested in the market.

Indian primary market is also passing through a confidence crisis. There are hardly any issue today and some that are coming

they are ebbed in the bad market conditions. Indian household investors have a huge appetite for IPOs, provided the issue price is right. As per research report Rs. 5,884 crore has been lost by the primary market investors since January this year. Investors in the primary market are fretting and fuming about the losses they have suffered by subscribing so many IPOs during the last one and half year. Out of the 117 IPOs that hit the market between January 2007 to July 2008, 81 IPOs are quoting below their issue price. The huge losses suffered by the investors have shaken their confidence in the primary market. Investors` woes have been compounded by aggressive pricing of some of the issues by promoters and merchant bankers during the 2007 boom.

Inventors need to tread with caution the slippery road to investment and pick out stocks as per their risk appetite from sectors that have the inbuilt strength to come out good from the shaky market conditions. Women Household Investors should be encouraged more to invest regularly as they are more disciplined investors. Remember: Early starter finishes richer. Being financially well informed helps out to take benefit of the emerging opportunities.

The MF Industry manages $53 trillion world-wide. Out of these top 10 countries manages 88% of the AUM. In 2000, not a single mutual fund scheme launched in China, but today they are managing $434 billion under AUM whereas India $110 billion. There is a tremendous growth prospect but not happening due to lack of educated investors. Many MF advisors are selling wrong products, as they get higher commission from the particular scheme. There is lot of mis-selling taking place. There is urgent need of educating the distributors also. In the world, retail investors park 55% of their money into equity-oriented scheme but in India the ratio is less than 30%.

Market participants were expecting rate cuts from the Reserve Bank of India in its mid-term review of monetary policy announced on Friday but were disappointed as key interest rates were left unchanged. Fears of a global recession and earnings downgrades across the world scared investors. FIIs, who had invested $7.93 billion in Indian equities in 2006 and $17.36 billion in 2007, withdrew

more than $3 billion in the period 1st - 23rd October 2008 to meet redemption pressures at home. Markets like India are suffering from a rub-off effect of global de-leveraging as a result of which the excess liquidity that had found its way into emerging markets is being sucked out. Global de-leveraging is taking its toll on other asset classes apart from equities as currency and commodity markets touch new depths. The Rupee went below 50 to the US dollar for the first time ever in opening spot trades on Friday. As of this writing, it is trading at 50.26.

Crude oil prices continued to fall despite the decision by OPEC (Organisation of the Petrol Exporting Countries) to cut output by 1.5 million barrels per day starting from the 1st November, 2008. NYMEX crude futures for near-term delivery fell to $64.15 a barrel on Friday (31st October), its lowest close since 31st May, 2007. Prices have declined around 56% from the record $147.27 a barrel reached on 11th July 2008.

27th October's equity market fall re-affirmed the fact that markets do move in cycles and at regular intervals the Indian markets have seen huge falls from peak levels in a short time. In the year 1992 the Sensex fell 46.84% from its peak levels and in 2000 we saw a drop of 39.44%. This year the Sensex fell 63.70% from its peak of 21,207 on 10th January 2008. Though there is no guarantee of past trends being repeated in the future, it goes on to show that stock market downturns could be followed by up trends that take place over a longer period of time. Thus, staying invested in market falls makes greater sense.

The current fall has made many stocks quote at or near their all-time lows. 25 out of the 30 stocks in the Sensex fell by 50% or more from their 52-week highs on Friday, making them look attractive from point of bottom-up stock-picking. From experience of over 15 years of investing on a bottom-up stock picking basis allows us to uncover the best investment opportunities in all market conditions. We believe that companies' strengths - and therefore their true value - can only be fully uncovered by examining them in thorough detail.

Comparison with World Indices:

Table 1: Average Daily Volatility Comparative Analysis Sensex / Nifty Vs World Indices

AVERAGE DAILY VOLATILITY AND ANNUALISED VOLATALITY IN THE WORLD INDICES

Country	USA Dow Jones	USA NASDAQ	UK FTSE	Hong Kong HIS	Malaysia KLCI	S. Korea KOSPI	Thailand SET	Singapore STI	Germany DAX	France CAC	Indo-nesia JCI	India Sensex	India Nifty
Apr-07	0.49	0.60	0.52	0.96	0.68	0.71	0.56	1.23	0.76	0.65	1.16	1.68	1.75
May-07	0.46	0.77	0.55	0.96	0.80	0.65	0.72	0.84	0.67	0.60	0.81	0.80	0.85
Jun-07	0.78	0.84	0.77	0.90	0.59	1.12	1.33	0.84	1.24	0.93	0.94	0.82	0.84
Jul-07	1.04	1.03	1.19	1.12	0.79	1.55	1.28	1.03	1.24	1.20	1.11	1.07	1.16
Aug-07	1.34	1.45	1.95	2.38	1.89	2.70	2.10	2.44	1.17	1.71	3.18	2.00	2.06
Sep-07	0.91	0.98	1.31	1.26	0.67	1.46	0.82	1.31	1.05	1.41	0.99	1.07	1.09
Oct-07	0.84	1.15	0.89	2.16	0.71	1.58	1.13	1.28	0.59	0.72	1.89	2.34	2.46
Nov-07	1.50	1.77	1.48	2.84	0.85	2.00	1.36	1.60	1.04	1.29	1.37	1.73	1.72
Dec-07	1.03	1.33	1.27	1.87	0.82	0.95	1.27	1.15	0.95	1.11	1.11	1.49	1.67
Jan-08	1.51	1.65	2.11	4.16	1.69	1.94	1.96	2.94	2.36	2.48	3.38	2.89	3.29
Feb-08	1.26	1.38	1.71	2.34	0.89	1.49	1.20	1.65	1.61	1.72	1.15	2.32	2.39
Mar-08	1.60	1.94	1.62	2.53	2.81	1.28	1.03	1.65	1.72	1.58	2.00	3.21	3.06
Apr-08	1.05	1.41	1.04	1.47	0.73	0.96	0.67	1.27	1.12	1.14	1.98	1.28	1.28
May-08	0.90	1.13	1.02	1.33	0.59	1.11	1.11	1.04	0.85	0.99	1.11	1.31	1.21
Jun-08	1.24	1.52	1.18	1.48	0.98	1.06	1.48	0.92	1.05	1.12	0.85	1.93	1.91

Jul-08	1.47	1.56	1.60	1.97	1.13	1.75	1.60	1.36	1.35	1.68	1.45	3.30	2.97
Aug-08	1.42	1.34	1.23	1.72	1.00	1.11	1.47	0.92	1.24	1.43	1.60	1.73	1.61
Annualized Volatility (April 2007 to August 2008)	19.55	22.14	19.63	25.84	14.40	19.96	21.00	17.86	18.16	20.74	22.91	33.76	31.20

Daily Average Volatility is Calculated as the Standard Deviation of Logarithmic Returns of Index Values for the particular period.

Annualised Volatility is Calculated by assuming that there are 251 trading days in the financial year 2008-2009.

Source: Bloomberg Financial Services, BSE, NSE

Chart 1: Volatility of World Indices

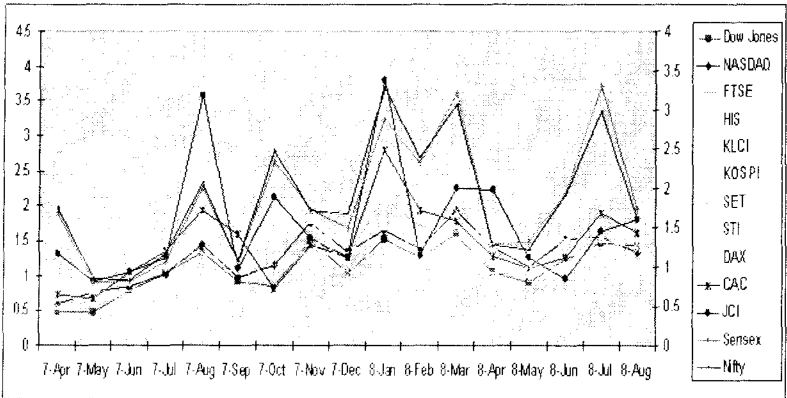
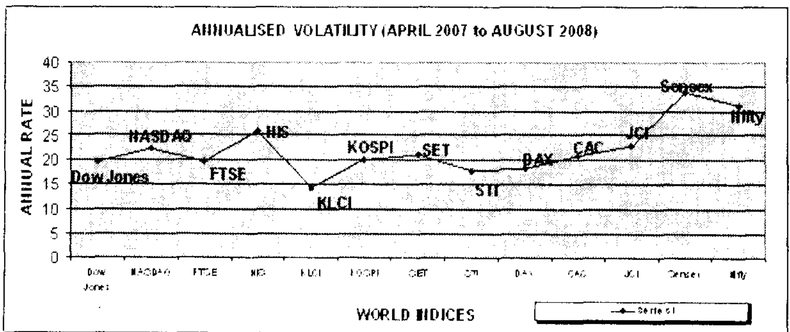


Chart 2: Annualized Volatility (2007-2008)



To measure how much the volatility increased during that month, the following two methods of estimating inter and intra day stock market volatility is used here. These measures are suggested in a recent SEBI Publication on volatility by Raju and Ghosh (2004).

The first formula measures inter day volatility by computing standard deviation of daily returns on stock prices. In this method, the formula used for calculating volatility is

$$\sigma = \sqrt{(1/n-1)\ \Sigma\ (r_t - r^*)^2} \qquad \text{where...}\ r_t = \ln\ (I_t/I_{t-1})$$

I_t is the closing value of the stock market index at time t, and ln is natural logarithm

The second formula uses intra day High and lows of stock market prices and estimate intra-day volatility. The following formula is used in this case:

$\sigma = k \sqrt{} (1/n (\log (H_t / L_t)^2$ *where H_t and L_t are intra day high and low prices, and following Parkinson (1980), k is taken as 0.601*

Daily Sensex data are used for estimation of volatility. Data are taken from the Bombay Stock exchange website (www.bseindia.com)

Calculations show that both inter and intra day volatility of BSE Sensex followed similar trend during 2008. From April 2007 to December 2007, both intra and inter day volatilities of Sensex were moving on a controlled way and moving between the 0.80 to 2.0 mark, except for two months i.e August 2007 and October 2007. Suddenly in January 2008 there was a spike in volatility and both inter and intra day volatility almost doubled for that month. However, from April to June, volatility has again subsided and has settled down to levels observed during the the year 2007 (Table 1). But in the month of July 2008 volatility gained to 2.97, but again come down to 1.61 in August 2008.

We can also observe from the Table 1 that Indian indices both Sensex and Nifty are the most volatile among all world indices. Average volatility for the period April 2007 to August 2008 are on a much higher side for Indian indices and even crosses 30 marks, among the two Sensex is more volatile than Nifty.

To further analyze the unusual movement of Sensex since the middle of April 2004, share price movements of the thirty Sensex companies are studied here. Average monthly closing prices of these thirty companies are used for this analysis. Table 1 shows the frequency distribution of price movements of Sensex companies for the period March 2007 to June 2008.

From the table it can be seen that between March to April, most Sensex companies experienced price increase and the Sensex increased by about 3.5 percent, however, between April to June, the Sensex declined by about 17 percent and twenty eight of the thirty Sensex companies experienced a decline in price. Only Infosys and Wipro,

the two companies dealing with Information Technology (IT), did not experience a price decline over this period. It also shows that twenty two of the thirty companies have experienced more than 10 percent decline in price during the same period. More than 25 percent price drop has been observed for 6 companies: Tata Power Co. Ltd, Hindustan Petroleum Corpn. Ltd, Reliance Energy Ltd, State Bank Of India, Maruti Udyog Ltd and Tata Iron & Steel Co. Ltd. The price decline of the Sensex companies is in stark contrast with the period just before the election when the stocks of 26 of the 30 constituent companies experienced a price increase.

If one looks at how the price decline has affected companies with different market capitalization and weightage in Sensex, some other interesting facts appear. It should be noted that Sensex is a weighted average of the share prices of the 30 constituent companies. Prior to September 2003, companies' weightage in Sensex was based on the total market capitalization of companies. A company's weightage in Sensex was proportional to its share in total market capitalization of the constituent companies. But currently the BSE Sensex is calculated on a free float basis where weightage is assigned depending upon the value of free float shares of the company. According to the BSE website:

"*Free-float market capitalization is defined as that proportion of total shares issued by the company, which are readily available for trading in the market. It generally excludes promoters' holding, government holding, strategic holding and other locked-in shares, which will not come to the market for trading in the normal course. Thus, the market capitalization of each company in a Free-float index is reduced to the extent of its Free-float available in the market*". From BSE website.

Table 2 reports how the price cut has affected companies with different market capitalization and (free float adjusted) weightage in Sensex[1]. The table shows that, on an aggregate basis, companies with higher market capitalization and weightage in Sensex have suffered progressively higher price decline in the April-June quarter. Twenty-two companies, which account for more than 75 percent of total market capitalization of Sensex and have more than 71 percent (free-float adjusted) weightage in Sensex, have experienced more than 10 percent price decline in this three month period. In fact, the average

Table 2: Frequency Distribution of Price Movements of Sensex Companies

(Average closing prices for the month)

	March-April 07	April-May 07	May-June 07	Jan-June 08	April-June 08
Price Increased	26	2	4	0	2
Price Declined <10%	4	15	14	9	6
Price Declined > 10 % and < 20%	0	11	11	11	11
Price Declined <20%	0	2	1	10	11
No. of Share in Sensex	30	30	30	30	30
Movement of Sensex In Percentage (average of monthly closing price)	3.49	–10.40	-7.32	-34.06	-16.96

Source: Calculated using data from CMIE Prowess database

price decline2 for these 22 companies is more than 21 percent. The two companies which did not experience a price decline had about 11.3 percent share in total market capitalization of Sensex companies and account for less than 10 percent weightage in the Sensex index. These observations show that the decline of Sensex in the post election period has been quite sharp, pervasive in nature and affected almost all the constituent companies.

Conclusion

To explain the anomaly, one can argue that after the elections FIIs were concerned about the continuation of reform process in India and started withdrawing their investments. This led to the stock market crash and prices of shares tumbled. However, once the assurance about the continuation of reform process was given, FIIs started buying back the shares they sold earlier. Taking advantage of the stock market crash, they managed to regain their portfolio at a much cheaper price. If this chain of events is true then it shows that the FIIs have come out as the clear winner in the post-election turmoil of the stock market. Not only have they gained financially out of the situation, but they have also managed to influence policy making

in this country. The pressure exerted by FIIs also allowed them to get some fiscal sops in the recent budget. It needs to be reiterated here that there has been no change in the macroeconomic fundamentals faced by the country before and after the volatile period in the stock market.

It needs to be remembered that in India, almost all previous experiences with high phases of stock market volatility have been associated with some form of irregularities and corruption. Given the frequent occurrences of scams and irregularities in the Indian stock market, the likelihood of market manipulation cannot be totally ruled out. The manner, in which record FII investments build up the stock market during the first quarter of the year and the way the stock market was brought down, strengthens this apprehension. It also needs to be considered here that FIIs have emerged as the major market drivers of Sensex companies and, in the past, there have been instances where the nexus between FIIs and big brokers of the BSE was found to be involved in price manipulations in the BSE.

The whole process also highlights another disturbing feature. During the study period, the sudden volatility in the stock market and the subsequent decline of Sensex was almost treated as a national emergency in India by the financial media and to a certain extent, by the incoming UPA government, and every now and then our Finance Minister have to come out with a statement. It is very difficult to understand why the government feels so concerned about speculative investors and the movements in Sensex.

Under these circumstances, it is not clear why so much importance is given to the stock market and portfolio investors by policymakers in India. It is high time to realize that in spite of the impression given by the financial media, movements of stock markets and Sensex do not necessarily imply any fundamental changes in the economy and these movements affect a very small minority of the country's population. It will be unfortunate if movements of speculative capital and the resultant stock market gyrations are allowed to influence macro-economic policymaking in India.

Foornotes:

1. The free float factors of the Sensex companies are available here: www.bseindia.com/about/abindices/bsc30.asp#list

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4

Lessons Learnt from Analysis of Financial Crisis

Sujit Sikidar
Jasojit Debnath

Abstract

The article stresses the genesis of the crisis that had emerged in Dubai known as Dubai financial crisis of 2009 and there after it also focuses on Greek debt crisis of 2010. It focuses to derive some lessons from the past crisis to take preventive measures for the future. It emphasizes the need for judiciary approach in international financial management at the domestic level and at the same time in currency exchange management. It concludes that such crises measure the prospect of euro to be used as another alternative global currency.

Introduction

The current recession began in December 2007, according to the National Bureau of Economic Research, USA. We do not believe that recurrence in business cycle takes place every time. The idea began to spread in the 1920s and reached its peak in the 1930s when a book titled 'Great Depression' was brought out by Lionel Robbins. In contrast 'Recession' a kinder, gentler term is used around the time 1937-38 to refer to a normal downturn in the business cycle. In

January 1938, The Chicago Daily Tribune offered a definition of recession calling it 'a new word for depression, coined by those who do not like to admit that we are still in one'. The proliferation of recession is a business cycle intersected with a rapidly growing public interest in Psychology. The word recession has a softer connotation than the term depression. Way back in 1931, the New York Times attributed recession to a 'mood of pessimism which had been carried to grotesque extremes'. The situation was compared to shouting fire in a crowded theatre. President Franklin D. Roosevelt is widely remembered for saying in 1933 that '**the only thing we have to fear is fear itself**'. While in 1937 'Think and Grow Rich', a book by Napoleon Hill on recession became a best seller; who offered 'auto suggestion' would bolster the unconscious self. Again in 1948 the Columbia University Sociologist Robert K. Merton wrote an article in The Antioch Review titled 'The Self-Fulfilling Prophecy' using the Great Depression as his first example. Coueism has been discredited generally as has been done in respect of old business cycle theory, but they live in our popular parlance as recessions. The New York Times News Service states while expressing doubt about the recovery and eventual end of recession, there is still a nagging doubt afloat that the current event is really just another example in that long sequence of recessions in which mental category does the current contraction: recession or depression? We may still be at a tipping point. To the extent that the theory of the self fulfilling prophecy is correct, there is a case for continued vigilance, to ensure that adverse events do not encourage widespread talk of the second category (The Economic Times, 24th November 2009).

Objectives of the article

1. Having discussed the genesis of the Great Depression we now proceed to discuss the genesis of Dubai crisis;
2. We also aim to discuss the Greek crisis and its fall out on unanimously deciding a bail out package by the 27 member nations of the European nation (EU);
3. The tensions arising there from in mitigating such crises.

We now proceed to through light on the genesis of Dubai crisis

Dubai Financial Crisis

Dubai World has refused to offload assets at fire saleprices to repay obligations, forcing it to seek a debt standstill. Stocks (securities) from Tokyo to New York have been haunted by concern that banks were exposed to state companies in Dubai. Dubai's main state owned firms wanted to suspend debt payments falling due in advances made in real estates, housing mortgages, asset bubbles. Dubai International Financial Centre (DIFC), a 110-acre free trade zone which opened in 2004, prides itself in its website as the world's fastest growing international financial centre. Bank of Baroda has given a $200 million loan to Dubai World, the beleaguered property arm of the Dubai government. State Bank of India has a $50 million exposure to Dubai World. Global markets from Sydney to Sao Paulo trampled on Thursday 26 November 2009 on fears that Dubai's attempts to reschedule loans might trigger a fresh round of financial trouble in a world just emerging from the worst economic crisis since 1930s.

Dubai World, the government company seeks time to repay debts worth $59 billion on 27th November 2009. The debt rollover is seen as sign the emirate itself is in trouble. During first part of the current year another $9 billion felt due. Dubai was hit hard by the worldwide recession. In February 2009, it had turned to Abu Dhabi for a $10 billion bailout. It planned everything big, splashing out giant hotels and man made island resort in an attempt to become a centre of finance and king size lifestyle. For now that dream has turned into nightmare. The company whose slogan is 'The sun never sets in Dubai World' has announced that it has sought extension of repayment time from lenders on some of its liabilities that total $59 billion till at least May 2010. The emirate which sought to build shining cities in the desert at breakneck speed through the import of foreign residents, finances and labour, promised to stump up the money required to rescue Dubai World. Debt ridden Dubai World adopted the following options to repay its $59 billion credit and liabilities.

- On schedule (December 14) repayment of $4 billion of Islamic bond from real estate arm Nakheel
- Seek extension to repay its multi billion dollar debt till May, 2010
- The other option considered include a scheme to offer

bondholders an 80 percent redemption of the value of their holdings, with a similar offer being made to bankers

- Alternatively, Dubai World may move forward with the plan to seek a general 'debt holiday' under the terms of last week's standstill proposal, by which payments would be frozen until May 30,2010 with a view to negotiate a rescheduling of all its debts
- Dubai World might embark on a general liquidation of assets in response to legal action by creditors

Abu Dhabi, the government emirate of the United Arab Emirates, on December 14, 2009 pledged to provide $10 billion to Dubai. The injection allows the repayment of a $4.1 billion bond issued by Nakheel, a property developer owned by Dubai World, the emirate flagship Investment Company and creator of the iconic palm shaped islands that have come to epitomize Dubai's construction boom and eventual real estate bubble. Following the decision, in Dubai and Abu Dhabi stocks of beaten down banks and real estate companies rallied sharply. Dubai, one of the seven members in the UAE had racked over $100 billion in debt in little more than a decade to finance a spectacular construction boom and drive to become a regional financial hub. While the bail out comes as a reprieve for Dubai World, it does not come close to wiping the state clean for Dubai Inc. as a whole. The UAE is India's biggest export market. Synthetic textiles export were worth Rs.16000 crores in December, 2009, with the share of Abu Dhabi and Dubai, which were points of transit being 25 percent during the first half of 2009-2010. UAE was the number one market for Indian goods with a 13.1 percent share in merchandise exports, piping the USA to the second spot whose share was 11.4 percent.

The greedy investors hesitate to learn lessons from past mistakes and repeat the same in search of quick pecuniary gain overnight. The same and similar type of event occurred in Greece, Portugal when the parties borrowed money from the market and became unable to repay the same

Greek Debt Crisis

The euro was trading around 1.5 dollar at the beginning of December 2009 and by the end of March 2010, it was down to 1.35

dollar; it had lost 10 percent of its dollar value in four months. Although the European Union (EU) has a Central Bank, it does not intervene in the exchange market like the Reserve bank of India. It is the market forces that have marked down the euro. It is apprehended that it might lead to recurrence of Greek crisis. In December 2009, Greece disclosed that its national debt was under reported, and as a result credit rating of the Greek government nosedived and it became difficult to finance maturing debt repayments. In February 2010, the Greek budget was placed under the supervision of the European Commission (EC) to restore confidence in the figures. But the EC needed approval of all the 27 member nations' head of state. Eventually they met in Brussels on March 26, 2010 in which Angela Markel refused to support a bailout for Greece. That was a turning point as it signaled the end of Germany's role as champion and protector of the EU which it has played steadfastly since the formation of the EU. It implies that Greece has to choose before long between declaring bankruptcy and tightening its belt unbearably. The lessons we learnt from the Greek crisis in management of foreign exchange are discussed hereunder:

- Greek's public debt is over $400 billion, 25 percent more than it's GDP, and its external debt is over $550 billion, 75 percent more than its GDP. With government revenue over $100 billion, Greece could perhaps continue to service its public debt. It is doubtful whether its balance of payments (BOP) can bear the strain of debt servicing.
- Greece is a member of EU and hence it has no currency of its own. Hence devaluation of its currency to improve the BOP is out of question. The only way it can be improved is by reducing domestic demand. If government does not do this by taxing more or spending less, the rest of the economy will have to undergo a contraction of incomes and jobs. If imports shrink as a result, that would help the BOP.
- Greece has a peculiar feature of deriving foreign exchange earnings from export of shipping services. It is the world's greatest maritime nation. Ships are not anchored in Greece's harbours, and they move out of Greece and be domiciled

anywhere. If the fortunes of Greece look uncertain, its ship owners could move out and register their ships in other countries. That would deprive Greece of Ship's earnings as well as its foreign exchange inflow (The Telegraph, 5th April 2010).

- The Euro zone finance ministers on April 11, 2010 have approved a detailed 30 billion euro ($40.5 billion) emergency aid mechanism for debt plagued Greece but stressed that they had not requested that the plan be activated now. Ministers from 16 nations backed a plan for Athens to borrow from the euro zone governments and the IMF at well below market rates if market funding dried up.
- The Greece debt crisis could undermine sentiment globally and prompt investors to move some of their assets out of riskier assets like emergency market equities, into safer instruments like US treasury bonds.

An alternative to the euro is needed to let Greece and other European nations devalue their currency on way to improving their financial health. European nations are constrained by the euro because they cannot reduce the costs of their goods and services with a cheaper currency, part of the solution in at least five major emerging-market crisis. The credit ratings of Spain and Portugal were cut in 24th to 30th April 2010 amid concern Greece's difficulty to pay its debt will spill over to Spanish and Portuguese markets. Some currency traders in Europe believe that Europe should split the euro into two classes to provide an alternative to struggling nations, namely

(a) Sestertii, and

(b) euro

The new currency called Sestertii after the Roman Empire coin once used across Southern Europe. In every other emerging market crisis, there has been a (i) currency devaluation; (ii) a debt restructuring; and (iii) tighter new fiscal policy. Greece and other nations cannot become competitive without a cheaper currency. From the analysis of the past currency crisis we experienced the Tequila crisis sparked by Mexico's currency Peso devaluation in 1994. The present credit crisis bears similarities which happened in Russia, Argentina and Brazil.

The role of IMF

The International Monetary Fund (IMF) could witness the relaxation of lending standards in the USA way back in June 2006 in its mortgage market. It was indicated by Hector Torres (in an article titled 'bankrupt-theology of deregulation' The Economic Times dated 26th April 2010) that borrowers at risk of significant mortgage payment remained a small minority, concentrated mostly among higher income households that were aware of the attendant risks. In September, 2006 the Global Financial Stability Report (GFSR) stated that, "major financial institutions in mature...markets were...healthy, having remained profitable and well capitalized". Moreover, the financial sectors in many countries were supposedly in a strong position to cope with any cyclical challenges and further market corrections to come. The IMF board could not act promptly and timely as alleged in some quarters.

- The IMF's radar started blinking only in April 2007 virtually when the default in repayment of housing loan and real estate finance was looming large.
- Before the 15th September 2008 crisis, the IMF's best known function i.e. lending to countries with balance of payment problems, was becoming irrelevant. Many emerging markets preferred to self insure by accumulating reserves rather than borrowing from the IMF.
- Mr. Hector Torres has expressed his unhappiness over the calculation of member nations' quota and he has admitted that exchanging money for votes is a perfectly adequate governing structure for a lending institution.
- As early as August 2005, Raghuram Rajan, the IMF chief economist at that time had issued warning of weaknesses in the US financial markets. Rajan saw that something potentially dangerous was happening, warning that competition forces were pushing financial markets to flirt continuously with the limits of illiquidity, and concealing risks from investors in order to outperform competitors.
- Rajan, however, argued something about competition and regulation. He argued that deregulation has removed artificial

barriers preventing entry of new firms and has encouraged competition between products, institutions, markets and jurisdiction. He candidly believed that regulation created artificial barriers and that competition between jurisdictions, i.e. between regulators was to be welcomed. IMF's creed at the time believed that markets perform better without regulation. And it was this boundless faith in markets' self regulatory capacity that appears to be at the root of the IMF's failure to find what it was not looking for.

- Gradually the regulating institutions, lending institutions have started realizing the mistake of reposing over faith in markets' operation in a free unregulated environment. To this the political economist Fred Block has noted: Societies invariably drawback from the brink of full scale experimentation with market self regulation. We are again engulfed by the dichotomy that self regulation is faith that is very difficult to dispel because the propagators of bankrupt theology of deregulation cannot be sure that deregulation is the ultimate panacea.

Tobin Tax and Currency Management

Unregulated currency movement, unrestricted capital flight has the possibility of creating an economic turmoil between or across the nations. During the period 1997-98 when many nations including Mexican Peso, Thai Bat, South Korean Won and other Asian nations witnessed adverse fluctuations in their currency movement and exchange rate owing to unrestricted entry of foreign capital caused widespread imbalance in micro economic management, decline in the purchasing power parity of domestic currency, adverse balance of payment and inability in meeting international debt payment obligations. It is therefore necessary to restore foreign investors' faith in domestic economy and also to attract foreign capital. It is imperative to contain the propensity of extra sensitivity, to avoid spikes and busts, it is mandated to analysis the cause and effect of off-share transactions, cross border movement of capital investment and diversion of foreign trade, currency movement and external receipt and payments.

To this end a tax called Tobin tax named after James Tobin, winner of noble prize in Economics in 1978 was introduced. James

Tobin proposed that all transactions in the currency market should be levied a lower rate of tax, as low as 0.05 percent of the currency transactions in order to discourage speculation in holding and release of currecy. He added that such availability of funds raised from the aforesaid tax, which could be in the order of $100 billion per year may be utilized for currency stabilization, economic development, emergency relief and other national and international crisis. To this direction some initiative was adopted by San Francisco Regional Advisory Committee (SFRAC) in June 1998. It named a principle called Multinational cooperation to tax currency speculators adopted by the SFRAC in June 1998 (K.S.Ravi, Speculative Currency Transaction and Tobin Tax, The Chartered Secretary, April 2010, p.517).

Conclusion

However Tobin tax has not been favoured by many as a final panacea. All though Tobin tax is a transaction tax on currency conversion, but Tobin tax has not been tested rigorously. We believe that no policy instrument is clearly off the table and the choice of instrument for the Central bankers' will be determined by the situation prevelant in current context. India has followed a consistent policy on allowing capital inflows in general and on capital account management in particular. Our position is that capital account convertibility is not a standalone objective but a means for higher and sustainable stable growth. Our central banker appears to be continuing to move towards gradually liberalizing our capital account, but they will revisit the road map to reflect the lessons learnt from the various global crises. Finally even in a liberalized market economy the currency management and debt management cannot be left alone with the market forces. We need a judicious balance of restricted capital account convertibility.

5

Microfinance Industry amidst Global Economic Crisis: Challenges Ahead

Reshma Tiwari
Debabrata Das

Abstract

Recent evidence so far indicates that the global financial crisis will stress the microfinance sector and its clients, but the sector is fundamentally robust and may emerge even stronger than before. Fitch Ratings (2009) states that contrary to some industry views that microfinance is resilient to wider economic shocks; it will be tough for the sector to remain immune from the global financial meltdown. According to Fitch Ratings, there will be (a) a funding or liquidity impact, which amplifies refinancing risks for MFIs and (b) an economic impact, whereby the financial performance will be affected by lower levels of lending, higher costs of funding, stringent net interest margins, higher impairment charges and increased fluctuation in foreign exchange losses/ gains. This is the negative aspect of the convergence risk of growing integration of microfinance with the formal banking system (Fitch Ratings, 2009). This paper aims to examine the impact of global economic crisis on the microfinance industry with some cross country analysis and the challenges ahead of it. As per a CGAP survey report, MFIs in Eastern Europe, Central Asia, Latin America and the Caribbean were found to be most affected as they have some of the most developed and highly leveraged microfinance markets, and it has resulted in less liquidity and

higher risk as compared to the other developing nations. However, the MFIs in Middle East and North Africa (MENA), Sub Saharan Africa (SSA) and South Asia are less affected due to their restricted exposure to the toxic assets (www.icrier.org).

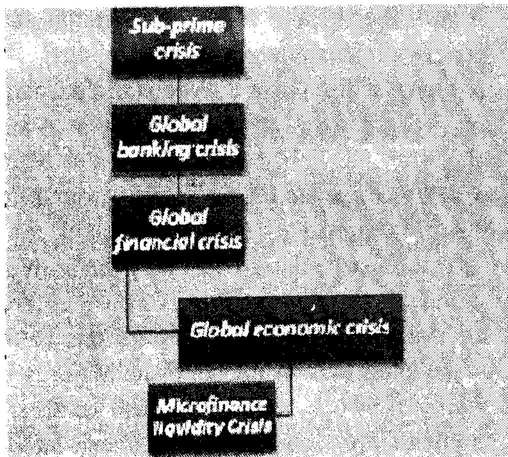
The crisis has highlighted the role of local sources of funding for microfinance. As international funding dries up, local deposits are becoming even more critical to fuel microfinance institutions' lending. Many microfinance institutions who borrow in foreign currency are facing both interest rate hikes and currency depreciation due to a strong U.S. dollar. Currency dislocation will challenge institutions' ability to raise financing and match assets to short-term liabilities, which are predominantly priced in hard currencies. It is pointed out that poor households that were already reeling from the increased cost of food are now being affected by the drop in remittances from family members abroad as job losses mount in Europe and the United States. These households are sometimes struggling to repay loans to microfinance institutions, but although there has been an increase in short-term arrears, there have been no defaults. The paper concludes with suggestive drivers of reducing liquidity crisis in the industry.

Current Financial Crisis: An Overview

The world economy is expanding again and recovery has set in, financial conditions have become stable and improved noticeably but still it has a long way to go. IMF survey reveals that the process of recovery is better than anticipated but as compared to advanced economies[1], the emerging and developing economies[2] have survived the financial crisis in a much better way than expected as compared to past experience, which shows enhanced policy frameworks (IMF, 2009). Further among emerging and developing economies, emerging Asia is leading the revival, while several emerging European and some Commonwealth of Independent States economies are lagging behind. Cross-border financial flows from advanced to emerging economies have increased along with real and financial activity showing a recovery from downturn in 2008. Since the end of 2008, both equity and bond flows are up because of rapid growth in emerging economies, large yield differentials in their favor, and returning appetite for risk. As banks continue to retrench their balance sheets, growth in cross-border flows has come mainly from outside the banking sector. The

renewed flows have eased financial conditions in many emerging economies (IMF, 2010).

Global economic crisis emanated from the sub-prime mortgage crisis[3] in the mid 2007 in United States. It led to collapse of large financial institutions, bailout packages for banks by central governments and downswing in the stock markets around the globe. Many economists consider it to be worst economic crisis since Great Depression of 1930s (www.reuters.com). The economic storm had its epicenter in the developed countries but its ferocity has rapidly spread to developing countries (World Bank, 2008). The chart below reveals how the "*sub-prime crisis*" in the US housing mortgage sector turned into a "*global banking crisis*" with the bankruptcy and failure of two major investment banks- Goldman Sachs and Lehman Brothers in September 2008, leading to "*global financial crisis*" due to dearth of funds and liquidity crunch in the financial market which subsequently resulted in "*global economic crisis*" as a result of uncertainty in the global financial situation due to integration of the US economy with the world economy and how the crisis had hit the global financial and economic system with unanticipated severity, not ever observed since the Great Depression of the twentieth century. The global economic crisis has created "*microfinance liquidity crisis*" as the sector has started feeling the pinch of the liquidity crunch prevailing in the developed world as well as the donor agencies (Figure: 1).



Microfinance:

Microfinance[4] is the alternative financial mechanism serving principally the poor. It is the provision of loans, savings, insurance and other financial products/ services to the poor and disempowered to carry out productive activities, helping them build assets, stabilize consumption and protect themselves against various forms of risks (Hammill et al. 2008). World Bank studies reveal that an inclusive financial system leads to rapid growth and better income distribution (Basu, 2006).

Access to finance in the form of microfinance helps in empowerment of poor by giving them an opportunity to come out of poverty. The evolution of microfinance as a tool of poverty alleviation and empowerment of the poor has been globally recognized. United Nations declared the year 2005 as the year of Microcredit with exclusive focus on "*building an inclusive system*" that serves the poor.

According to some studies the poor and the disadvantaged are the most vulnerable to economic shocks. Studies of the East Asian crisis indicated a rapid rise in poverty and worsening of health and education indicators due to both falling incomes and reduced services. In Indonesia, UNICEF studies found a sharp decline in the usage of public health services by people who could not afford the fees or found that services began to run out of essential supplies such as drugs. The gender dimensions of the evil effects of the recession indicates that women tend to lose their jobs to their male counterparts as the tendency is to protect employment for men and compromise on women's job whenever job retrenchment takes place as males are considered to be bread-earner for the family around the globe across cultural divides. But women's incomes are equally important for the family survival, more particularly when they themselves are the heads of the family and/ or in poor families. Often they are compelled to work in much worse and unfavorable situations at the time of job crisis as they cannot afford to be unemployed. Majority of microfinance clients are women (Swope, 2005). In case of Grameen Bank 97 percent of its clients are women (www.grameen-info.org). The main aim of microfinance is to help poor to get out of poverty. It is a

means of economic development of the poor. According to M.Yunus, father of modern microcredit movement "Microfinance, microcredit is a credit and financial service to the poorest people without collateral, without guarantee and without any lawyers in the system. It focuses more on women-particularly the poorest women".

The Context:

The global financial crisis is spreading rapidly in emerging economies but there is not much data on the impact of global financial crisis on microfinance sector. However, as microfinance has become a part of the global financial system so the crisis is likely to have a positive or negative impact. M. Yunus of the Grameen Foundation viewed that microfinance system is unaffected by the global financial crisis and has remain untouched and continued working as a sustainable institution by evolving a financial mechanism to serve the financial needs of the poor and utilized finance as an effort to eradicate poverty even in the wake of global financial crisis. It has proved to be an effective tool to survive and grow in difficult times. The well established and self financed MFIs which are not dependent on the banks also proved their immunity to the crisis as compared to the commercial banks. Fitch Ratings (2009) states that contrary to some industry views that microfinance is resilient to wider economic shocks; it will be tough for the sector to remain immune from the global financial meltdown. According to Fitch Ratings, there will be (a) a funding or liquidity impact, which amplifies refinancing risks for MFIs and (b) an economic impact, whereby the financial performance will be affected by lower levels of lending, higher costs of funding, stringent net interest margins, higher impairment charges and increased fluctuation in foreign exchange losses/ gains. This is the negative aspect of the convergence risk of growing integration of microfinance with the formal banking system (Fitch Ratings, 2009).

However the Micro Finance Institutions (MFIs) receiving aid or foreign funding from various banks, organizations and donor agencies, foundations, NGOs, or apex institutions are likely to have a negative impact on their flow of funds due the liquidity crunch (www.microcapital.org). MFIs have reported decline in client's

purchasing power and increase in cash needs as well as withdrawal of savings and difficulty in repayment schedule. It has created both liquidity and credit risks for MFIs. Opportunely demand for subsistence goods tends to remain steady during times of economic retrenchment. Many micro enterprises are engaged in this business and some are of the views that nimble microfinance clients might be even benefited if they can encash this situation by managing their inventory to sell cheaper goods to meet newly frugal demands of customers (Littlefield and Kneiding, 2009).

The recession[5] during Asian financial crisis[6] in 1997-98 resulted in decreased job, higher poverty, increasing the number of prospective clients of credit providing microfinance institutions, increased competition, reduced demand of microenterprise output, reduction in government's funding support to MFIs. The MFIs linked with the formal financial system were worse affected. Further the financial crisis in Latin America in the year 1998 and 1999 broadly affected Argentina, Brazil, Mexico Bolivia, Colombia, Ecuador and Peru. Particularly the commercial banks were adversely affected with poor financial results with respect to its loan portfolio, profitability and poor picture of loan repayments (Dokulilová et al, 2009). However, the current financial crisis has its deeper impact due to the irrelevancy of the 'decoupling theory' (RBI Bulletin, 2009)[7] in today's globalizing world.

The contagion effects of financial turmoil originating in the rich countries has been transmitted to the poor countries through various distinct channels, viz., diminishing trade due to fall in exports and exchange rates, investment, migrant remittances and aid flows. Due to fall in exports to the USA and other industrial countries, extensive lay-offs in China and other developing countries have been observed. Trade protectionism initiatives in the industrial countries will magnify this problem (Roy, 2009). World Bank (2008) reports also support that devastating effects can be observed in fall in exports and foreign capital inflows. Further many developing countries faced sharply tighter credit and higher interest rates. GDP growth in 2009 in developing countries was expected to fall to 4.5 percent from 7.9 percent in 2007. Private capital flows in the form of Foreign Institutional

Investments (FIIs) and Foreign Direct Investment (FDI) and External Commercial Borrowings (ECBs), etc were expected to drop from $1 trillion in 2007 to $530 billion in 2009. Remittances that migrant workers send to home countries were also expected to decline which provide a lifeline to poverty-stricken areas (World Bank, 2008). Llanto and Badiola states that the global financial crisis has affected both the assets and liabilities side of the balance sheets of rural and microfinance institutions, instigating problems and challenges about future source of funding and clients' access to financial services (Llanto and Badiola, 2009).

Thus the effects may vary (for MFIs) from country to country depending on the economic environment, its financial system, the status of the microfinance clients in terms of their earnings, expenditure, and need for microfinance and repayment capability. Further it is also influenced by the funding and interest structure of MFIs.

Before the slowdown, the microfinance industry fascinated numerous new investors like investment funds, banks, private equity funds, pension funds and so on as it seemed to be a commercially viable venture to earn and grow at above average growth rates, with less default rates (Murphy, 2008). To have a better understanding and respond to the requirements of the microfinance industry amidst the liquidity crisis, Standard & Poor's (S&P) conducted an extensive survey of MFIs, major investments banks, microfinance investment funds, the largest microfinance networks and microfinance industry associations. The survey concludes that many industry experts view this period of dampened growth as a positive opportunity since they think that slower growth will persuade MFIs to improve their operating discipline, and ensure that their infrastructure (enterprise risk management systems, internal controls, management capabilities and so on) is enhanced to meet the demands of future development (Eddy, 2008).

Financial stability is necessary for efficient working of the microfinance sector. Finance acts as the nervous system of microenterprises as the interest of poor and disadvantaged section of society is involved who are most vulnerable to least economic shocks.

Financial stability can be defined as a situation in which the financial system – consisting of financial intermediaries, markets and market infrastructures – is competent to sustain the shocks and the unraveling of financial imbalances, thereby mitigating the risk of turmoil in the financial intermediation process which is severe enough to crucially damage the allotment of savings to lucrative investment ventures (European Central Bank, 2009).

The present paper aims at proving a literature review of the global economic crisis on microfinance sector and its clients on regional basis. The analysis is based and conclusions have been drawn from various research studies conducted by research agencies, development practitioners and information gateways worldwide.

1. Financial Crisis and Clients in Eastern Europe & Central Asia (ECA):

The ECA region includes 22 countries with a total population of about 366 million people. As of January 2008, the ECA region had over 7,200 active MFIs serving almost 8 million borrowers (www.cgap.org). Several countries of ECA region pierced the global crisis in a vulnerable condition with comparatively high current account deficits, soaring external debt levels, very rapid credit growth, and a consumption boom financed by foreign currency borrowings. The region is most affected as they have some of the most developed and highly leveraged microfinance markets, resulting in less liquidity and higher risk as compared to the other developing nations. The microfinance clients are facing higher repayment problem (due to increase in unemployment, fall in remittances and unprecedented losses of jobs). Further micro-entrepreneurs' profits are also down which is augmenting the problem of accessing liquidity. The credit risk and liquidity constraints for the MFIs has also increased as 87 percent of MFIs in the region reported increase in portfolio at risk and 50 percent of MFIs reported liquidity constrains during the last six months as per CGAP survey in March 2009 (Table: 2 and Chart: 3 & 4). Notably clients in urban areas appear to be more affected than rural ones. However compared to other regions there is lower food insecurity (CGAP, 2009).

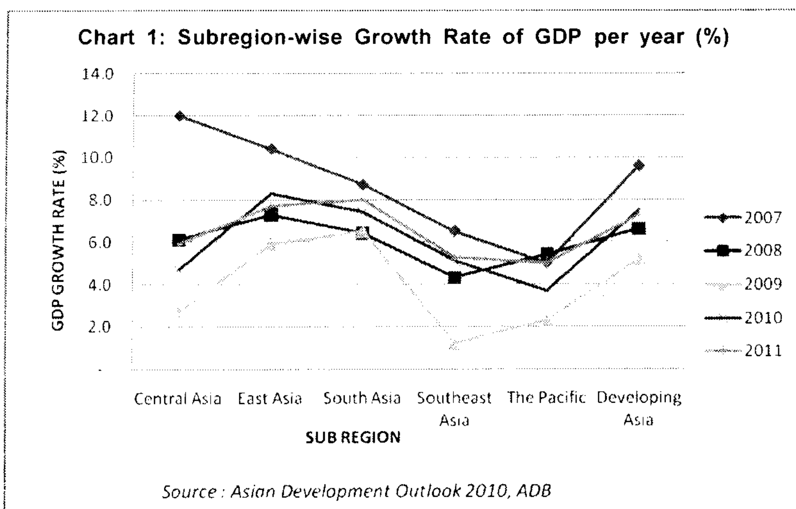
The economy and the clients of ECA region are highly affected. The biggest multilateral fund providers and lenders in Eastern Europe (i.e. the EBRD, the EIB Group, and the World Bank Group[8]) have pledged to provide up to € 24.5 billion to support the banking sectors to fund lending to businesses in the region affected by the global economic slowdown (World Bank, 2009). The CGAP survey on different regions on a scale of one to five reveals that microfinance clients of ECA region are worse affected with a mean impact 3.5 (Chart: 2).

As per World Bank estimates the number of poor and vulnerable people is expected to rise to 35 million by the end of 2010 throughout Eastern Europe and Central Asia, increasing by about 5 million people for every 1 per cent fall in GDP (World Bank, 2009). The GDP growth figure of Central Asia[9] slumped to 2.7 per cent in 2009 from 12 per cent in 2007 due to major bank failures and depressed non-oil activity and reduced inflows of workers' remittances. Expansion is expected to accelerate the GDP growth by 4.7 percent in 2010 and 5.9 per cent in 2011 (ADB, 2010) (Chart: 1).

2. *Financial Crisis and Clients in East Asia & the Pacific (EAP[10]):*

The EAP region contains 22 per cent of the world's population and 25 percent the world's poor. The three main sub-regions with substantial heterogeneity in the EAP are China, the Pacific, and East Asia. As a whole, EAP has witnessed a stable economic growth rate and as compared to the other economies of the world EAP is comparatively resilient to the financial downturn (www.cgap.org).

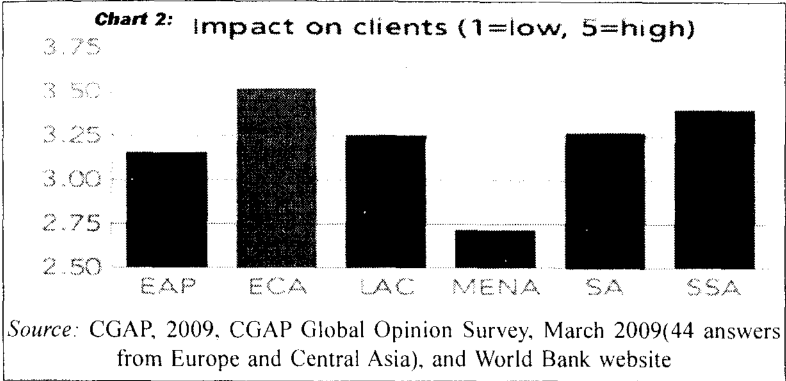
East Asia[11] also had to encounter the slowdown which is reflected by the figures of the GDP growth rate. The GDP growth fell to 5.9 percent in 2009 from 10.4 per cent in 2007. The effect was severe in East Asia because strong economies like Hong Kong and Taipei showed negative growth of 2.7 per cent and 1.9 per cent respectively and GDP of Republic of Korea grew by only 0.2 per cent in 2009. However in the midst of strong recoveries in the countries like Hong Kong, Mongolia; and Taipei the projected growth rate for the region has been estimated at 8.3 per cent in 2010 and 7.7 in 2011(Chart: 1).



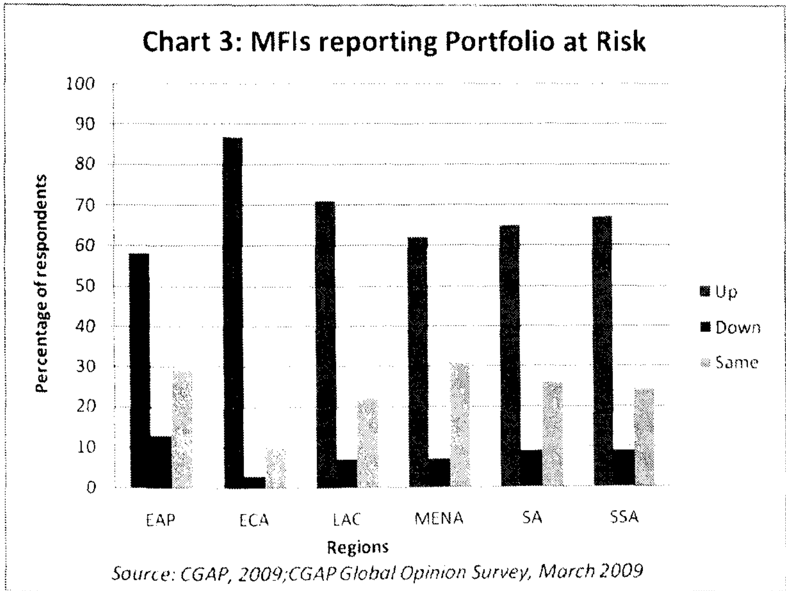
In the Pacific GDP growth declined to 2.3 per cent in 2009 from 5 per cent in 2007. Aggregate growth in the Pacific is forecast to rise by 3.7 per cent and 5 per cent in 2010 and 2011 respectively. The decline in growth has been observed all over the world and the projections for the region are also low but projections for East Asia are comparatively high and lowest for the Pacific. The growth for the region can be attributed to growth in China (Chart: 1).

Despite the fact that many economies are agriculture based; the region was hit relatively hard by the food crisis. However as compared to MFIs in other regions, fewer (58 percent) have reported rising levels of portfolio at risk and 50 per cent of the MFIs have reported liquidity constraints (Chart: 3 & 4). Portfolio growth[12] has been mainly sluggish or negative so far, but forecasts for the future are positive. The microfinance Clients of EAP region are moderately affected on a scale of one to five (Chart: 2). The highest share of income of the clients is expended on food, further the prices of seeds and raw materials have also gone up resulting in less savings in many parts of the region. Above all female clients in the region are worst sufferers compared to other regions because to mitigate the crisis they are compelled to eat less and work hard. Due to reduced demand in the developed economies exports have declined drastically and workers in export-oriented manufacturing, construction, tourism, textile and

the mining sector are extensively affected due to increased layoffs which have shown a negative impact on the repayment rates of the microfinance clients. However clients running micro enterprises seemed to be less affected as they operate locally (www.cgap.org).



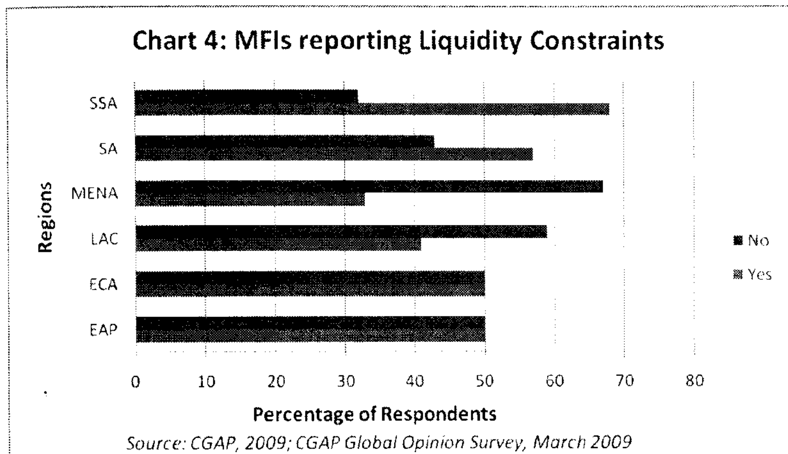
Source: CGAP, 2009, CGAP Global Opinion Survey, March 2009(44 answers from Europe and Central Asia), and World Bank website



Source: CGAP, 2009;CGAP Global Opinion Survey, March 2009

3. Financial Crisis and Clients in Latin America & the Caribbean (LAC):

The LAC region is posting a strong recovery after facing the global downturn. External as well as domestic demand is facilitating the output growth in the region. The major factors shaping the recovery in LAC are accommodative policies, good fundamentals i.e. sound financial system, solid balance sheets and higher commodity prices and external demand. These are contributing towards strengthening domestic demand, re draw capital flows. The GDP in the LAC region is projected to grow at 4 per cent in 2010 and 2011, with varying degree of prospects across the region. The recovery is projected to be especially strong in several commodity-exporting, financially integrated economies (Brazil, Chile, Mexico, Peru) but to be less strong in many commodity-importing economies in the region having large tourism sectors (Antigua and Barbuda, The Bahamas, Barbados, St. Lucia) due to weaker tourism prospects and less accommodative policies (IMF, 2010). With an estimated gross loan portfolio of more than $15 billion and nearly 13 million borrowers, in 2008, there were at least 400 MFIs across Latin America (www.cgap.org). According to CGAP client's loan repayment capability of microfinance clients (particularly urban clients and women) have declined in the LAC region and they are most affected after ECA and 71 percent of MFI respondents have reported their portfolio to be at risk during last six months (Chart: 3). Micro entrepreneurs' business activity and remittances from abroad have diminished and 41 per cent of MFIs have reported liquidity constraints during the last six months (Chart: 4). Increased and volatile food prices are also adversely affecting the MFI clients. The clients engaged in small production and petty trading activities are most affected. The CGAP survey on different regions on a scale of one to five reveals that microfinance clients of LAC region are moderately affected with a mean impact 3.25 (Chart: 2) (CGAP, 2009).



Source: CGAP, 2009; CGAP Global Opinion Survey, March 2009

4. *Financial Crisis and Clients in Middle East and North Africa (MENA):*

This widespread region extends from Morocco in Northwest Africa to Iran in Southwest Asia and includes about 6 per cent of the world's population (www.cgap.org). The major funding sources for MFIs in the region constitute borrowings, donations and retained earnings (The Micro Banking Bulletin, 2008). Compared to other regions the clients in the MENA region are least affected on a scale of one to five with of a mean impact 2.7 (Chart: 2). Further only 33 percent of MFIs have reported liquidity constrains during the last six months where as 62 per cent of MFIs have reported their portfolio at risk for last six months (Chart: 3 & 4). Clients of the lower section are not severely affected by the slowdown but bigger borrowers have less appetite for expansion and credit. Securing food expenditure remains priority but less challenging compared to other regions, especially to rest of the African continent (CGAP, 2009). The recovery process has set in with varying degree of recovery prospects across the MENA region. The underlying forces contributing towards the pace of recovery are higher commodity prices and external demand (which are enhancing production and exports in many economies in the region) along with government spending programs. According to CGAP, unemployment is stable in most countries, and local banks are still unaffected by the crisis in the region. However, vulnerable financial

sectors and weak property markets in some economies (Kuwait, United Arab Emirates) along with slow recovery in Europe are hindering export growth, workers' remittances, and tourism revenues in the other parts of the MENA region (Morocco, Tunisia). GDP in the MENA region is expected to grow at 4½ percent and 4¾ percent in 2010 and 2011 respectively (IMF 2010).

5. *Financial Crisis and Clients in South Asia (SA):*

The microfinance market in South Asia[13] is widely diverse ranging from budding microfinance market of Afghanistan, to the nearly four decades old and well developed microfinance system of Bangladesh. India became the hub of foreign inflows with the convergence of Indian economy with the global economy due to huge inflow of private equity investment in the form of FIIs, FDIs and ECBs. Further MFIs of India are growing at the fastest pace compared to any country in the world. However the growth rate of microfinance is a bit slow in other countries of the region i.e. Pakistan, Nepal or Sri Lanka. The closed economic nature of the region along with the comparatively conservative policies of the government and the banking sector and restricted exposure to toxic assets[14], the SA region was relatively less affected by the global downturn. On the whole the performance of microfinance is reasonably good, even though repayment problems have been witnessed in Pakistan along with signs of stress in Bangladesh and India. As microfinance expands the industry is struggling to derive the techniques to fight competition, institute credit information agencies and expand the outreach in profitable or commercial as well as responsible manner (www.cgap.org).

South Asia was the only region which was not that adversely affected by the slowdown as some of the countries have less exposure and integration with the developed economies while the other countries were supported by the continued fiscal stimulus and monetary easing policies by the governments. In comparison to 2007 when the GDP growth was 8.7 per cent the GDP growth was only 6.5 per cent in 2009 but it will be worth noting that in 2009 the GDP growth was rather a fraction more than in 2008 which shows the regions capability to fight the menace of recession. In this backdrop the GDP growth projections for 2010 and 2011 have been pegged at 7.4 per cent and 8 per cent respectively (Chart: 1).

The clients of the SA region were moderately affected when measured on a scale of one to five (Chart: 2). Further 65 percent of respondents have reported their portfolio at risk and 57 per cent of respondents are facing liquidity constraints during the last six months (Table: 2 and Chart: 3 & 4).

6. *Financial Crisis and Clients in Sub-Saharan Africa (SSA):*

SSA region have one of the diversified and enhanced microfinance network in the world. The various types of institutions engaged in microfinance includes NGOs, financial cooperatives and credit unions, rural banks, associations, non-bank financial institutions, microfinance banks, postal and savings banks, and commercial banks. The wide ranges of diversified institutions facilitate better competition and promote enhanced services for the microfinance clients. Recently mobile phone operators are extending mobile banking facilities through phones, ATMs, points of service (PoS), and agent network. Despite being a developing country and having least integration with the world economy, the SSA region is also affected by the food and fuel price rise that crop up in 2008 and was followed by the global crisis more particularly by the liquidity crisis. According to the International Monetary Fund, GDP growth declined to 5.5 percent in 2008 from 7 percent in 2007. The poor in the region are adversely affected by the drastic fall in remittances and rise in food prices[15]. After the ECA region, microfinance clients in SSA are highly impacted when observed on a scale of one to five (Chart: 2). The 195 African MFIs registered on the global MIX Market database in 2008, reported more than 6.5 million borrowers and 16.6 million savers (www.cgap.org). The strong savings base of the region reduces the dependence of the microfinance sector on international debt and equity. The trend analysis of MFIs in SSA region for 2006, 2007 and 2008 reveals that deposits constitute the major portion of the funding structure of MFIs and SSA accounts for largest growth in depositors in 2008 (40 percent), but the size of deposits fall by 22 percent between 2007 and 2008 due to reduced cash flow of the households, adverse affect of the multiple crisis on the small businesses of the clients and rise in food prices. A slowed growth in borrowers was observed in SSA in 2008 as it slowed down to 12 per cent from 25 per cent in 2007 (MIX and CGAP, 2010). Due to global slowdown, MFIs were reluctant to augment their client

outreach and preferred to focus on trusted and familiar borrowers. However, the main cause of concern for MFI managers is liquidity as 68 per cent of respondents have reported the liquidity constrains and 67 per cent of MFIS have reported portfolio at risk during the last six months as per the CGAP survey in 2009 (Chart: 3 & 4). The impact of the present crisis is not uniform on all the nations due to varying dependency on global trade and foreign direct investment and the fragility of their financial sectors but, the economic slowdown in Europe and the US is distressing foreign aid and is putting local governments under strain and this will result in a negative impact on the Sub-Saharan Africa (Murphy, 2008).

Suggestions:

The current financial crisis has made the need for transparency and industry benchmarks even more relevant to the microfinance sector as it faces new challenges. In response to the need for globally accepted and standardized analytical tools, Standard & Poor's Ratings Services is taking steps to develop ratings criteria for MFIs (Eddy, 2008). Further microenterprises can garner the opportunity by offering local products as the consumer would like to switch to cheaper and easily available local products. Some suggestions for the better and smooth functioning of MFIs are (www.microfinancegateway.org):

1. The MFIs need to focus on quality of their portfolio even at the time of decreasing profit margins and tough competition.
2. MFIs should learn the lesson from the sub-prime crisis and improve their risk management practices.
3. MFIs should expand and have access to alternative sources of funding to mitigate disturbances at the time of crisis and should make efforts to access diversified sources of funding.

Conclusion

Due to global slowdown many countries in different regions witnessed fall in GDP rate, outflow of foreign investment, decline in exports, increase in layoffs and fall in remittances which resulted in decline in client's repayment capability and many MFIs reported

liquidity constraints and portfolio at risk while some were reluctant to augment their client base. However clients running micro enterprises seemed to be less affected as they operate locally. The accommodative policies of government, good fundamentals of the economies and increase in external demand are restoring the confidence of foreign investors and these are the factors shaping the recovery process in many countries leading to revival of MFIs in different regions.

MFIs in Eastern Europe, Central Asia, Latin America and the Caribbean were found to be most affected as they have some of the most developed and highly leveraged microfinance markets, and it has resulted in less liquidity and higher risk as compared to the other developing nations. However, the MFIs in Middle East and North Africa (MENA), Sub Saharan Africa (SSA) and South Asia are less affected due to their restricted exposure to the toxic assets.

The immunity of MFIs has taught us the following lessons:

1. The importance of local sources of funding i.e. saving and deposits.
2. The institutions depended on foreign funding or international help are likely to have adverse affect.
3. As compared to the deposit taking institutes the credit providing institutions are likely to face higher adverse affects.

Footnotes:

1. ***Advanced Economies:* It comprises of 33 countries:** Australia, Austria, Belgium, Canada, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hong Kong SAR, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, Singapore, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Taiwan Province of China, United Kingdom, and United States. Source: http://www.imf.org/external/pubs/ft/weo/2010/01/weodata/weoselagr.aspx#a200
2. ***Emerging and Developed Economies:* It comprises** of 149 countries: Republic of Afghanistan, Albania, Algeria, Angola, Antigua and Barbuda, Argentina, Armenia, Azerbaijan, The Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei Darussalam, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, Chile, China, Colombia, Comoros, Democratic

Republic of Congo, Republic of Congo, Costa Rica, Côte d'Ivoire, Croatia, Djibouti, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Eritrea, Estonia, Ethiopia, Fiji, Gabon, The Gambia, Georgia, Ghana, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Hungary, India, Indonesia, Islamic Republic of Iran, Iraq, Jamaica, Jordan, Kazakhstan, Kenya, Kiribati, Kuwait, Kyrgyz Republic, Lao People's Democratic Republic, Latvia, Lebanon, Lesotho, Liberia, Libya, Lithuania, Former Yugoslav Republic of Macedonia, Madagascar, Malawi, Malaysia, Maldives, Mali, Mauritania, Mauritius, Mexico, Moldova, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nepal, Nicaragua, Niger, Nigeria, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Qatar, Romania, Russia, Rwanda, Samoa, São Tomé and Príncipe, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Solomon Islands, South Africa, Sri Lanka, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Sudan, Suriname, Swaziland, Syrian Arab Republic, Tajikistan, Tanzania, Thailand, Democratic Republic of Timor-Leste, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Uganda, Ukraine, United Arab Emirates, Uruguay, Uzbekistan, Vanuatu, Venezuela, Vietnam, Republic of Yemen, Zambia, and Zimbabwe. ***Source:*** http://www.imf.org/external/pubs/ft/weo/2010/01/weodata/weoselagr.aspx#a200

3. **Sub-prime mortgage crisis** is financial crisis triggered by a domestic rise in mortgage delinquencies and foreclosures in the United States, with major adverse consequences for banks and financial markets and financial markets around the globe. ***Source:***www.wikipedia.org

4. According to Dokulilová et al (2009) the microfinance institutions which can be divided into three main categories, based on their organizational composition:

   i. *Informal institutions* voluntarily providing microfinance without the formal institutional structure such as self-help groups, credit associations, families, individual money lenders. They are not guided by any kind of control or regulation.

   ii. *Semi-formal institutions* which are usually registered associations regulated by the relevant financial laws and not subject to banking regulation, functioning as a connecting link between the clients and the formal institutions and are known as microfinance financial intermediaries (MFFIs). They are most traditional form of MFIs such as financial NGOs, financial cooperatives, and credit unions, postal saving banks.

They are generally engaged in extending credit or collecting deposits. The financial NGOs being the most popular having greater outreach, operate principally by providing microcredit for development activities combined with the technical assistance and other social intervention for the clients. Their pool of fund usually consist of donations by supranational institutions and agencies, donor states, raising private funds and/ or deposit mobilized from the clients.

iii. *Formal institutions* which can be classified into three main categories i.e. microfinance banks (MFBs), microfinance oriented banks (MFOBs) and microfinance sensitive banks (MFSBs). All are engaged in deposit mobilization and credit extension and hence directed by banking regulation.

5. Recession is the economic impact of global slowdown which causes slowdown in overall economic activities, including, investment, employment rate, profits data of companies etc. It is defined by 'The National Bureau of Economic Research' as "a significant decline in economic activity spread across the economy, lasting more than a few months" (http://www.mumbaispace.com).

6. The common causes of the Asian financial crisis in 1997-1998 were hyped exchange rates, structural flaws in the financial system and too much short-term borrowing (role of IMF) - resulting in asset price inflation, speculation and increases in non-performing loans leading to recession in many East Asian countries, slower growth rate, sharp rise in unemployment, increased inflation and higher interest rates. The worst affected countries were Thailand and Indonesia, whereas, Philippines was able to sustain the initial shock while India and other South Asian nations were slightly affected.

7. According to this theory, even if advanced countries went into a downturn, emerging economies will at worst be affected only marginally.(RBI Bulletin January 2009)

8. The World Bank sanctioned $8.2 billion for East Asia and Pacific in fiscal 2009 for 40 development projects, almost double the $4.5 billion financed in fiscal 2008. Support included $6.9 billion in IBRD loans and $1.2 billion in IDA commitments, including $36.4 million in grants. Source:http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/0,, menu PK:208946~pagePK:146732~pi PK :146828~theSitePK:226301,00.html

9. Central Asia comprises of Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.

10. EAP region includes Cambodia, China, Fiji, Indonesia, Kiribati, Korea,

the People's Democratic Republic of Lao (Lao PDR), Malaysia, Marshall Islands, FS Micronesia, Mongolia, Palau, Papua New Guinea, the Philippines, Samoa, Solomon Islands, Thailand, Timor-Leste, Tonga, Vanuatu, and Vietnam.(Source: http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/EASTASIAPACIFICEXT/0,,menuPK:208959~pagePK:146748~piPK:146812~theSitePK:226301,00.html)

11. East Asia comprises of People's Republic of China; Hong Kong, China; Republic of Korea; Mongolia; and Taipei, China
12. Pacific comprises of Cook Islands, Fiji Islands, Kiribati, and Republic of the Marshall Islands, Federated States of Micronesia, Nauru, Papua New Guinea, Republic of Palau, Samoa, Solomon Islands, Democratic Republic of Timor-Leste, Tonga, Tuvalu, and Vanuatu
13. South Asia comprises of Islamic Republic of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
14. Derivative products are now labeled as 'toxic assets' as they along with other assets caused the closure or large losses of international banks in OECD economies. ***source:*** *Llanto, G. M,. and Badiola, J. A. R.,2009, The Impact of the Global Financial Crisis on Rural and Microfinance in Asia, Discussion Paper Series No. 2009-24 (Revised), Philippine Institute for Development Studies, p13, http://www.microfinancegateway.org/gm/document-1.1.4338/07.pdf*
15. However some countries have experienced a raise in remittances like Senegal

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Table: 1 Growth Rate of GDP (percent per year)

Sub region/economy	2007	2008	2009	2010	2011
Central Asia	**12.0**	**6.1**	**2.7**	**4.7**	**5.9**
Azerbaijan	25.1	10.8	9.3	9.5	9.7
Kazakhstan	8.9	3.3	1.2	2.5	3.5
East Asia	**10.4**	**7.3**	**5.9**	**8.3**	**7.7**
China, People's Rep. of	13.0	9.6	8.7	9.6	9.1
Hong Kong, China	6.4	2.1	-2.7	5.2	4.3
Korea, Rep. of	5.1	2.3	0.2	5.2	4.6
Taipei, China	6.0	0.7	-1.9	4.9	4.0
South Asia	**8.7**	**6.4**	**6.5**	**7.4**	**8.0**
Bangladesh	6.4	6.2	5.9	5.5	6.3
India	9.2	6.7	7.2	8.2	8.7
Pakistan	6.8	4.1	2.0	3.0	4.0
Sri Lanka	6.8	6.0	3.5	6.0	7.0
South East Asia	**6.5**	**4.3**	**1.2**	**5.1**	**5.3**
Indonesia	6.3	6.0	4.5	5.5	6.0
Malaysia	6.2	4.6	-1.7	5.3	5.0
Philippines	7.1	3.8	0.9	3.8	4.6
Singapore	8.2	1.4	-2.0	6.3	5.0
Thailand	4.9	2.5	-2.3	4.0	4.5
Vietnam	8.5	6.2	5.3	6.5	6.8
The Pacific	**5.0**	**5.4**	**2.3**	**3.7**	**5.0**
Fiji Islands	-0.5	-0.1	-2.5	-0.5	0.5
Papua New Guinea	7.2	6.7	4.5	5.5	7.7
Developing Asia	**9.6**	**6.6**	**5.2**	**7.5**	**7.3**

Source: Asian Development Outlook 2010, Macroeconomic management beyond the crisis, Asian Development Bank, p 8

*Notes: * Projected data for 2010 and 2011.*

(Data for Bangladesh, India and Pakistan are recorded on a fiscal year basis. For India, the fiscal year spans the current year's April through the next year's March. For Bangladesh and Pakistan, the fiscal year spans the previous year's July through the current year's June.)

Table: 2 Microfinance institutions reporting Portfolio at Risk and Liquidity Constraints for last 6 months

Region	Percentage of MFIs reporting Portfolio at Risk			Percentage of MFIs reporting Liquidity Constraints	
	Up	Down	Same	Yes	No
EAP	58	13	29	50	50
ECA	87	3	10	50	50
LAC	71	7	22	41	59
MENA	62	7	31	33	67
SA	65	9	26	57	43
SSA	67	9	24	68	32

Source: CGAP, 2009, CGAP Global Opinion Survey, March 2009

6

Global Recession and its Impact on Indian Banking Sector

Sonit Dutta
Anurag Singh

Abstract

Banking sector is the backbone of Indian economy. A sound banking system is an important tool to achieve economic growth and stability, which helps in allocating capital investment towards the most productive channels. However, sometimes such a sound system is also affected adversely by financial crunch and cripples the global economy. The present global economic meltdown of 2007-08 is such an event that shook all nations across the globe and their economies slowed gradually. As a result of which there was a panic situation in the global financial market. Indian banking sector is also not an exception to it. However the magnitude was not much higher in India. The present study is an attempt to review the impact of the global recession on Indian banking sector. The paper also analyzes the measures taken by the RBI and the Government of India to handle the recession. Finally, the paper ended up with suggestion and relative solutions for the overall development of the banking sector in India in future.

Introduction

The economic recession of 2007-08 is mainly resulted from the sub prime mortgage crisis in the US of July 2007, which became a global issue. US, Japan, Germany and Italy are main economies that faced the great impact of economic recession. Around the world stock markets have fallen, large financial institutions have collapsed or been bought out. The global financial markets had shown strains on a scale and scope was not witnessed in the past five quarters of a century. Elevated losses on US sub prime mortgage have spread beyond the boarders of the United States. Risk spreads had ballooned, liquidity in some market segments had dried up and large complex financial institutions have admitted significant losses. From 31st December 2007 to 18th December 2008, the entire world's stock exchange fell dramatically by 30-40%, sometimes even more. Stock exchange fell 45% in Turkey and 60% in Russia and China. The BSE Sensex has fallen by more than 55% in the course of 10 months, from all time high level of 20,873- below 9,000 (first time since July 2005). After three years of growth over 9%, Indian economy experienced 6.7% in 2008-09 fiscal year. As a result of which liquidity crisis has emerged in the financial sectors and it has also created inflationary situation.

Turbulence in the Global Banking Landscape

Gaurav Sharma (2009) of Assocham Research Bureau has pointed out the following interesting facts.

1. After the collapse of Lehman Brothers in September 2008, crumbling banking institutions in US, UK and other European countries during 2008-09 sought government support by way of massive capital injections to avert severe implications of toxic financial assets worth USD 4 trillion.
2. US alone accounted for as many as 60 banks failures during 2008-09, costing the FDIC Deposit Insurance Fund a whopping USD 25 billion.
3. Failure of number of banks in countries like US, UK, Iceland, Ukraine, Belgium, Ireland, Latvia, Russia and Spain had severe impact on their economy. However, the Indian banking sector not only resisted such a scenario but improved significantly.

4. After pumping in hundreds of billions of dollars to stabilize the domestic banking and financial institutions, the outcome of the stress test of US banking sector highlighted the shortfall of another 75 billion in banks to have adequate capital level.

Review of Literature

Lots of researches conducted so far to study the effects of economic crisis in different countries and areas. Bartlett (2008) revealed that the main cause of the crisis was the downfall of US sub-prime mortgage industry; the intensity of this collapse was significant. Barlett also observed that it is the largest financial loss in history, as compared to Japan's banking crisis in 1990 about $780 billion, losses stemming from the Asian crisis of 1997-98 approx $420 billion and the $380 billion savings and loan crisis of U.S itself in 1986-95. Khatiwada and McGirr (2008) stated that "many of these sub-prime mortgages actually never made it on the balance sheets of the lending institutions that originated them"; and they were made attractive to foreign banks by high investment grading, "when sub-prime borrowers failed to repay their mortgages, the originating institution needed to finance the foreclosure with their own money, bringing the asset back on its balance sheet. This left many banks in a financially unviable situation, in a rather short, unmanageable timeframe". DeBoer (2008) stated that it was a series of events which caused the crisis; it begins with the collapse of currencies in East Asia in 1997 and became edgy due to the financial crisis of Russia in 1998. Next, in USA was the 'dot-com' stock collapse in 2001, and the final stroke was again in USA, when after a swift decline in housing prices and rapid contraction in credit, it fell into recession. Malik, Ullah, Azam and Marwat (2009) observed that the current crisis affected the developing countries due to financial contagion and spillovers for stock markets in the markets. They added that banks in the developing economies will see their credit lines from foreign banks squeezed and the increasing financial flows that these economies have been experiencing are going to dry up. Jena and Sahoo (2009) revealed that the slowdown of USA has affected Indian economy mainly into two reasons. Firstly, USA is India's largest trading partner. Exports are showing the signs of flagging, customers have started canceling orders and payments are

not made on time. Secondly, the financial linkage it has with India may take a severe turn because of prolonged recession. In a statement Dr. Manmohan Singh (2009) said that, "A crisis of this magnitude is bound to affect our economy as it has. International credit has shrunk, with adverse effect on our companies and banks".

Numerous researches concentrated on the global financial crisis and its effects on various sectors of different countries were done so far. In past we have noticed the worst impact of global financial crisis on the banking sector of US and other related market. India is the part of global economy therefore some shadow was noticed on banking sector. Finding the gap between the various researches and the importance of this sector in present economic crisis and up coming time, this study was undertaken with the below mentioned objectives.

Objectives of the Study

The main objectives of the present study are:

1. To analyze the impact of global recession on Indian banking sectors.
2. To study the measures taken by the government to handle the recession.

Methodology

The type of research followed for the present study is exploratory in nature. The study is based on secondary data available from July 2007 to April 2010. For this purpose various journal, website, government publication and newspaper on global economic crisis are referred and acknowledged in the reference of this paper. The secondary data collected is unambiguous and free from any critics. The reliability of the information collected was checked. Information was further edited as per the requirement of the study.

Global Recession and Indian Banking Sector

The global recession has resulted into liquidity crisis in the financial sector. Although Indian banks have very limited exposure to the US mortgage market, directly or through derivatives, and to the failed and stressed financial institutions yet Indian economy is experiencing

the knock-on effects of the global crisis. The capital adequacy ratio of Indian banks has increased from 9%-13%, which indicates inefficiency in use of capital. Banks prefer to invest in bonds and debentures instead of corporate lending. The banks have parked huge fund in government securities. Below is the impact of meltdown on the Indian banking sector.

Liquidity

The liquidity taps resembled the ones in the 'Thar Desert' and the banking system was made to fight a lone battle to tide over this liquidity crunch. It resulted into lack of additional bank credit for the corporate sectors (Chelluri, 2008). Advance tax payouts in September 2008, dollar selling by RBI (to prevent steep depreciation of the rupee) in the forex market (due to selling by FIIs and demand from oil companies among others) led to a short-term liquidity squeeze. Consequent to the global events, Indian banks were also finding it difficult to raise funds from abroad, and had to rely on the domestic borrowing to pump that money for their overseas operations. The borrowing by banks from the RBI also rose during this period. Consequently, the domestic liquidity tightened and manifested in call money rates soaring to as high as 23% in 2008.

Inflation and Interest Rates

Inflation in India has climbed steadily close to 12% in July 2008. This cause decreased demand for goods and services, which in turn lead to decrease in production, lay-offs and a sharp rise in unemployment. Investors spent less as they fear stocks values will fall and thus stocks markets fall on negative sentiment. The Cash Reserve Ratio (CRR) was down to 6.5% and interest rates i.e. repo rate, came down to 7-8% in March 2008. This has resulted in slowdown in deposits. The deposits growth rate has been reduced from 20.5% in November 2008 to 25.3% in November 2009. A large number of customers have moved from private sector banks to public sector banks. This is mainly because of security against their investment. In the light of the steps taken by RBI both on liquidity and interest rates, several public sector banks had announced plans on reducing their prime lending rates.

Credit Growth

While credit growth close to 25% in the first half of FY09 was healthy, it was due to the higher demand from the oil, fertilizer and infrastructure sectors. Some of the demand was from the Indian corporate sector. India Inc, raised cheaper loans from abroad, but those rates have increased in line with the tight liquidity conditions (Chelluri, 2008). The rupee's depreciation is made the condition worse. The recent meltdown on the bourses has meant that raising money from the equity route is also largely closed. As a result of it, banks are witnessing credit demand from bigger corporate. However, even as the fears of higher inflation are subsiding but higher interest rates have led to a slowdown in the industrial activity. Higher rates and bottlenecks in raising funds have led the projects to postponed in the course of time. Some companies are already reportedly cutting production and have announced plans to postpone expansion plans, all of which are clearly an indication of slowing economic growth. Banks, too, on their part have shown the cautiousness in lending due to tight liquidity conditions, and perhaps the threat pertaining to deteriorating economic conditions. International exposure, to the banks has slow down the growth substantially.

Profitability

ICICI Bank whose market capitalization fell by 8.6% and HDFC Bank, which fell by 6%, were among those Indian firms listed on American bourses that incurred loss to the tune of $10 billion during October 2008. The cheaper CASA deposits didn't come easily as the depositors had shown an inclination for term deposits. It was evident from the lower CASA ratio for many banks in Q1FY09. Any substantial conversion of CASA to term deposits increases the cost of funds for the banks, and finally the pressure on net interest margins. According to CRISIL (2008) report, "The profitability of Indian banks was under pressure due to increased cost of borrowing, declining interest spreads, and lower fee income due to slowdown in retail lending. Profit levels were also impacted by mark-to-market provisions on investment portfolios and considerably lower profit on sale of investments, as compared with previous years."

Asset Quality

Although Indian banks are well capitalized and regulated, and are seen in a better position to endure any probable increases of Non Performing Asset (NPA). The situation was monitored as the trend was changed. In a high interest rate and slowing economic growth scenario, asset quality of banks has come under rigorous scrutiny. The retail non-performing assets were in the uptrend, even though banks have recently pared exposure towards retail assets to improve their asset quality. The NPAs were also arisen from small and medium enterprises segment from the last quarter of FY09. In a statement Rajesh Mokashi (2008), executive director, CARE Ratings, said that, "The overall asset quality of 44 Indian banks studied by CARE has shown an improving trend with median Gross NPAs reducing from 2.54 % as on March 31, 2007, to 1.83 % as on March 31, 2008. The first quarter FY09 median Gross NPA numbers for 32 banks studied by CARE have marginally increased to 1.93%, however they are substantially lower than the corresponding period in the previous year."

Remedial Measures

In due course of time the RBI has taken several measures to ease liquidity crisis which aimed at infusing rupee as well as foreign exchange liquidity and to maintain credit flow to productive sectors of the economy.

Interest Rate Management

In order to deal with the liquidity crunch and the virtual freezing of international credit, RBI took steps for monetary expansion which gave a cue to the banks to reduce their deposit and lending rates (Choudhari, 2009). The major changes in the interest rate policy of RBI are:

- Reduction in CRR by 400 basis points from 9% in August 2008 to 5% in January 2009.
- Reduction in the repo rate (rate at which RBI lends to the banks) by 425 basis points from 9% as on October 19 to 4.75% by July 2009 (the lowest in past 9 years) in order to improve the flow of credit to productive sectors at viable costs so as to sustain the growth momentum.

- In order to make parking of funds with RBI unattractive for banks, the reverse repo rate (RBI's borrowing rate) was reduced by 275 points which stands at 3.25% in July 2009.

The above said policy changes since mid-September 2008, enabled RBI to infuse Rs.5, 61,700 crore (excluding Rs.40, 000 crore under SLR reduction) in market in order to ensure ample liquidity in the banking system.

Risk Management

There has been a sustained demand from various quarters for exercising regulatory forbearance in regard to extant prudential regulations applicable to the banking sector. As a part of counter-cyclical package, RBI has made several changes to the current prudential norms for robust risk disclosures, transparency in restructured products and standard assets which are given below:

- Implementation of Basel II w.e.f. March 2009 by all Scheduled Commercial Banks except Regional Rural Banks (RRBs) which would promote closer cooperation, information sharing and coordination of policies among sector wise regulators, especially in the context of financial conglomerates (Choudhari, 2009).
- Further guidance to strengthen disclosure requirements under Pillar 3 of Basel II.
- Counter-cyclical adjustment of provisioning norms for all types of standard assets (except in case of direct advances to agriculture and small and medium enterprises which continue to be at 0.25%).
- Reduction in the risk weights for claims on unrated corporate and commercial real estate to 100%.
- Reduction in the provisioning requirement for all standard assets to 0.40%.
- Improve and converge financial reporting standards for off balance sheet vehicles.
- Develop guidance on valuations when markets are no longer active, establishing an expert advisory panel in 2008.

- Permitting housing loans to be restructured even if the revised payment period exceeds ten years.
- Making the restructured commercial real estate exposures eligible for special treatment if restructured before June 30, 2009.

Hence, RBI has ensured perseverance of prudential policies which prevent institutions from excessive risk taking, and financial markets from becoming extremely volatile and turbulent.

Credit Management

There was a noticeable decline in the credit demand during 2008-09 which is indicative of slowing economic activity-a major challenge for the banks to ensure healthy flow of credit to the productive sectors of the economy (Choudhari, 2009). The reduced funding demands on the banks enable them to reduce the interest rates on deposit and thereby reduce the overall cost of funds. In order to facilitate demand for credit in the economy the RBI has taken several measures.

- Opening a special repo window under the liquidity adjustment facility for banks for on-lending to the non-banking financial companies, housing finance companies and mutual funds.
- Extending a special refinance facility, which banks can access without any collateral.
- Unwinding the Market Stabilization Scheme (MSS) securities, in order to manage liquidity.
- Accelerating Government's borrowing programme.
- Upward adjustment of the interest rate ceilings on the foreign currency non-resident (banks) and non-resident (external) rupee account deposits.
- Allowing corporates to buy back Foreign Currency Convertible Bonds (FCCBs) to take advantage of the discount in the prevailing depressed global markets.
- Instituting a rupee-dollar swap facility for banks with overseas branches to give them comfort in managing their short-term funding requirements.

- Extending flow of credit to sectors which are coming under pressure include extending the period of pre-shipment and post shipment credit for exports.
- Expanding the lend able resources available to the Small Industries Development Bank of India, the National Housing Bank and the Export-Import Bank of India.

Conclusion and Policy Implications

The global financial crisis has a significant effect on the financial institutions of developing countries. Although Indian banks have very limited exposure to the US mortgage market, directly or through derivatives but still our economy is experiencing the knock-on effects of the global crisis. The banking industries in our economies have to suffer contractions in credit lines and reduced financial flows. Although the government has taken certain measures to curtail the inflation and liquidity crisis, but few more initiatives were required like reintroduction of programs to recapitalize banks, guarantee bank liabilities, and provide liquidity to banks by funding markets and in some cases support troubled asset markets.

Few more measures at the front of government could have brought better results. Asset price inflation should have made under the control of monetary policy authorities by government. The policy implications to the crises should have been methodical, inclusive, decisive, and well-organized as global multilateral solutions.

On the basis of the facts give in the findings it can be said that the impact of global recession was not very tough. What ever the little effect was there, we by the balanced initiatives of the government have now overcome the great impact of global financial crunch. This is the high time to learn the lesson from the past and should take all the measures in advance to overcome such type of difficulties in future.

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7

Current Global Crisis and Great Depression of 1930s

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Abstract

In general sense there is a strong parallel between what happened during the Great Depression of the 1930s and what the world is passing through this day. While the main cause of the crisis shared a similar pattern, but the unprecedented boom in stock markets, with leveraged finance supporting the securitized assets, and the continuing flows of capital to finance the trade and fiscal deficits of US had to give way to unfulfilled expectations in the market. As for the magnitude of the loss in terms of output and employment, the current scene certainly overtakes the thirties in terms of absolute magnitudes. One only hopes that duration of the slump will not be as long as it happened earlier and the intensity of the current global economic crisis, in terms of its damaging effects over a decade or more, will be far less than that of the Great Depression of the 1930s.

Introduction

After its healthy performance during the period 2003-07, the world economy has since August, 2007 been experiencing adverse developments on several fronts. The crisis first surfaced in the US subprime mortgage market in the third quarter of 2007 and soon

assumed a global dimension, encompassing both financial and real sectors. Indeed, the on-going troubles are the most serious the world economy has faced since the Great Depression in the 1930s.

The proximate cause of the current financial turbulence is attributed to the subprime mortgage sector in the USA. At a fundamental level, however, the crisis could be ascribed to the persistence of large global imbalances, which, in turn, were the outcome of long periods of excessively loose monetary policy in the major advanced economies during the early part of this decade (Mohan, 2007, Taylor, 2008).

Most of the crises over the past few decades have had their roots in developing and emerging countries, often resulting from abrupt reversals in capital flows, and from loose domestic monetary and fiscal policies. In contrast, the current ongoing global financial crisis has had its roots in the US. The sustained rise in asset prices, particularly house prices, on the back of excessively accommodative monetary policy and lax lending standards during 2002-2006 coupled with financial innovations resulted in a large rise in mortgage credit to households, particularly low credit quality households. Most of these loans were with low margin money and with initial low teaser payments. Due to the 'originate and distribute' model, most of these mortgages had been securitised. In combination with strong growth in complex credit derivatives and the use of credit ratings, the mortgages, inherently sub-prime, were bundled into a variety of tranches, including AAA tranches, and sold to a range of financial investors.

Evolution of the Crisis

The international financial crisis originated in the sub-prime mortgage crisis which surfaced nearly two years ago in the US. With interest rates rising and home prices falling, there was a sharp jump in defaults and foreclosures. However, this would have remained as a purely mortgage market crisis but for the fact that these sub-prime mortgages were securitized and packaged into products that were rated as investment grade. Once doubts about these assets arose they turned illiquid; it also became very hard to price them. As a result, it started affecting a host of institutions which had invested in.

The deep and lingering crisis in global financial markets, the extreme level of risk aversion, the mounting losses of banks and financial institutions, the elevated level of commodity prices (until the third quarter of 2008) and their subsequent collapse, and the sharp correction in a range of asset prices, all combined, have suddenly led to a sharp slowdown in growth momentum in the major advanced economies, especially since the Lehman failure. Global growth for 2009, which was seen at a healthy 3.8 per cent in April 2008, is now projected to contract by 1.3 per cent (IMF, 2009). Major advanced economies are in recession and the EMEs - which in the earlier part of 2008 were widely viewed as being decoupled from the major advanced economies - have also been engulfed by the financial crisis-led slowdown. Global trade volume (goods and services) is also expected to contract by 11 per cent during 2009 as against the robust growth of 8.2 per cent during 2006-2007. Private capital inflows (net) to the EMEs fell from the peak of US $ 617 billion in 2007 to US $ 109 billion in 2008 and are projected to record net outflows of US $ 190 billion in 2009. The sharp decline in capital flows in 2009 will be mainly on account of outflows under bank lending and portfolio flows. Thus, both the slowdown in external demand and the lack of external financing have dampened growth prospects for the EMEs much more than that was anticipated a year ago.

International Co-ordination

The present crisis calls for co-ordinated efforts of all affected countries. First, a simultaneous effort at stimulating the economy will have a profound effect on aggregate demand. Second, the various countries must avoid protectionist policies. This is a lesson that we have learnt from the depression of 1930s. Third, the international financial institutions need to strengthened in order to enable them to meet the financial needs of poor developing countries badly affected by the crisis. There are of course, some fundamental issues which need to be addressed with respect to the international financial institutions, such as ownership, voting power and management control.

Impact on India

The Indian financial system is not directly exposed to the "toxic" or "distressed" assets of the developed world. This is not surprising

since Indian banks have very few branches abroad. However, the indirect impact on the economy because of the recession abroad is very much there. The "decoupling" theory does not hold good.

The indirect impact is felt both through trade and capital flows. The fall in international commodity prices and more particularly crude oil is reducing sharply the import bill from previous estimates. The recession abroad is having an adverse effect on our exports of goods and services. There is a sharp deceleration in the rate of growth of exports in 2008-09. The decline in growth rate in exports will affect strongly some sectors where exports constitute a significant proportion of the total production. Some examples are textiles, automobile components and gem & jewellery.

In contrast, to the strong inflow of over $100 billion last year, this year may not see any net increase in capital flows. Portfolio capital has already turned negative, with a significant impact on the stock market. Indian firms may also experience difficulties in raising money abroad. All this will impact the exchange rate.

The direct effect of the sub-prime crisis on Indian banks/financial sector was almost negligible because of limited exposure to complex derivatives and other prudential policies put in place by the Reserve Bank. The relatively lower presence of foreign banks in the Indian banking sector also minimised the direct impact on the domestic economy. The larger presence of foreign banks can increase the vulnerability of the domestic economy to foreign shocks, as happened in Eastern European and Baltic countries. In view of significant liquidity and capital shocks to the parent foreign bank, it can be forced to scale down its operations in the domestic economy, even as the fundamentals of the domestic economy remain robust. Thus, domestic bank credit supply can shrink during crisis episodes. For instance, in response to the stock and real estate market collapse of early 1990s, Japanese banks pulled back from foreign markets - including the United States - in order to reduce liabilities on their balance sheets and thereby meet capital adequacy ratio requirements. Econometric evidence shows a statistically significant relationship between international bank lending to developing countries and changes in global liquidity conditions, as measured by spreads of interbank interest rates over overnight index swap (OIS) rates and US Treasury Bill

rates. A 10 basis-point increase in the spread between the London Interbank Offered Rate (LIBOR) and the OIS sustained for a quarter, for example, is predicted to lead to a decline of up to 3 per cent in international bank lending to developing countries (World Bank, 2008).

The global economic crisis being witnessed currently is the biggest crisis witnessed by the capitalist world since the Great Depression of the 1930s. The recession has deepened considerably over the past few years mainly during the period 2008-2009.

- The latest IMF World Economic Outlook Update, January 2009 projects that the world economy will grow only at 0.5% in 2009, the lowest since the Second World War.
- The combined GDP of the advanced capitalist economies taken together is projected to contract by 2% in 2009. This will be the first annual contraction, i.e., absolute fall in output, experienced in the advanced economies in the post-war period. As a consequence of this crisis, job losses are occurring across the world and unemployment is on the rise.
- All the major capitalist centres - the US, EU and Japan - are simultaneously witnessing recession. In the US, the unemployment rate has shot up to 8.1% in February 2009 with the number of unemployed persons reaching 12.5 million (1.25 crore), an increase of about 50 lakh in the past one year.
- The latest Global Employment Trends report of the ILO concludes that the global unemployment rate rise to 6.5% in 2009, with the total number of unemployed persons rising from 17.89 crore in 2007 to 21 crore in 2009.

Differences between the Financial Crisis in US, Europe and India

Unlike the US and Europe, India did not face the problems of subprime lending, toxic derivatives, bank losses threatening capital erosion, bank credit crunch and mistrust between banks. India's problems include a reduction in capital flows leading to a pressure on the balance of payments (BoP), weakened sentiments on stock markets,

temporary monetary /liquidity impact on MFs/NBFCs, reduction in flows from non-banking institutions, and perceptions of a credit crunch.

India's problems also include an increased fiscal stress; rise in the oil, fertiliser, food subsidies; pay commission, debt waiver, and NRE, substantial stimulus packages, a worsening GFD to GDP ratio, and large increase in market borrowings.

For coping with the crisis, especially on the fronts of Capital account and financial sector, (a) India has adopted a more calibrated and gradual approach towards opening up. (b) It has been encouraging equity flows. (c) It has been managing debt flows subject to ceilings and some end-use restrictions. (d) It has been progressively liberalizing capital outflows.

Comparison of Current Crisis with Great Depression of 1930s

The consequences of the Great Depression of the thirties include a sharp fall in world trade and international capital flows, the latter dropping by 9% during 1927 33 and matched by significant declines in primary commodity prices which hit developing countries. These included India and other colonies which faced the brunt of the depression. Migration across nations also fell drastically in the process. The Great Depression of the thirties also witnessed a revival of economic nationalism, neo mercantilism and protectionism which was matched by a rise of fascism in Germany (1934) and Italy (1936) with considerable loss of labour status.

Comparing the current scene, the immediate impact of the crisis was an end to the financial boom, which was brought about by end of 2007 with a collapse of the sub prime loan market in US. Losses therein were spread to the rest of the financial business, in US as well as in other advanced countries by October 2008. In US a large number of investment banks and other financial institutions including the mega insurance company AIG felt the heat and were nearly at a point of collapse. Monetary and fiscal measures to bail out and to instill liquidity in the system via banks have not worked sufficiently so far. On the whole the impact has been pervasive, especially as one considers the contractions in the real economy, with fall in output and employment all over the world.

Thus the GDP of the advanced nations have recorded a negative growth rate while those for the fast growing developing countries have fallen drastically, both with domestic contraction and drop in export demand from abroad. A direct response of the output and job losses as have followed the financial crisis in the advanced countries has been the emergence of protectionism, which is happening in disguise, thanks to the formal compliance to the WTO regime.

As a consequence of above, most countries including the developing ones today are facing sharp drop in exports, output and employment.

Conclusion

The ongoing global financial crisis can be largely attributed to extended periods of excessively loose monetary policy in the US over the period 2002-04. Very low interest rates during this period encouraged an aggressive search for yield and a substantial compression of risk-premia globally. Abundant liquidity in the advanced economies generated by the loose monetary policy found its way in the form of large capital flows to the emerging market economies. All these factors boosted asset and commodity prices, including oil, across the spectrum providing a boost to consumption and investment.

As far as India is concerned, we already see signs of recovery in the second half of 2009 and hope will see a distinct improvement in growth fiscal 2010-2011.

There are some of the views that India "escaped" from a serious impact of the financial crisis because financial sector reforms were not pushed forward. This is not true in real sense. The financial sector reforms in India are intended to improve the efficiency of the financial system. If we pushed hard in this direction, it would not have had any adverse effect. The shock waves produced by the financial crisis will have their own effect on the structure of capitalism. Acceptable capitalism would require more regulation. Future discussions must centre on the nature and scope of such regulation. Run-a-way financial innovations that are non-functional do more harm than good. There are the lessons that we can draw from the current financial crisis.

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8

Economic Slowdown, Impact of Downsizing on HR: Antecedents and Consequences

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Abstracts

The psychological well-being of employees who survive organizational downsizing and restructuring remains a contemporary theme in the work environment. This situation has a substantial influence on organizational success. This study examined the relationship among survivor attributes (attitude, commitment and motivation) after downsizing in selected manufacturing organizations. To have a better understanding of the relationship between survivor attributes after downsizing, a total of one hundred and fifty survivors (n = 150) who had experienced downsizing participated in the study. Four null hypotheses, investigating the levels and relationships among the attributes were tested by means of specific statistical methods, such as measures of central tendency and correlation analysis. The results showed that survivors had high levels of motivation and moderate to satisfactory levels of attitude and motivation. A significant relationship was observed between survivor motivation and commitment. Specific recommendations are provided to ensure improved survivor quality after downsizing.

Introduction

One of the biggest challenges facing organisations today is how to deal with the current business challenges. These challenges range from increased oil prices, political instability, HIV/AIDS and economic recession and their impact on productivity. Melaine (2006) asserts that developing the adaptive ability of a learning organisation within a changing environment is a key challenge to productivity.

Globally, organisations that do not respond to the aforementioned business challenges through engaging in strategies intended to reduce expenses, enhance performance, and maximise productivity do so at their own peril because their survival and viability in the current competitive environment will be compromised. To remain competitive, most organisations are changing the way they are doing business (Taylor, 2008). They are adopting and implementing cost saving strategies in order to prevent the erosion of their productivity baseline.

The target of cost reduction measures invariably is to reduce expenditure on manpower. Therefore, workforce related expenses are usually the target of early investigations by many organisations on causes directly related to productivity erosion. Because there is pressure on today's managers to account for all the expenses and identify their sources, the strategy adopted by organisations as part of their response to the business challenges they are facing is downsizing through workforce reduction. The result is more work with less staff.

While it has become a common practice for organisations operating in the current global economy characterised by recession and political instability to downsize in order to remain competitive, a grave problem of survivor quality arises. Survivor quality according to Vinten and Lane (2002) is characterised as the worker's, attitude, commitment and motivation in the new work situation after downsizing. As previously indicated, workers who remain after downsizing are likely to be affected in terms of survivor quality. Survivor quality is viewed as a critical component in guaranteeing increased productivity and long-term growth and productivity after downsizing (Littler, Wiesner and Dunford, 2003). Survivor quality is also seen to account for the organisation's credibility, and bottom line impact (Vinten and Lane, 2002). The literature argues that often management overlooks the psychological effect of downsizing in terms of survivor quality.

Vinten and Lane (2002) point out that downsizing leaves the survivors frustrated, anxious, resistant and with the "wait and see" attitude, a scenario also known as 'survivor syndrome' (Kusum, 2004). Good (2005) also notes that survivors are the greater losers when compared to those who have been terminated, because they have to endure disillusionment, frustration and generally have a perception of insecurity.

There is no doubt that organisations need to continually evolve as they adapt to new and often challenging environmental changes. Planning for downsizing is critical in order to take into account factors that affect survivor quality. Frydenberg and Lewis (2002) suggest that the quality of survivors in terms of attitudes towards the new work situation, commitment towards the organisation and motivation to carry out the new tasks often undergo change as downsizing begins or after it ends. Such changes can cause heightened stress levels which in turn affect job performance and consequently productivity. Research (e. g., Noronha and D'Cruz, 2005) shows that in the new environment created after downsizing, an organisation's success depends on the well being of the survivors in terms of their attitudes, commitment and enthusiasm to work. Therefore, an understanding of the relationship between survivor quality factors is an essential step in getting closer to dealing with survivor qualities after downsizing. Knowledge of survivor quality aspects will enable Human Resources (HR) practitioners design methods to involve survivors in the decision-making process, improve worker conditions, and initiate survivor re-training focused on the new job demands. This will result in improved survivor morale, commitment and motivation. The relationship of aspects of survivor quality will also help organisations to be proactive by focusing inwards at their departments and outwards at their customers in order to effectively reorganise and enhance the efficiency of their delivery systems without jeopardising worker quality.

Problem Statement

The relationship among attitudes, the levels of motivation and commitment among survivors is not clearly understood after downsizing. To ensure improved efficiency, effectiveness, competitiveness and productivity, the relationship among survivor qualities need to be studied and understood. Ryan (1989) stresses that

as many organisations downsize, survivors' attitudes, commitment and motivation towards the new working environment become important elements of productivity. Therefore, benefits of downsizing will continue to be at stake if planners continue to ignore the factors influencing survivor quality. Consequences of neglecting the interplay of survivor quality factors may be poor productivity, negative attitudes towards work, poor job satisfaction, and lack of organizational commitment among survivors. Researchers (Applebaum, Patton and Shapiro, 2003; Fisher and White, 2000; Iverson and Pullman, 2000) have documented extensively on downsizing, discussing issues like job security, organisational commitment, and other aspects as single concepts without broadening their investigations towards the relationship of these factors, especially as it relates to survivor quality. Interest has been on change management and organisational effectiveness (Willcoxson, 2006). Nonetheless, researchers are credited for pointing out the importance of survivor quality and further, discussing the effects of downsizing on survivors, such as job security, mental and physical health and organizational productivity, but fall short of exploring the relationship of many of these variables as they relate to the survivors after downsizing, especially in contexts that are unstable, economically. This study investigated the relationship among perceived attitude, work commitment, and motivation among survivors of downsizing in an unstable economic environment. The investigation was guided by the following questions: What attitudes, commitment and motivation do survivors have after downsizing? Is there a relationship among these survivor quality factors?

Objectives

The aim of the study was to investigate the relationship among attitude, commitment, and motivation among survivors of downsizing. To help achieve this main objective, the following specific objectives were identified:

i) To explore the concepts of downsizing and survivor quality.

ii) To determine the attitude, commitment and motivation of survivors after downsizing.

iii) To determine whether a correlation exists among attitude, commitment and motivation after downsizing.

iv) To formulate recommendations for downsizing planners in terms of survivor quality, provide a foundation for academic training and make recommendations for further research.

Theoretical Framework

Organisations largely depend on committed and dedicated employees. An understanding of factors that influence survivor quality after downsizing is grounded in theories that explain the reactions of employees to organisational downsizing. Such theories include the organisational justice theory (Greenberg, 1987), and the attribution theory (Weiner, 1995). Organisational justice is defined as employees' perception of the fairness with which they have been treated by an organization (Campbell and Finch, 2004). The theory focuses on perceptions of fairness in organisations, by categorizing employees' views and feelings about their treatment and that of others within an organisation (Saunders and Thornhill, 2003). Three types of organisation justice theory have been identified in literature. Perceptions about outcomes of decisions taken from the basis of distributive justice (Homans, 1961) cited in Campbell and Finch (2004). Perceptions about the process used to arrive at decisions to downsize form the basis of procedural justice (Cropanzano and Greenberg, 2001) while perceptions about the quality of the interpersonal treatment that an individual receives during the enactment of organisational procedures form the basis of interactional justice (Campbell and Finch, 2004).

Within the context of downsizing, distributive justice is concerned with perceptions of fairness by survivors arising from organisational allocations of resources to victims and the outcomes thereof. Perceptions of unfairness among survivors are more likely to lead to positive inequity, where survivors perceive they had a better claim to allocations leading to feelings of guilt and decreased motivation. In this way, an outcome may be favourable but may not facilitate fairness, trust or commitment owing to perceptions of the lack of integrity in the relation process (Bews and Uys, 2002).

Alternatively, perceptions of unfairness may lead to negative inequity, where survivors feel that they have a greater claim to an outcome compared with the person receiving it, leading to feelings of anger, and possibly less effort in work (Saunders and Thornhill, 2003). Procedural justice would be concerned with, for example,

survivors' feeling with regards to whether supervisors or managers conducted downsizing in a fair manner. Positive views of the procedures are linked to higher levels of trust in the organisation and the supervisors. Justification of downsizing and the use of empathetic communication (interactional justice) with both victims and survivors are likely to produce perceptions of fairness. Thus, survivors are more likely to accept decisions, even unfavourable ones, when given an adequate and genuine reason for them (Saunders and Thornhill, 2003). This assumption points to the role effective communication may play in engendering the reactions and subsequent behaviours of survivors in the new organisational setting.

Weiner's (1985, 1986) cited in Hareli and Tzafrir (2006) attribution theory provides another framework for analysing potential positive and negative emotional, and consequently, behavioural reactions of employees who survive organisational downsizing. Attribution theory focuses on causal attributions - subjective thoughts about the causes of a given outcome and their link to affective and behavioural reactions. Downsizing involves major changes for the individual and the organisation as a whole. Such a situation is likely to lead to emotional reactions on the part of the individuals at the nexus of the event (Mossholder, Setton, Armenakis, and Harris, 2000).

Emotions arise from the way a person appraises a given situation. One type of appraisal known to contribute to an emotional reaction and, which may play an important role in the context of downsizing is attribution information, that is, information concerning the reasons underlying the given outcomes.

In the context of downsizing, attribution information mainly involves the reason why an employee was retained in the organisation or was dismissed. This information is likely to be spontaneously generated by the employees because significant outcomes, such as fear, insecurity, guilt, tend to elicit causal thinking. The likelihood for causal thinking increases when the situation is unexpected, as is the case with downsizing, and the chances for attribution thoughts in the context of downsizing also increases (Brockner, DeWitt, Grover and Reed, 1990). In addition, rumors related to downsizing and the formal information provided by a manager may also include information concerning the reasons for the decision. Hareli and Weiner (2002)

argue that this attribution information is known to be an antecedent of different emotional reactions and behaviours on the part of the person who is considering the information. The specific emotion elicited by such attributions is partially a function of the nature of the causal information contained in the attribution. For example, survival attributed to mere luck is likely to elicit fear or anxiety resulting from the perceptions of the probability of being laid off in a possible future wave of downsizing. Survivors embroiled in such fear are not able to perform effectively. They are likely to stay demotivated and less committed in the postdownsizing phase.

Clarification of Concepts

The concept of downsizing

According to Noer (2001), downsizing is defined as a deliberate organisational decision to reduce the workforce in order to increase organisational performance. The decision to downsize can be triggered by economic decline (Budros, 2002), mergers and acquisitions (Appelbaum, Everard and Hung, 1999) or market regulations (Michael, 1997), among others. Other euphemisms used to refer to downsizing are retrenchment and/or layoffs. Sandringham (2000) points out that there are various strategies used in downsizing, namely workforce reduction, work redesign, and systemic strategies. Workforce reduction employs tactics such as early retirement, transfers and out-placement, buy-out packages, lay-offs and firings (Makawatsakul and Kleiner, 2003). It is mostly done through top-down directives. With it usually come other strategies such as work redesign and systematic changes. Work redesign includes eliminating functions, hierarchical levels, divisions, or products, consolidating and merging units, and reducing the working hours, while systematic changes entail changing the organisation's internal and external systems such as values, communication, production chains in terms of suppliers and customers (Bleuel, 2001).

Downsizing using the workforce reduction strategy has been regarded as the harshest way of improving efficiency, productivity and worker competencies because of its impact on both the victims and survivors. For the purpose of this study, downsizing is defined as a quick and involuntary reduction in head count.

Survivor quality

According to Armstrong-Stassen (2003), the quality of the remaining employees after downsizing will largely determine the effectiveness and quality service provided by the organisation. Within the downsizing context, survivor quality entails the psychological well-being of survivors in terms of their work-related attitudes, commitment to the organisation and motivation to exert more work effort. The quality of survivors in terms of these attributes after downsizing should be positive in order for them to champion the organisation's competitiveness and productivity objectives. The quality management literature notes the importance of having quality employees who will in turn support all the quality initiatives of the organisation (Lam and Reshef, 1999).

Indeed, the long-term performance and success of any organisation depends on the strong quality foundation of its human capital, that is, the value of its employees with job related abilities, experience, ideas, energies, creativity and dedication. Therefore, after downsizing, the creation and development of human capital (survivors) possessing the correct competencies, creativity and expertise, and commitment becomes imperative because the benefits outweigh the costs of doing so.

Influence of downsizing on survivor quality

Downsizing, in general has been shown in the literature to cause a plethora of organisational problems. One finding that researchers of the downsizing phenomenon agree upon is the cluster of reactions among surviviors in the organisation - a cluster that has become known as 'survivor sickness' (Noer, 1993) or survivor syndrome (Cascio, 1993). Other researchers (e. g., Barusch and Hind, 2000) refer to it as negative responses of employees who retain their jobs after downsizing.

Survivor syndrome is the major factor that contributes to the failure of most organisations to achieve their corporate objectives after downsizing (Appelbaum et al., Chipunza and Berry 1999). Although not as severe in corporate downsizing as in major tragic traumatic events, 'corporate survivor's syndrome has proved to be no less physically or mentally devastating (Applebaum, Schmidt, Peytchev, and Shapiro, 1999). As a result, the survivor syndrome

manifests itself in a number of ways. These include anger, depression, fear, guilt, risk aversion, distrust, vulnerability or powerlessness, loss of morale and motivation and reduced work and organizational commitment (Nixon, Hitt, Lee and Jeong, 2004).

The literature on downsizing consistently points to the potentially negative impact of downsizing on the survivor attitudes. For example, Worrall, Cooper and Campbell (2000) observed the negative impact of downsizing in the public sector as breakdown of the psychological and reduced job security among managers. Mone (1999) found out that feelings of loss of control over the situation and the uncertainty caused by the possible loss of their own jobs cause severe stress reactions in the survivors.

These are further exacerbated by the sharp increase in the work overload, longer working hours, and fewer vacation days, leading to inefficiency and burnout. The job/work transition theory states that organizational change caused by downsizing results in changes in responsibilities, reporting relationships, co-workers, policies and procedures. In tandem with this theory, Allen, Freeman, Russel, Reizenstein and Rentz (2001) found out that that job attitudes such as job satisfaction, organisational commitment, job involvement, role overload, role clarity, satisfaction with top management, and turnover intentions become less favourable after downsizing. These findings indicate that downsizing seem to have an impact on a number of work-related attitudes.

Despite these findings, Armstrong-Stassen (2006) has shown that some survivors are driven to work harder after surviving a layoff, particularly those who become worried about their own job security after watching lay-offs.

Similarly, findings by Nelson, Cooper and Jackson (1995) relating to employee attitudes after downsizing showed that after downsizing, survivors' personal control and job certainty perceptions improve over time. Others, for example, Armstrong-Stassen (2001), Parker, Chmiel and Wall (1997) have shown that uncertainty and stress are elevated during the change process, but then decrease or stabilise after the implementation of change. Allen et al. (2001) also concluded that the in impact of downsizing on attitudes varies over time and that some attitudes are related to each other after downsizing. Thus, the

influence of downsizing on survivor attitudes seems to be inconclusive and varying with author and context.

Organisational commitment is defined as the acceptance of organisational goals and values, a willingness to exert effort on behalf of the organisation, and desire to maintain membership in the organisation (Gautam, Dick and Wagner, 2004). Three kinds of commitment commonly discussed in the literature are affective,continuance and normative (Allen and Meyer, 1990). Normative commitment is the sense of responsibility an employee develops in helping to sustain the organisation and its activities (Allen and Meyer, 1990). Continuance commitment is defined as commitment to the organisation based on investments made in the organisation that make it costly for individuals to leave (Brown, 1996). Affective commitment describes how emotionally attached a person is to an object (e. g., the organisation) and is referred to as 'want to' part of commitment (Brown, 1996). Studies suggest that committed workers contribute to the organisation in a more positive way than less committed employees (Metcalfe and Dick, 2001). In addition, high commitment among employees is related to turnover intentions (Greenberg, 1996).

The way survivors perceive the reasons, process and outcomes of downsize might determine their commitment levels. Thus, relationship has been shown between continuance commitment and procedural justice (Cohen-Charash and Spector, 2001). Similar findings on affecttive commitment have been reported. For example, after some organisational change, the levels of affective commitment were related to survivors' perceptions of how they were treated by the organisation (Meyer and Allen, 1997). Employees who show high affective commitment levels are those that have an obligation to do so.

However, it has been shown that affective commitment significantly predicts intention to leave (Leung and Chang, 1999). It is therefore worth assuming that affective commitment after downsizing can be favourable for individual and organisational outcomes such as lower turnover, job satisfaction and high productivity. The sum total of skills, knowledge and general attributes (human capital) alone, among survivors, is not enough for a downsized organisation to ensure the correct attitudes, performance and productivity required.

Survivors are required to translate their human capital into some form of action that results in performance that contributes to the achievement of organisational goals (Hitt, Miller and Colella, 2006). Motivation is the process through which this translation takes place. The concept refers to forces within an individual that account for the level and persistence of effort expended at work (Schermerhorn, Hunt and Osborn, 2005). There is empirical evidence that downsizing is associated with reduced work effort and thereby job performance. For example, Armstrong-Stassen (1994) has shown that perceived job insecurity is directly related to the amount of work effort exerted and lower job performance. Similarly, Brockner, Grover, Reed, and DeWitt (1992) found that work effort was especially likely to decline in conditions of perceived high job insecurity and lack of control. Armstrong-Stassen, Wagar, and Cattaneo (2004) found significant differences in motivational levels among survivors in moderate work-groups (work group without major changes) and those in intact groups.

Similarly, Grunberg, Anderson-Connoly and Greenberg (2000) reported that layoff contact - either direct contact (at risk for being laid off) or indirect contact (close ties with the laid off; e.g., coworkers) - was associated with higher work effort by survivors in lower positions. Thus, how survivors put effort into their current work stations and whether they are motivated to do so may partly be explained by judgments of fairness of the organization when dealing with the laid off. Such judgments are based on answers to the following questions: Were the layoffs seen as truly necessary? Was the layoff consistent with the organisation's history and culture? What criteria were used to determine which employees would be laid off and those that get to remain? The conclusion from these assertions can be that after downsizing, perceptions of organisational justice have an influence on the ability of survivors to put effort in their new work roles.

Economic slowdown and downsizing

External events like economic slowdown should not be seen as an event of downsizing only. Companies (especially those in distress) are finally looking for "square peg/round hole" "career transition" talent. They realize they are in an environment that they have never faced before and those in the know may not know what's needed.

Fresh ideas become very appealing, even critical. Some companies are requesting that recruiters deliver a slate of traditional and non-traditional candidates. If one have a strong value proposition that is "portable" and can cross industries, it's possible one've never had a better time to move.

We've just experienced the worst week of market losses, ever. Those who have successfully navigated companies through multiple US and global recessions and recoveries will be valued for the knowledge that experience provides. A recent MBA, emerging professional, finance whiz kid, or mid-career executive — no matter how good — cannot offer that "street cred." A touch of silver in ones' hair is not an issue when a company is looking for salvation. The economic crisis has affected the financial sector in a big way, yet there are growing opportunities within the green, sustainable, and alternative/clean energy fields. The global climate and energy crises are not going away anytime soon, the voting public is demanding change from both parties, and growth will be strong moving forward.

When an industry contracts another industry often benefits. Here are just 2 examples. People are not buying cars, especially gas guzzlers. The auto industry is hurting. Auto mechanics, tire companies, and replacement part manufacturers will fill the void as people keep their vehicles longer and require maintenance to keep them on the road. Suppliers to the building industry are hurting, but if they have retooled their offerings to appeal to home repair and renovation, they have a growing market as people stay longer in their homes waiting for an uptick in home process, or move into newly less-expensive homes they want to update. Historically, retained recruiters sought "passive" currently-employed executives to persuade away from their positions and get on board with their client company. Companies and recruiters shied away from "active" (meaning unemployed or "looking") executives. Now with so much talent on the street they can no longer limit themselves to passive candidates. If one have a strong value proposition and clear record of ROI contribution, "active" is no longer a dirty word.

Based on the above-mentioned arguments, the following hypotheses were formulated to investigate the relationship among survivor quality dimensions after downsizing:

Ho1: The attitude, commitment and motivation levels of survivors remain unchanged after downsizing.

Ho2: There is no association/correlation between survivor attitude and commitment.

Ho3: There is no association/correlation between survivor attitude and motivation.

Ho4: There is no association/correlation between survivor motivation and commitment.

Research Methodology

To investigate the relationship among survivor qualities after downsizing, an empirical study was undertaken.

Research approach

The quantitative research method was used in this study. It is a form of conclusive research, which involves a large representative sample and structured data collection procedures are used. The quantitative research approaches used are exploratory/descriptive research and confirmatory research.

The sample

The population for the study comprised of 2667 survivors from 13 identified IT organisations in India that had downsized in the previous year or two to ensure that survivors still had the memory of the downsizing event. Only downsized IT organisations that employed 50 or more people and had clear organisational structures were selected. A probability sampling procedure was used and a random sample size of 150 survivors was drawn.

The questionnaire

A structured, five point numerically scaled Likert-type questionnaire, was constructed for the purpose of this study to meet the criteria recommended by de Vos, Strydom, Fouche and Delport (2006). The questionnaire was divided into nine sections. The verbal scale utilised in each section differed according to how the main question was worded.

Pilot study

In order to pre-test the questionnaire, it was given to a statistician

to ascertain the practicality of the instrument in terms of response categories and items for statistical analysis. 15 employees were also asked to evaluate the questionnaire in terms of, among other things, time to complete the questionnaire and clarity of items. After processing and analyzing data from the pilot study, the questionnaire was refined and some minor changes were made regarding wording, sequence and layout.

Data collection

Four months before the actual data collection, permission was sought from the 13 identified downsized organisations. Questionnaires were left with the human resources person identified from each organisation for distribution to the respondents at a time conveniently known to him or her. A total number of 500 questionnaires were distributed, 100 in each city or town. Clear instructions were given to the human resources person regarding how the respondents were to complete the questionnaire. Data was collected over a period of three months and the contact person in each organisation would make a follow up every other week.

Data processing and analysis

The returned questionnaires were inspected to determine their level of acceptability. They were edited where necessary and coded. The data were transferred to an Excel sheet. A statistical computer package, Statistical Analysis System (SAS), was used to process the results. The techniques used during data analysis included descriptive statistics (e.g. measures of central tendency) and correlation coefficients.

Results

Response rate

A follow up of the questionnaires showed a marked increase in the total response rate from all the towns and cities from the first month 42 (18.6%) to the third month 64 (28.3%). At the end of the data collection phase, the total number of the completed questionnaires was 150. Given that the sample size of the study was 226, this represented a response rate of 66.4%.

Sample description summary

This study was based on a random sample of 150 employees who survived downsizing exercises in different IT organisations in India. Close to 95% (140) of the respondents were Indian and 82.4% (122) were males. About half of the respondents were in the 31-39 years age group followed by about 35% (53) being older than that. The respondents were not equally distributed according to educational level with 133 (91.7%) who had at most diploma level education. Five respondents did not provide their educational levels. The majority 93 (62.4%) of these respondents had at least 11 years experience with the organisation while 16 (10.7%) had less than three years and the rest had between 4 and 10 years experience.

Reliability of the questionnaire

External validity refers to the generalization of research results to other population and is ensured by means of a proper and sound sampling procedure. Clear guidelines were given regarding the place, time and conditions under which the study was to be conducted. Internal validity of the instrument's scores is ensured through both face and content validity. Expert judgement and a pilot study were undertaken to assist in this regard. Cronbach's alpha coefficient was used to determine the internal consistency reliability of the questionnaire. As shown in Table 1, within section Cronbach's alpha coefficients were quite high with the lowest being 71% detected for the job involvement section. This is evidence that each section clearly dealt with a single issue/aspect.

Table 1. Within-section reliability analysis.

Section	Title	Cronbach's alpha
F	Impact	0.86
G	Security	0.85
H	Control	0.75
I	Satisfaction	0.89
J	Involvement	0.71
K	Future plans	0.89
L	Commitment	0.85
M	Motivation	0.88

A cross - section reliability analysis was also done to determine the possibility of deriving a single variable out of sections measuring survivor attitude. A Cronbach's alpha coefficient of 0.80 was found for this analysis. This provides evidence that these sections represent one construct, namely, survivor attitude. Therefore, survivor attitude, commitment and motivation were derived from the original variables generated from the questionnaire based on results of a reliability analysis of the instrument/questionnaire. These were the central variables of interest in this study.

Measures of central tendency

These derived variables of interest were measured on a continuous scale within the interval [1; 5] while all biographical variables were categorical. One way frequency distribution tables for the original variables were generated for purposes of describing the sample as well as getting the patterns of responses for the variables of interest. In order to establish determine the attitude, commitment and motivation levels of survivors after downsizing (hypothesis 1), measures of central tendency and dispersion for the responses of each variable were computed. The results of the analysis are presented in Table 2. As shown in Table 2, the mean survivor motivation score of 3.4 was the highest, while survivor commitment and motivation were found to be average to satisfactory as reflected by 95% confidence intervals of the mean scores contained within [3.1,3.5]. Survivor attitude on the other hand was average as shown by a central 95% confidence interval of the mean score of [2.8, 3.0]. Based on these results, hypothesis 1 was therefore rejected.

Correlation analysis

Using Spearman's correlation coefficient, pair wise correlations among the variables survivor attitude, commitment and motivation were computed to determine the strength, direction and statistical significance of correlations. This measure was found suitable for the data because the variables, though continuous in [1; 5], assume only a few of the values in that interval.

Table 2. Means, standard deviations and confidence intervals.

Variable	N	Mean	Std. dev.	Lower 95% CL for mean
Survivor attitude	103	2.8924	0.3935	2.8156
Survivor commitment	128	3.3201	0.7189	3.1944
Survivor motivation	139	3.4187	0.7976	3.2849

Table 3. Correlations of survivor quality components.

Variables	N	r	p-value
Attitude vs. Commitment	98	0.03	0.7438
Attitude vs. Motivation	101	0.11	0.2767
Motivation vs. Commitment	123	0.40	0.0001

The correlation results in Table 3 indicate that only the correlation between survivor motivation and commitment was statistically significant ($r = 0.40$, $p < 0.0001$). Hypothesis 3 was therefore rejected and hypotheses 2 and 3 were not rejected.

Discussion

The main purpose of this study was to investigate the relationship among attitude, commitment and motivation among survivors of a downsizing exercise among selected manufacturing organisations in a volatile economic environment. The results indicate that survivor motivation was high and, survivor attitude and commitment were average to satisfactory. The results show that the survivors were satisfied with the downsizing process in their organisations. Because survivors perceived the process of downsizing as satisfactory, this probably had an impact on their commitment and motivation levels.

This assertion is supported by previous studies which point out that there is a positive relationship between justice perceptions and continuance commitment (Cohen-Charash and Spector, 2001), affective commitment (Hendrix, Robbins, Miller and Summer, 1998) and motivation (Brockner, 1992) after downsizing. If the assertions about these relationship are true, one might argue that survivors in the present study who were strong in continuance commitment, and who might have felt that they had made investments in their organisations were less likely not to be committed since they always perceived that decisions to downsize were made by management with an attempt to be fair. Similarly, because affective commitment develops from antecedents such as an employee's experiences with the organisation (Meyer and Allen, 1997), survivors' level of commitment reflected concerns with other issues that they were not happy with in the downsizing process. With regard to the average level of motivation shown by survivors in the present study, motivational studies (e. g., Brockner, Grover, Reed and DeWitt, 1992) related to layoff survivors would explain it as having been influenced by survivors' perception of the outcome-input ratio. Thus, the moderate levels of motivation probably reflected survivors' effort to reduce the feelings of inequity they had experienced when the process of downsizing was unfolding.

Survivors showed average to satisfactory levels of attitude, meaning that after downsizing, they were moderately satisfied with

their jobs, moderately involved with their jobs, and felt moderately secure in their current positions. The literature (Kinicki, McKee-Ryan, Schriesheim, and Carson, 2002) argues that downsizing makes survivors develop affective and cognitive feelings about their organisations and jobs. The combination of a survivor's thought concerning the organisation and how the survivor feels about the organisation determines their satisfaction, job involvement and job security levels. The present findings indicate that the antecedents of such thoughts and feelings, such as ensuring that all procedures and interactions are fair during and after downsizing might have been addressed, but survivors had a lot of other reservations about the whole process.

The correlation between survivor motivation and commitment showed that highly committed survivors were also highly motivated. This finding confirms the previous results which show that survivors had moderate levels of both commitment and motivation. Indeed, the literature has shown that both commitment and motivation are affected by variables such as perceptions of justice (Campbell-Jamison, Worrall and Copper, 2000), training provided to survivors (Tella, Ayeni and Popoola 2007) and clarity and adequacy of information given throughout and after the downsizing process (Appelbaum and Donia, 2001). All these variables are concerned with support for the survivor before, during and after downsizing and they seem to have been satisfactorily provided for during the downsizing process.

Survivor attitude had no correlation with motivation and commitment of survivors. Contrary to this finding, research indicates that highly satisfied survivors have been found to be those who exert much effort in their work and achieve high performance (Greenberg, 1996). Similarly, other studies have found that job involvement after downsizing is affected by, among others, situational characteristics, and the differential treatment of men and women during and after downsizing (Aryee, 1994).

Armstrong-Stassen (2001) found that compared to management and non-management survivors after downsizing, non-management survivors reported significantly lower levels of job satisfaction, perceived threat of job loss and lower levels of morale. Despite this evidence, lack of correlation between attitude and both commitment

and motivation in the present study might therefore suggest that variables that affected survivors' attitude may not have been the same as those that affected their commitment and motivation, while those that affected commitment and motivation were likely to be the same as shown above.

Conclusion and Recommendations

There seem to be changes in survivor attitudes, commitment and motivation after downsizing in a highly volatile environment. Additionally, survivors of downsizing in context volatile economic environment experience high levels of motivation and commitment. The implication of these conclusions for human resources managers is that:

(1) They should have knowledge of the context in which downsizing is taking place. Such knowledge makes them effective in deciding the criteria, processes and procedures to be adopted when downsizing and,

(2) There should be differential of treatment of employees during and after downsizing. This might lead to the strengthening of commitment towards the new organizational order. However, it might also lead to strengthening negative perceptions of deepening discrimination among the survivors. The managerial challenge, then, is to navigate carefully through the downsizing process and maintain a balance among those who leave (victims) and those who remain (survivors). In other words, the elements of downsizing need to be managed with sensitivity to ensure positive psychological outcomes for the survivors and positive economic outcomes for the organisation.

Limitations of the Study

The uniqueness and strength of this study is that it is focused on the investigation of the constructs of survivor quality in a changing environment. However, there are limitations to and problems with the present study. These limitations include, collecting information from employees whose organisations had downsized in the previous one or two years. There was no guarantee for the researcher that some of the survivors still had the organizational memory of how the downsizing event had taken place.

Those who participated in the study were mostly males. This unequal distribution with regards to gender might be problematic since some other factors relevant to females might have been omitted. Studies have shown that women of a certain age tend to have continuous work histories and are therefore not vulnerable to lay-off (Kozlowski, Chao, Smith and Hedlund, 1993).

The study was conducted in an environment that was unstable in terms of economic growth. Though this was a unique feature of the study, the context raises questions of the generalisability of the results in contexts other than those from where the sample was drawn. In addition to this, because the variable 'volatile or unstable environment' was not measured within the study, the results might not be a true reflection of survivors' reactions as influenced by the observed factors, but some other factors.

As part of good research practice, it would have been proper, and more interesting results could have emerged, if the researcher had obtained the levels of survivors' attitude, commitment and motivation before the actual downsizing took place and then compare them with levels of these constructs after downsizing. Data were collected from manufacturing organisations involved in different business activities. Assuming that each organisation had developed its own personality and culture, the results could be a reflection of feelings and perceptions of survivors from one organisation which had more respondents than the others. This means that the results' applicability might also present some problems.

Future research might want to look at the factors that influence the levels of survivor quality dimensions after downsizing as well as the observed relationships among the dimensions within the same context. There might also be a need to, after downsizing, correlate the different aspects of survivor attitude in similar studies.

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9

Impact of Global Economic Crisis on Indian Banking Sector

Smita Meena

Abstract

The Indian economy, which is one of the fastest growing economies in the world, is poised to maintain its leading position, despite the global financial crisis and economic slowdown. India has managed to beat the global financial turmoil due to sound regulation, prudent financial supervision and proactive policies. Banks are the main mode of savings and allocators of credit in an economy. Developing economies and emerging financial markets are facing one central problem of strengthening their financial system and the whole economy. A sound financial system is an important way to achieve economic growth through the mobilization of financial savings. This paper formulates a simple model framework to analyse the implications of global crises on SBI's performance.

Introduction

The impact of the global crisis has been transmitted to the Indian economy through three channels, viz., the financial sector, exports, and exchange rates. On the financial front, the Indian banking sector was not overly exposed to the sub-prime crisis. The turmoil in the international financial markets of advanced economies that started around mid-2007 has exacerbated substantially since August

2008. The financial market crisis has led to the collapse of major financial institutions and is now beginning to impact the real economy in the advanced economies. As this crisis is unfolding, credit markets appear to be drying up in the developed world. India, like most other emerging market economies, has so far, not been seriously affected by the recent financial turmoil in developed economies. The severity and suddenness of the crisis can be judged from the IMF's forecast for the global economy. For the first time in 60 years, the IMF is now forecasting a global recession with negative growth for world GDP in 2009-10.

The Indian economy looked to be relatively insulated from the global financial crisis that started in August 2007 when the 'sub-prime mortgage' crisis first surfaced in the US. In fact the RBI was raising interest rates until July 2008 with the view to cooling the growth rate and contains inflationary pressures. The financial sector including the banking sector, equity markets, external commercial borrowings and remittances has not remained unscathed though fortunately, the Indian banking sector was not overly exposed to the sub-prime crisis. Only one of the larger banks, SBI, was partly affected but managed to thwart a crisis because of its strong balance sheet and timely action by the government, which virtually guaranteed its deposits.

The RBI has infused about USD80 billion, as additional liquidity by cutting the CRR, lowering the SLR and unwinding the MSS. The RBI has also signalled its expansionary preference by cutting its repo rate, at which it lends funds to commercial banks from nine to five percent in less than six months. The reverse-repo rate has also been brought down to 3.5 percent to discourage banks from parking overnight funds with the RBI. Three fiscal stimuli have been announced between November 2008 to February 2009. These amounts to about 1.3 percent of the GDP. The financial sector, especially banks, is subject to prudential regulations, both in regard to capital and liquidity. As the global financial crisis has shown, liquidity risks can rise manifold during a crisis and can pose serious downside risks to macroeconomic and financial stability. The Reserve Bank had already put in place steps to mitigate liquidity risks at the very short-end, risks at the systematic level and at the institution level as well. The relatively limited impact of the ongoing turmoil in financial markets of the

advanced economies in the Indian financial markets, and more generally the Indian banking sector, needs to be assessed in this context.

A detailed study undertaken by the RBI in September 2007 on the impact of the subprime episode on the Indian banks had revealed that none of the Indian banks or the foreign banks, with whom the discussions had been held, had any direct exposure to the sub-prime markets in the USA or other markets. However, a few Indian banks had invested in the collateralised debt obligations (CDOs) / bonds which had a few underlying entities with sub-prime exposures. Thus, no direct impact on account of direct exposure to the sub-prime market was in evidence. However, a few of these banks did suffer some losses on account of the mark-to-market losses caused by the widening of the credit spreads arising from the sub-prime episode on term liquidity in the market, even though the overnight markets remained stable.

Review of Financial Performance Of SBI

State Bank of India was formed in 1955 by an Act of the Parliament, i.e., The State Bank of IndiaAct, 1955 (Act) SBI is the largest bank in India.SBI accounts for almost 1/5th of nation's loans. The SBI is the largest commercial bank in India in terms of profits, assets, deposits, branches and employees .It has six banking subsidiaries.SBI has 28 associate banks and it operates more than 14000 branches within India.SBI has more than 92 offices in nearly 35 other countries including multiple locations in the US, Canada, and Nigeria. The bank has other units devoted to capital markets, funds management, factoring and commercial services and brokerage services.

Table (i): Financial Highlight

YEAR	2006-07	2007-08	2008-09
Total income	45260	57645	76479
Total expenditure	40719	44538	58564
Net profit	4541	6729	9121
Earnings per share	86.29	126.62	143.77
Return on equity	14.24	17.82	15.73

YEAR	2006-07	2007-08	2008-09
Capital adequacy ratio	12.34	13.54	14.25
Profit per employee	236.81	372.57	473.77
Net npa ratio	1.56	1.78	1.76
Advances	337336	416768	542503
Business per employee	35700	45600	55600
Return on assets	0.84	1.01	1.04
Deposits	435521	537404	742073
Domestic branches	9517	10186	11448
Foreign branches	83	84	92

Profit

The Operating Profit of the Bank for 2008-09 stood at Rs. 17,915.23 crores as compared to Rs. 13,107.55 crores in 2007-08 registering a growth of 36.68%. The Bank has posted a Net Profit of Rs. 9,121.23 crores for 2008-09 as compared to Rs. 6,729.12 crores in 2007-08 registering a growth of 35.55%. While Net Interest Income recorded a growth of 22.63% and Other Income increased by 45.96%, Operating Expenses increased by 24.11% attributable to higher staff cost and other overhead expenses.

Dividend

The Bank has increased dividend to Rs. 29.00 per share (290%) from Rs. 21.50 per share (215%) in the last year.

Net Interest Income

The Net Interest Income of the Bank registered a growth of 22.63% from Rs. 17,021.23 crores in 2007-08 to Rs.20, 873.14 crores in 2008-09. This was due to growth in interest income on advances. The gross interest income from global operations rose from Rs. 48,950.31 crores to Rs. 63,788.43 crores during the year. This was mainly due to higher interest income on advances. Interest income on advances in India registered an increase from Rs. 32,162.68 crores in 2007-08 to Rs. 42,989.36 crores in 2008-09 due to higher volumes. Also average yield on advances in India increased from

9.90% in 2007-08 to 10.15% in 2008-09. Interest income on advances at foreign offices also increased due to higher volumes.

Operating Expenses

There was an increase of 25.19% in the Staff Cost from Rs. 7,785.87 crores in 2007-08 to Rs. 9,747.31crores in 2008-09 attributable to higher pension provisioning and increased staff strength. Staff Cost included an amount of Rs.1414 crores towards wages revision provision as compared to Rs. 575crores in the previous year. Other Overhead Expenses have also registered an increase of 22.36% mainly due to increase in expenses on rent, taxes and lighting as a result of opening of new branches, advertising & publicity, printing & stationary, postage and telephones and miscellaneous expenditure. Operating Expenses, comprising both staff cost and other overhead expenses, have registered an increase of 24.11% over the previous year.

Reserves and Surplus

- An amount of Rs. 5,291.79 crores (as against Rs. 4,839.07 crores in 2007-08) was transferred to Statutory Reserves.
- An amount of Rs. 826.56 crores (as against Rs. 4.44 crores in 2007-08) was transferred to

Capital Reserve Fund.

- An amount of Rs. 306.89 crores (as against Rs. 362.09 crores in 2007-08) was transferred to other Reserve Funds.

Assets

The total assets of the Bank increased by 33.66% from Rs. 7, 21,526.31 crores at the end of March 2008 to Rs. 9, 64,432.08 crores as at end March 2009. During the period, the loan portfolio increased by 30.17% from Rs. 4, 16,768.20 crores to Rs. 5, 42,503.20 crores. Investments increased by 45.62% from Rs. 1, 89,501.27 crores to Rs. 2, 75,953.96 crores as at the end of March 2009. A major portion of the investment was in the domestic market in government and other approved securities. The Bank's market share in domestic advances was 16.03% as of March 2009.

Liabilities

The Bank's aggregate liabilities (excluding capital and reserves) rose by 34.79% from Rs. 6,72,493.65 crores on 31st March 2008 to Rs. 9,06,484.38 crores on 31st March 2009. The increase in liabilities was mainly contributed by increase in deposits and Other Liabilities & Provisions. The Global deposits stood at Rs. 7,42,073.13 crores as on 31st March 2009, representing an increase of 38.08 % over the level on 31st March 2008. The Bank's market share in domestic deposits was 17.72% as of March 2009.

Operation of Foreign Offices

The Bank at the year end had a network of 92 overseas offices spread over 32 countries covering all time zones. The 92 offices comprised 37 Branches, 5 Sub Offices, 8 Representative Offices, 35 Branches of Subsidiaries, 3 Managed Exchange Companies and 4 Joint Ventures. The asset level of Foreign offices and subsidiaries was US$ 23.73 billion registering a growth of 20% over last year. Foreign Offices earned a net profit of US $ 151 million during the year.

Overseas Expansion

Consequent upon receipt of Qualifying Full Bank licence, the Bank started retail operations in Singapore during the year. Three new Branches and seven ATMs were set up to boost retail operations. One branch and a sub office were added to the network in Male and a Representative Office in Tianjin in China was operationalised. SBI California, the Bank's wholly owned subsidiary in USA, opened its seventh Branch at Bakersfield. PT Bank Indomonex, a partly owned subsidiary in Indonesia, opened 2 branches during the year. Nepal SBI Bank Ltd.,a Joint Venture, opened 16 new branches. The Bank's two partly owned subsidiaries in Mauritius viz. Indian Ocean International Bank Ltd. and SBI International (Mauritius) Ltd. were merged during the year to create a new entity titled SBI (Mauritius) Ltd. Significant addition to the overseas network is planned for the current year

Table: 1 Key Performance Indicators

Indicators SBI SBI Group				
	2007-08	2008-09	2007-08	2008-09
Return on Average Assets (%)	1.01	1.04	0.99	0.94
Return on Equity (%)	17.82	15.73	17.93	16.30
Expenses to Income (%)(Operating Expenses to Total Net Income)	49.03	46.62	56.64	52.65
Basic Earnings Per Share (Rs.)	126.62	143.77	168.61	172.68
Diluted Earnings Per Share (Rs.)	126.50	143.77	168.45	172.68
Capital Adequacy Ratio (%) (Basel-I)	13.54	12.97	13.49	12.90
Tier I	9.14	8.53	8.95	8.21
Tier II	4.40	4.44	4.54	4.69
Capital Adequacy Ratio (%) (Basel-II)	–	14.25		14.17
Tier I	–	9.38	–	9.03
Tier II	–	4.87	–	5.14
Net NPAs to Net Advances	1.78	1.76	1.43	1.49

Conclusion

Financial stability in India has been achieved through perseverance of prudential policies which prevent institutions from excessive risk taking, and financial markets from becoming extremely volatile and turbulent. The outlook for the current financial year is encouraging. Overall, the growth momentum is expected to be sustained, with continuing credit and investment demand from industry and services as well as agriculture, infrastructure and retail sectors.

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10

Impact of Global Economic Crisis on Insurance Sector in India

Pushpender Kumar

Abstract

An important challenge for Indian insurance sector during the sub-prime crisis is protecting the interest of the policyholder. This paper investigates the effect of global economic crisis on Indian insurance sector. The research focus on the insurance penetration, new polices, market share, commission expenses, operating expenses and benefits paid, investment income and profit of life insurers, and return to shareholders during the economic crisis. This paper present the findings readings the different dimensions studied to understand the impact of global crisis on Indian life insurance sector. The study also found on the basis of available data that there is no negative impact of global economic crisis on Indian insurance sector. But the impact of the global economic crisis is indirect and exponential on insurance policyholders.

Introduction

The performance of the insurance sector in financial year 2008-09 was largely influenced by the sub-prime crisis. The sub-prime crisis started in the United States in late 2007, evolved as a financial crisis in US and later engulfed Europe and UK. By late 2008 it seeped into Asia. As a result, the financial crisis deepened among many

countries of the world, thus forcing the respective governments to take necessary steps to come out of the crisis. Besides increased unemployment in various countries, economic growth was also hampered.

Internationally, except for a few large companies, insurance companies were fairly insulated, though for the first time since 1980, insurance premiums declined in real terms with non-life premiums falling by 0.8 per cent and life premiums falling at a much higher rate of 3.5 per cent.

The governments across the world have started infusing capital into the financial system so as to bring back stability into the system. Though well insulated, India, could not totally escape the tide of the financial crisis. Due to its higher levels of income growth during the past five years as also because of prudent financial management underpinned by sound and solid banking system supporting the payment and settlement procedures, India had limited the contagion effect. The Indian economy which had grown at an average of 8.8 per cent before 2008-09 could grow only at 6.7 per cent.

Insurance in India has been viewed as a tax saving instrument and risk cover in life insurance was purely incidental. The mindset continues to be the same, although the unit-linked instruments are becoming popular. The moment of truth in an insurance contract lies at the time of claim settlement. It could be at the end of several years in the case of some contracts. Being so, it is bound to leave heartburn for the policyholder if it is repudiated. Ideally, when the two parts of the contract have been fulfilled totally, there would be no repudiation. Claim repudiations occur owing to several reasons - some deliberate and others inadvertent. In a domain where the awareness levels are low, there is a need for extending additional help in order to obviate the problem of repudiation. The role of the distributor in this regard is very crucial. The interests of the policyholders can be well protected if the premium collected from them by the insurers is properly and prudently invested.

The outlook for insurance sector in 2008-09

The outlook for insurance industry in 2009 looks uncertain due to many challenges. Reduced demand, low interest rates and the need

for additional capital by many companies are some of the major challenges facing the insurance industry in 2009.

1. Insurance penetration: Insurance penetration (insurance premium as per cent of GDP) measures the level of insurance activity relative to the size of the economy. As GDP per capita rises, it is expected that individuals will purchase more insurance. The latest Swiss Re report reveals that the insurance penetration in India was 4.6 per cent in 2008 consisting of 4.0 per cent in life business and 0.6 per cent from non-life business, unchanged from 2007. The fiscal 2008-09 witnessed global financial meltdown. Despite it, the Indian insurance industry, which has big opportunity to expand, given the large population and untapped potential, grew satisfactorily. While life insurance business registered a growth of 10.15 per cent, general insurance business recorded a growth of 9.09 per cent in 2008-09. With this, Insurance penetration (premium volume as a ratio of GDP) in rupee terms for the year 2008-09 stood at 4.74 per cent; 4.17 per cent for life insurance and 0.57 per cent for non-life insurance. The level of penetration, particularly in life insurance, tends to rise as income levels increase. India, with its huge middle class households, has exhibited growth potential for the insurance industry. Saturation of markets in many developed economies has made the Indian market even more attractive for global insurance majors. The insurance market in India has witnessed dynamic changes including entry of a number of global insurers. Most of the private insurance companies are joint ventures with recognized foreign institutions across the globe.

2. New policies: New policies underwritten by the life insurers were 509.23 lakh in 2008-09 as against 508.74 lakh during 2007-08 showing a marginal increase of 0.10 per cent. The private insurers exhibited a growth of 13.19 per cent, which is much lower than 67.40 per cent recorded in the previous year. LIC, showed a negative growth for the second consecutive year at 4.52 per cent as against its previous year negative growth of 1.61 per cent. Life insurance industry recorded a premium income of Rs.221791.26 crore during 2008-09 as against Rs.201351.41 crore in the previous financial year, recording a growth of 10.15 per cent. Out of Rs.221791.26 crore, premium from unit-linked products, stood at Rs.90645.78 crore. This resulted in a fall in the share of unit linked premium to the total premium to 40.87 per cent in 2008-09 from 46.14 per cent in 2007-

08. The decline was observed both in the case of LIC and private insurers.

3. Market share: In terms of premium underwritten, the market share of private life insurance companies continued to rise in 2008-09, which surged to 29.08 per cent from 25.61 per cent in 2007-08. The market share of private insurers in first year premium increased to 38.88 per cent in 2008-09 from 35.98 per cent in the previous year. While, there has been an increase in the market share in the regular premium, market share of private insurers in single premium has declined. In the case of regular premium, the market share of private insurers went up further to 61.23 per cent in 2008-09 from 52.23 per cent in 2007-08.

4. Commission expenses: The commission expenses in 2008-09 increased by 5.64 per cent and amounted to Rs.15532.98 crore (2007-08: Rs.14704.30). However, the increase in these expenses was lower than the increase in the gross premium collected by the insurers. As such, the commission expenses ratio (commission expenses as a percentage of premium) marginally declined to 7.00 per cent in 2008-09 from 7.30 per cent of 2007-08. While the commission expenses increased in the case of renewal premium, there has been a fall in the commission paid towards both single and regular premium. This was commensurate with premium underwritten in 2008-09.

5. Operating expenses: The operating expenses of the life insurers have increased in 2008-09 from their earlier levels. The operating expenses towards life insurance business were Rs.25723.89 crore as against Rs.20298.66 crore in 2007-08. Operating expenses, as a per cent of gross premium underwritten increased marginally in 2008-09 for both LIC and private insurers. However, the average expense ratio increased to 11.60 per cent as against of 10.08 per cent in 2007-08. For the private insurers this ratio worked out to 25.83 per cent higher than previous year's ratio of 23.25 per cent.

6. Benefits paid: The life industry paid lower net benefits of Rs.58343.10 crore in 2008-09 (Rs.61686.37 crore in 2007-08) constituting 26.32 per cent of the gross premium underwritten (30.64 per cent in 2007-08). The benefits paid by the private insurers were Rs.5864.97 crore (Rs.5136.05 crore in 2007-08), which showed an increase of 14.19 per cent constituting 9.11 per cent of the premium

underwritten (9.96 per cent in 2007-08). LIC paid benefits of Rs.52478.14 crore in 2008-09, constituting 33.36 per cent of the premium underwritten (Rs.56550.33 crore in 2007-08; 37.75 per cent of the total premium underwritten). The benefits paid by the life insurers net of re-insurance was Rs.58324.03 crore (Rs.61726.64 crore in 2007-08). There has been a significant decrease in the benefits paid on account of surrenders/withdrawals which stood at Rs.13869.56 crore as against Rs.21677.25 crore in 2007-08. It is expected that with the stipulation of minimum lock-in period of three years for ULIP products, surrenders as a per cent of premium underwritten would come down.

7. Investment income: As the operations of the life insurers stabilize, their investment base gets strengthened, resulting in investment income forming a larger proportion of their total income. In the case of LIC, the investment income including capital gains was lower at Rs.43122.17 crore in 2008-09 compared to Rs.56672.91 crore in 2007-08. As a percentage of total income, it declined by 23.91 per cent in 2008-09 from an increase of 37.78 per cent in 2007-08. As against this, the share of investment income to the total income for the private life insurers declined by 336.81 per cent in 2008-09 (as against an increase of 23.37 per cent in 2007-08).

8. Profits of life insurers: At the end of March 2009, the life insurance industry reported a total loss of Rs.4878.49 crore. It is 42.95 per cent higher than the previous year's total loss of Rs.3412.81 crore. Out of twenty-two life insures, only four have reported profits. They are, LIC, Kotak Mahindra, Met Life and Shriram. Life Insurance Corporation of India has reported an increased profit of Rs.957.35 crore as compared to the previous year profit of Rs.844.63 crore. SBI Life, which was the first private life insurer to report profit and has been making profits for the past three years, has reported a net loss of Rs.26.31 crore during 2008-09. ICICI Prudential, the largest private sector life insurer, reported losses for the eighth consecutive years. The company which reported a loss of Rs.1395.06 crore in 2007-08 has recorded a loss of Rs.779.70 crore during 2008-09. During the year under review, the net losses of 12 companies have gone up as compared to the previous year. Four new life insurance companies came into existence during 2008-09, among them, except

Aegon Religare, other companies viz., Canara HSBC, DLF Pramerica and Star Union Dai-ichi have reported losses.

9. Return to shareholders: Of the surplus generated by LIC of India, the company has paid a dividend of Rs.929.12 crore to the Government in 2008-09 as against Rs.829.59 crore paid in 2007-08. No private insurer has paid any dividend.

10. Infusion of capital: The total capital of the life insurers at end March 2009 stood at Rs.18253.04 crore, with additional infusion of capital to the extent of Rs.5956.62 crore. There had been no infusion of capital in the case of LIC, which continued to be Rs.5 crore. The infusion of additional capital of Rs. 5956.62 crore comprised of Rs. 987.05 crore from new companies and remaining Rs. 4969.57 crore from existing private insurers.

Analysis of Information

Key variables	Year 2007-08	Year 2008-09
Insurance Penetration (%)	4.6	4.74
New Policies	508.75	509.23
Market share (%) (Premium underwritten)	25.91	29.08
Markets share Pvt. Insur. (Ist. year premium)	35.98	38.88
Commission Expenses	14704.30	15532.98
Commission Expenses ratio (commission expenses as a % of premium)	7.30	7.00
Operating Expenses	20298.66	25723.89
Average expenses ratio	10.08	11.60
Benefits paid	61686.37	58343.10
Investment Income (capital gain)	56672.91	43122.17
Profits of life insurers	3412.81	4878.49
Return to shareholders (cr.) (loss)	829.59	929.12

The above given data clearly show the impact of global economic crisis on Indian insurance sector.

Conclusion

Insurance industry around the world works on regulations. Every aspect of insurance business has a relevant regulation. As the main focus of the regulator is protecting policyholders interests and helps in growth of the industry, the action point lies on spreading not only awareness about the importance of insurance to people but also their rights. The regulator should also comfort the policyholders through release of important information both technical and non-technical regarding the financial position of the companies. The information available on government report shows us rosy picture of insurance sector where penetration and market share is increasing during recession period. But indirectly, recession has created negative impact on the mind of policyholders and potential customers via giving less benefit to customer and showing having less capital gain. Mostly companies are earning loss expect few like SBI and LIC. Insurance is very complex by nature so there is need to handle it carefully through adherence to stringent laws in the interest of policyholders and society.

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11

Political Dimensions of the Global Economic Crisis

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Abstract

Generally all the discussions on the global financial and economic crisis mainly focused on the issues related with risk management, monetary policy and weak regulation. It mainly has focused on the advanced capitalist economies, although there is now increasing recognition that developing countries are severely affected by the crisis. The political dimensions of the global economic crisis received little attention. In this paper we mainly focused on the various political alignments which eventually allowed many global financial regulations. With the political ascendancy of finance capital and extensive capital market liberalization that followed, social goals were delinked from economic policy making, while macroeconomic stabilization and "fiscal prudence" replaced them as primary objectives. The period of capital market liberalization was also a period of growing inequality. Changes in power relations and political configurations were instrumental in facilitating the rise of financialization, deregulation and other aspects of global crisis.

Introduction

The international financial crisis originated in the sub-prime mortgage crisis which surfaced nearly three years ago in the U.S. With interest rates rising and home prices falling, there was a sharp jump in defaults and foreclosures. The world is passing through a difficult time since then and more so, the developed world. This will be perhaps the deepest recession in the post-second world war period. Globalisation spreads both prosperity and distress. The contagion works both ways.

In the most influential world economy and its universal contagion but also it's self-invited nature, as the lessons learnt from the 1930s crisis were deliberately discarded and an old and exploded orthodoxy of laissez faire capitalism was embraced. Also disturbingly serious is the social and grossly iniquitous character and massive number of the victims, the silent sufferers, the passive and excluded economic entities, who are made to bear the brunt of the meltdown of the major firms and dominant national economies. The magnitude of the burden entailed by the fiasco of the financial system can well be inferred from the fact that the IMF estimate of the worldwide losses for financial institutions comes to US$4.1 trillion.

Financial crisis generally occurred in several countries over the past decade and a half: in Mexico, South East Asia, Russia, Brazil, Argentina and Turkey. But most significant this time, however, is that the financial crisis hit the US itself, which is the leader of the capitalist world. With the collapse of the real estate bubble in the US in 2007, all the big banks, insurance companies and other financial companies, which had indulged in reckless speculation, started suffering huge losses and many of them like the Lehman Brothers and Bear Stearns eventually went bankrupt. Other advanced capitalist countries like Britain, Germany and France also witnessed similar bubbles and meltdowns. Once growth collapsed in the US, the entire capitalist world, which under globalisation has become increasingly dependent on the US market, has sunk into a recession.

Global Policy Response to the Crisis

The initial response of the governments of the US and other advanced capitalist countries was to provide bailouts for the private

banks and financial companies using public funds. These bailout packages, however, created a huge public outcry against the socialisation of private sector losses. Public pressure forced the governments of capitalist countries to partly nationalise the banks and financial companies, which were being bailed out using taxpayers' money. The deepening of the crisis has eventually caused a significant policy shift at the international level. Governments across the world began abandoning fiscal conservatism and expanding public expenditure on a big scale, abandoning neoliberal policies.

Changes in power relations and political configurations were instrumental in facilitating the rise of financialization, deregulation and other aspects of neoliberal orthodoxy. Many developing country governments adopted this agenda as a result of conditionality associated with the multilateral lending agencies and donor governments, as well as the buy-in from certain interest groups and technocrats committed to liberalization "from within".

Regulatory Failure

What stands out glaringly in the current episode is the regulatory failure. The regulatory failure was two-fold. First, some parts of the financial system were either loosely regulated or were not regulated at all, a factor which led to "regulatory arbitrage" with funds moving more towards the unregulated segments.

The second failure lies in the poor understanding of the implications of various speculative products. When the speculative products become too complex to discern where the risk lies, they become a major source of concern. Rating agencies in the present episode were irresponsible in creating a booming market in suspect speculative products. Quite clearly, there was a mismatch between financial innovation and the ability of the regulators of various economies to monitor them. It is ironic that such a regulatory failure should have occurred at a time when intense discussions were being held in Basle and elsewhere to put in place a sound regulatory framework. In other sense, political dimension of various economics are also responsible for such failure.

New political alignments allowed global financial regulations to be substantially changed in the early 1970s. With the political

ascendancy of finance capital and extensive capital market liberalization that followed, social goals (full employment) were delinked from economic policy making, while macroeconomic stabilization and "fiscal prudence" replaced them as primary objectives. The period of capital market liberalization was also a period of growing inequality, both between and within countries, along with labour market informalization and changes in state-market relations; changes in housing, pensions and wage policies; the rise in the structural and instrumental power of financial institutions and transnational corporations; and the general disembedding of the economy from society and from democratic politics.

Issues in Financial Regulation

Finally, the current global financial crisis has again shown that markets can fail and such market failures have huge costs. The financial system is prone to excesses, given the high leverage of banks and other financial institutions. Within the financial system, banks are 'special', whether locallyor foreign-owned, because they effectively act as trustees of public funds through their deposit taking activities and are the lynch pins of the payments systems. The speed with which a bank under a run collapses is incomparable with any other organization. A failure of one bank can have a strong contagion on the rest of the banks, even if they are healthy. In this age of globalisation, as the current crisis has revealed, the lack of confidence in banks in one country can also have a contagion on banks in the rest of the world. It is because of this that many governments in EMEs had to guarantee the deposits in their banking systems during the later part of 2008. Given the risks to financial stability, governments in advanced economies had to bail out their largest banks and financial institutions. The notion that markets will take care of weaknesses has once again been proven wrong. So far, the focus of banking regulation globally has been on capital adequacy. As this crisis has shown, liquidity issues are equally important and it is appropriate to note that, in India, we have focussed our attention on these issues as well.

International Co-ordination

The present crisis calls for co-ordinated efforts of all political leaders of various affected countries in spite of their personal differences.

First, a simultaneous effort at stimulating the economy will have a profound effect on aggregate demand.

Second, the various countries must avoid protectionist policies. This is a lesson that we have learnt from the depression of 1930s.

Third, the international financial institutions need to strengthened in order to enable them to meet the financial needs of poor developing countries badly affected by the crisis. There are of course, some fundamental issues which need to be addressed with respect to the international financial institutions, such as ownership, voting power and management control.

Conclusion

It is in this context that political heads of all economics should tightened the regulatory regime in regard to NBFCs over the next few years in a phased manner. It is, therefore, important that banks and other financial sector players are well-regulated, while permitting them the necessary flexibility to grow and expand and meet the financing needs of a growing economy. A host of other issues such as accounting, auditing and compensation have also received attention in the aftermath of the global financial crisis. All these issues are engaging the active attention of policymakers and academia alike around the world. In view of the fast pace of technological and financial innovations, regulatory authorities would have to follow an approach that would have to be dynamic and adjust in response to changing economic environment.

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12

Role of Indian Economic Policy on International Financial Capital: Its Efficacy in Dealing Global Economic Meltdowns

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Abstract

The United States of America, generally considered the final destination for international capital investment by almost all the economies of the world, suffered from major stock market crashes both in 1929 and 2007. The Inflow of foreign funds to the economy encouraged easy availability of credit thereby increasing its dependability on debt financed consumption. With abundance availability of funds at hand, the United States created a make believe situation that it is financially well-off, thereby acting as the principle creditor to other economies of the world. However, both in 1929 and 2007 the debt bubbles eventually burst and crashing along with it the stock market. To set its own house in order, America not only stopped extending financial assistance to foreign countries, but also withdrew its funds from its overseas ventures. This triggered global capital depletion thereby leading to global financial disasters. India was affected by such depletion during both the global meltdowns but the intensity of the crisis was much more during the 'Great Depression' of 1930s compared to the 'Great Recession' of 2007.

The imperialistic economic policies of the British Raj during the

Great Depression of 1930, though beneficial to the United Kingdom, caused severe damage to the Indian economy. Gold was transported to Britain from India to maintain the value of the pound sterling and thereby revitalised the British economy. The 2007 crisis which was triggered by the US housing bubble burst also affected India to an extent since in a globalised world complete decoupling is impossible. However the intensity of impact is seen to be lesser in the current period and the reasons can be credited to India's huge domestic market and diversification of trade to countries other than the US. In this paper an attempt has been made to analyse the variation of impact of the two global meltdowns on the Indian economy and the role of the Indian economic policy during such periods of economic crises.

Introduction

Developing economies like India suffer from scarcity of capital due to their low level of income and low level of capital accumulation. However, in their bid to accelerate their pace of economic development, they embark upon rapid industrialization. This calls for substantial investment which in turn requires high level of saving. Hence emerges a resource gap between savings and investment. These countries, therefore, have to depend on international capital for filling up the resource gap.

Foreign capital can enter the country in the form of foreign aid or private foreign investment, i.e. Foreign Direct Investment or Foreign Institutional investment. Foreign capital not only brings the much needed capital, but also brings technical knowhow, improves labour productivity, assists human capital formation, contributes to integration of international trade, helps to create a more competitive business environment and improves the efficient use of resources.

In its endeavour to integrate the Indian economy with the rest of the world and propel the economy to a higher growth trajectory, the Government has been continuously pursuing economic reforms since 1991. Comprehensive liberalization measures have been taken to improve the supply-side of the economy. To attract more international investment into the country Government has liberalized capital flows in the form of FDI as part of the package of external sector reforms. This has resulted in an unprecedented growth in FDI from $2,696

million in 1996-1997 to $20 billion in 2007-2008. India has now become the third most favoured destination for FDI, behind China and USA, attracting investors from across the world. Although the reforms have yielded positive results by way of increased flow of international financial capital to the country, Government has formulated policies and guidelines to regulate the inflow of international capital. This has helped to keep unscrupulous investors at bay, thereby protecting the domestic entrepreneurs from external takeovers and also insulating the economy from violent fluctuations in economic activity which may result in net buying and selling by foreign investors.

In a globalised world, however, complete decoupling is impossible. A downturn in business activity in the US, which is an important trading partner and a major source of international financial capital of India, is bound to have an impact on the economic activity in India. This scenario motivated us to study the variation of impact of the two global meltdowns that originated in the US in 1929 and 2007, on the Indian economy and the role of the Indian economic policy during such periods of economic crises. The rest of the paper is laid out in the following manner. In section 2 we discuss the Great Depression of 1930s and its impact on India. In section 3 we study the Great recession of 2007 and its impact. The efficacy of the Indian economic policy on international financial capital to deal with global meltdowns is discussed in section 4. Conclusion with suggestive policy measures is given in the last section.

The Great Depression of 1930s: Causes and its impact on India

High wartime expenditure during the First World War and protective economic policies of European countries increased their debt burden. UK borrowed from US to lend funds to war ravaged Germany to pay off its debts. This created a situation where in all European countries became dependent on the United States of America which was on the victorious side of the war, making it the principal creditor country.

The debt bubble which was initiated by margin lending of American brokerage firms burst, causing the American stock market to crash on October 24, 1929. Before the crash, huge investments on the stock market was made and such investments were financed through

margin buying. In other words, brokers required investors to put in very little of their own money and the rest was loaned by the brokerage firms. During the 1920s leverage rates of up to 90 percent debt were not uncommon. But when the market contracted and margin calls were made, many of the investors did not have the resources to cover their margin position. To recover such position shares were sold causing further market decline. As Margin calls were made, loan defaulter increased resulting in the loss of billions of dollars in banks assets. Withdrawal of deposits by depositors from the banks triggered multiple bank run. America stopped providing loans to the European countries. During the first 10 months of 1930, 744 US banks failed. This triggered the panic button worldwide resulting in global financial disaster. 9,000 banks failed during the 1930s depression period all over the world. Around $7 billion in deposits had been frozen in failed banks.

Despite a healthy market system in operation, the country was pushed into depression due to the incorrect monetary policy pursued by the Federal Reserve which is the central bank of the United States. As a result there was a sharp decline in prices, output and savings between 1929 and 1933. The policy makers felt that they needed to keep their currencies in gold. The United States Gold Reserve Act of January 30, 1934 was passed and the Federal Reserve as well as the public was forced to return the gold and gold certificates in their possession to the Treasury of the US Government.

The UK on the other hand, sold gold to other European countries to increase its financial reserves. But since the price of gold was declining rapidly, it failed to augment its reserves. On the contrary, a depleting gold reserve weakened the value of the pound sterling, inflicting a severe blow to an already deteriorating economy. It was then that UK turned to India to increase its gold reserve. Gold was transported to Britain from India to maintain the value of the pound sterling and thereby revitalised the British economy.

The imperialistic economic policies of the British raj destroyed the Indian economy to benefit Britain. The protective trade policies of the Government of British India resulted in drastic fall in exports and imports crippling seaborne international trade. The imports fell by over 47% while the exports fell by over 49% between 1929 and

1932. Between 1928-29 and 1933-34, exports due to seaborne trade decreased by 55.75 % to Rs. 1.25 billion while imports decreased by 55.51% to Rs. 2.02 billion.

Decline in international trade resulted in lesser use of the railways for transportation of goods, thereby resulting in decline in railway revenue. There was a decrease of Rs. 150 million in the railway revenues between 1930 and 1932.

The international financial crisis combined with detrimental policies adopted by the Government of British India resulted in soaring prices of commodities. Indian farmers who had switched to cash crops to meet the growing demands of the mills of Britain, especially the textile mills of Manchester and Lancashire, were neither able to sell their products in the domestic market due to the high price nor could they export it to Britain as Britain had banned imports from India. On the other hand, decline in sales of indigenously manufactured products coupled with less exports resulted in accumulation of goods thereby leading to a fall in price. The price decline from late 1929 to October 1931 was 36 percent in India compared to 27 percent in the United Kingdom and 26 percent in the United States. Falling commodity prices along with high land rent and taxes forced the Indian farmers to sell gold and silver in their possession forcing them to abject misery.

India also had to pay her 'Home Charges' in terms of gold due to the collapse of international trade. As a result, during the period 1931-32 to 1934-35, India had to export Rs. 2,330 million worth of gold to Britain. The British economy, thus, recovered with the gold and silver from India.

The Great Recession of 2007: Causes and its impact on India

The 1930 Depression was caused by a very fragile monetary policy of the US banks whose highly leveraged investors failed to meet the margin calls. The debt disaster of the 1930 crisis was not a lesson learnt. Mini-crises of similar characteristics were ignored as long as it did not have visible impact on the economic fundamentals.

The triggering cause of the 2007 crash was the collapse of the Global Debt Housing Bubble which again resulted in liquidity crisis in the US Banking System. This rapidly developed a chain reaction

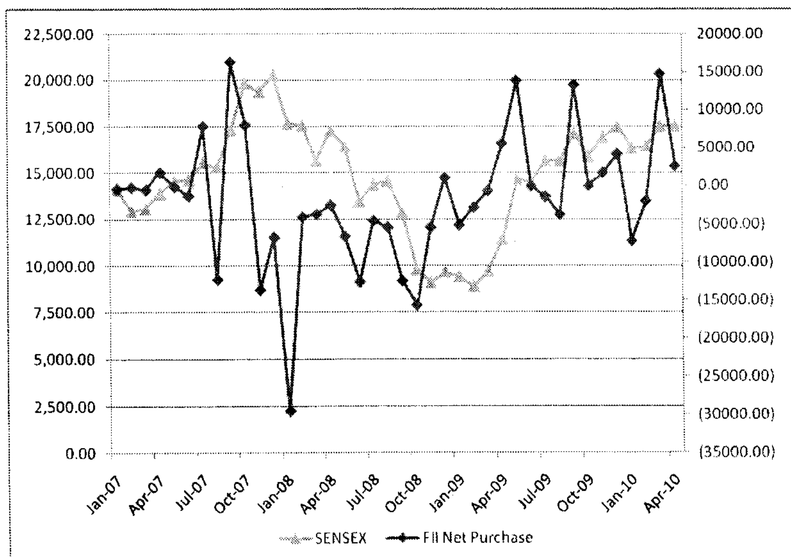
turning it into a global economic shock with failures of large financial institutions and stock market downturns around the world. Nobel laureate Joseph E Stiglitz, chairman of the UN Commission of Experts on Reforms of the International Monetary and Financial System, believes that the financial crisis that began in America's sub-prime mortgage market, later snow balled into a global recession.

Availability of funds at low interest rate encouraged debt-financed consumption. While the bubble built, a process called 'financialization' was gaining popularity. Repackaging of loan payment through mortgage-backed securities (MBS) and collateralized debt obligations (CDO), deriving their value from mortgage payments and housing prices, greatly increased. Such financial innovation enabled institutions and investors around the world to invest in the booming U.S. housing market. However, once interest rates began to rise, adjustable rate mortgages (ARM) also increased simultaneously. The initial easy term, encouraged borrowers to refinance their previous debt. But as interest rates continued its upward surge, housing prices crumpled. Refinancing became more difficult. Defaults and foreclosure activity increased dramatically as easy initial terms expired, home prices failed to go up as anticipated, and ARM interest rates reset higher. Financial Institutions which had invested generously in such sub-prime MBS faced asset value depletion. Moreover, such assets had to sold, to pay back obligations that could not be refinanced in frozen credit markets. This further accelerated the solvency crisis and caused a decrease in international trade. However one of the reason due to which this crisis only ended at recession level was the bailout of banks and financial institutions by national governments thereby preventing further collapse of international economy.

The massive drop in demand for goods and services had a tight squeeze on exporting countries like China and India therefore damaging growth and production in these countries. Although the crises gained momentum by the third quarter of 2007 it was still considered as a rich world problem up to August 2008. Though India had expected the steep correction in its Stock market in January 2008, the only main concern had been the sharp increase in inflation caused by an upward spiral in commodity price. However such acceleration was viewed more as a global phenomenon. This view, gained support from the fact that India's economic growth in the first half of FY

2008-09 was still close to 8%, a little less than the 9% growth experienced in the previous five years.

This illusion was however completely shattered in September 2008 with the collapse of huge Wall Street banks and the worldwide liquidity crunch. The liquidity shock was experienced in India when FII's withdrew their funds, credit for foreign trade vanished and loan from foreign banks dried up. Before the end of 2008 India's economic growth dwindled to a mere 5.3%. Sensex, the economic barometer of the Indian economy had plummeted from 20,286.99 pts in December 2007 to 8,467.43 by December 2008 as can be seen in the graph below.



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India was affected by the crisis due to its increased trade and financial integration with the rest of the world as is evident in the increasing ratio of external transaction (gross current account flow plus gross capital flows) to GDP from 46.8% in 1997-'98 to 117.4% in 2007-'08. The impact of the crisis was, however, less severe than that in other emerging markets. This is due to India's large domestic

demand, comfortable foreign exchange reserve to deal with adverse balance of payments situation, relatively modest merchandise exports accounting for 15% of the GDP and limited exposure of Indian banks to US mortgage markets, either directly or through derivatives, and failed financial institutions.

The downturn in the US economy did however slow down the growth rate of the Indian economy. Deceleration of growth in the manufacturing, infrastructure and services sectors especially in transport and communication, construction, trade, hotels and restaurants resulted in a decline in GDP from 9.7% in 2006-'07 to 6.7% in 2008-'09. Tables 1 and 2 reveal the decline in the annual and quarterly rate of GDP growth in various sectors of the economy.

Table 1: Rate of Growth at Factor Cost at 1999-2000 Prices (per cent)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Agriculture, forestry &Fishing	10	0	5.8	4	4.9	1.6
Mining & quarrying	3.1	8.2	4.9	8.8	3.3	3.6
Manufacturing	6.6	8.7	9.1	11.8	8.2	2.4
Electricity, gas & water supply	4.8	7.9	5.1	5.3	5.3	3.4
Construction	12	16.1	16.2	11.8	10.1	7.2
Trade, hotels & restaurants	10.1	7.7	10.3	10.4	10.1	9
Transport, storage & communication	15.3	15.6	14.9	16.3	15.5	9
Financing, insurance, real estate & business services	5.6	8.7	11.4	13.8	11.7	7.8
Community, social & personal services	5.4	6.8	7.1	5.7	6.8	13.1
Total GDP at factor cost	8.5	7.5	9.5	9.7	9	6.7

Source: Central Statistical Organisation

Table 2: Rate of Growth at Factor Cost at 1999-2000 Prices (per cent)

	2007-08				2008-09			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture, forestry and fishing	4.3	3.9	8.1	2.2	3	2.7	-0.8	2.7
Mining & quarrying	0.1	3.8	4.2	4.7	4.6	3.7	4.9	1.6
Manufacturing	10	8.2	8.6	6.3	5.5	5.1	0.9	-1.4
Electricity, gas & water supply	6.9	5.9	3.8	4.6	2.7	3.8	3.5	3.6
Construction	11	13.4	9.7	6.9	8.4	9.6	4.2	6.8
Trade, hotels, transport & communication	13.1	10.9	11.7	13.8	13	12.1	5.9	6.3
Finance, insurance, real estate & business services	12.6	12.4	11.9	10.3	6.9	6.4	8.3	9.5
Community, social & personal services	4.5	7.1	5.5	9.5	8.2	9	22.5	12.5
Total GDP	9.2	9	9.3	8.6	7.8	7.7	5.8	5.8

Source: Central Statistical Organisation

Decline in global demand led to a sharp decline in exports from 22.6% in 2006-'07 to 3.6% in 2008-'09. Imports also registered a decline during the same period. Once the bubble of the 'expanding market' burst, millions of jobs created in the export sector, all over the world, literally vanished. According to a sample survey conducted by the commerce ministry, 109,513 people engaged in export sector mainly IT, IT-enabled services, BPO, KPO, textiles, leather, engineering, gems and jewellery, handicrafts and food processing, lost their jobs in India during August-October 2008. BPO, KPO, IT and IT-enabled services industries which contributes around 52% to India's GDP suffered, because of their substantial trade links with US.

Although the crash in the US stock market resulted in sharp decline in our index and consequent fall in economic activity in certain sectors of the economy, the policy makers felt that the country is relatively unscathed by the global financial crisis as compared to other economies. On the contrary, they discounted the impact of the

U.S crises on Indian Market claiming that India is fundamentally strong.

India's Economic Policy on International Financial Capital during Global Meltdowns

The economic policy pursued by the Government of British India during the colonial rule was exploitative in nature. To deal with the depression of the thirties, most of the economies like Australia, New Zealand, Brazil and Denmark devalued their currencies and also increased government spending to increase mobility of cash. But the Government of British India did not take any such action to lift the Indian economy from the morass of depression. On the contrary, the Government adopted a protective trade policy restricting imports from India. To revive a deteriorating British economy, there was an outward flow of capital from India to Britain. The then Viceroy of British India, Lord Willingdon remarked, that, owing to the economic situation, Indians were selling gold and so they were able to send as much as 25,000,000 sterling to London within a span of two to three months in 1931. Since there was no "lender of last resort" present, banks failed all over the country. The detrimental policies followed by the government intensified the nationalist movement and forced the government to concede to some demands including the establishment of the Reserve Bank of India in 1935 with Sir Osborne Smith as its first Governor.

Though independent India's policy makers recognized the importance and need for foreign capital, in the early phase of the planning era, yet the policy towards international financial capital was selective and restrictive. Foreign capital was permitted only in priority areas where we had not developed our capabilities. However, India's foreign investment policy has undergone a sea change in the post reform period. There has been a shift from inward looking development strategy, to outward market-based approach; thereby resulting in gradual withdrawal of external capital controls and simplification of procedures of foreign investment.

In-bound International Investment Policy

The present policy allows foreign investors to invest in most sectors and activities through the automatic route, which does not

require prior permission from RBI, Government or any other regulatory agency. However, enterprises receiving foreign investment are required to inform RBI within 30 days of receipt of funds and also comply with documentation requirements of issue of shares to foreign investors within the same period. Investment in certain sectors/activities however requires prior permission and can be routed through Government-administered route. Although foreign investment is welcome in manufacturing sector, there are restrictions as far as foreign ownership is concerned in several services. While most of India's agriculture is closed to foreign investment, it is prohibited in atomic energy, lottery business, gambling and betting and retail trading (except single-brand retailing).

Foreign investors are permitted to collaborate with local partners or establish wholly owned subsidiaries (WOSs). Joint ventures and WOSs can be incorporated as resident enterprises under the Indian companies act (1956). Foreign-owned enterprises can also be unincorporated entities such as project/liaison/branch offices.

Foreign investors can repatriate investment, dividends and profits and dispose equity shares without seeking prior permission of the Government. While foreign investors are allowed to acquire immovable property as incorporated/ unincorporated entities, notifying acquisition within 90 days to the RBI, the property cannot be transferred without permission of RBI. This is according to the Foreign Exchange Management Act of 2000.

Foreign investors are allowed to acquire stakes in existing resident companies. In case of merger & acquisition, equity can be transferred from residents to non-residents through the automatic route, except in sectors/ activities which require prior permission. Expatriate Indian investors (NRIs, PIOs) can invest under the automatic route, more than the prescribed ceilings, in specific sectors. They can invest as much as 100% in domestic scheduled passenger airlines, group handling and cargo services as opposed to non-expatriate ceiling of 49%.

Foreign Institutional Investors (FIIs), after registering with SEBI, can invest in equity shares and convertible debentures of resident enterprises. FIIs can split capital portfolios in 70:30 ratios between equity and stocks. While FIIs do not require permission of RBI to

trade in notified stock exchanges, they cannot hold more than 10% equity in paid up capitals of Indian enterprises. The aggregate FII holding is capped at 24%.

Foreign investors get special tax exemptions if they invest in Special Economic Zones and infrastructure. Foreign investments in SEZs are exempted from taxes on export profit, capital gains, dividend distribution as well as custom duties on imported goods and local excise. Investments in specific areas of infrastructure like roads, airports, seaports, inland waterways, electricity generation, transmission and distribution, sanitation and sewage systems, solid waste management, housing and hospital development attract full income tax exemptions. India has double tax avoidance agreement (DTAA) with 69 countries, which enables foreign investors to choose their preferred tax turfs.

In India, capital gains from the sale of Indian securities are taxed, regardless of the seller's residence. This also acts as a deterrent to frequent withdrawals by foreign investors. The percentage of tax on capital gains is as under

	1+ years	< 1 year
Public Company / Exchange Transaction	0	10
Public Company / Non-Exchange Transaction	10	10
Private Company	20	40

Out–bound International Investment Policy

Until the year 1991, India's international trade exposure was negligible. Earlier, international exposure was predominant only to export with emphasis on export promotion strategies and restrictions on cash outflows, so as to conserve our foreign exchange reserves. With capital liberalization it became imperative for business houses to increase their share in the world market, not only by exporting goods, but also by acquiring overseas assets and gaining access to new technologies, to ensure rapid growth of their entities and the economy as a whole.

The policy on Indian investments overseas was first liberalized in 1992. Over the years, the liberalization measure for overseas

investment by Indian companies has continued. Indian companies are allowed to invest abroad in companies which are listed on a recognized stock exchange, having shareholding of at least 10% in an Indian company and listed in a recognized stock exchange in India (as on 1st January of the year of the investment). Such investments by the foreign companies however, cannot exceed 35% of the Indian company's net worth, as on the date of latest audited balance sheet.

Resident individuals are also allowed to remit up to US $ 100,000, per financial year, for any permitted current or capital account transactions or a combination of both.

The Indian Survival Story

Strong regulations and continuous monitoring by regulatory authorities on the movement of international financial capital, have helped India endure the recent Global Recession. Although the Indian economy has been opened to international trade, following liberalization, India's international exposure is still under a tight rein and watchful eyes of the concerned regulatory body. The RBI still ensures that there is transparency in any international trading, thereby controlling any deviation that may arise during the normal course of business. India's regulated liberalization policy has laid out certain basic objectives:[1]

- Recognizing the link between trade and investment flows, to provide a framework for Indian industry and business to access global networks.
- To ensure that such flows, though determined by commercial interests, are consistent with the macroeconomic and balance of payment compulsions of the country, particularly in terms of the magnitude of the capital flows; and
- To give liberal access to Indian business for technology-sourcing or resource-seeking or market-seeking as strategic responses to the emerging global opportunities for trade in goods or services.
- To give a signal that there is a qualitative change in the approach of the Government, from one of regulator or controller to one of facilitator.

- To encourage the Indian industry to adopt a spirit of self-regulation and collective effort for improving the image of Indian industry abroad.

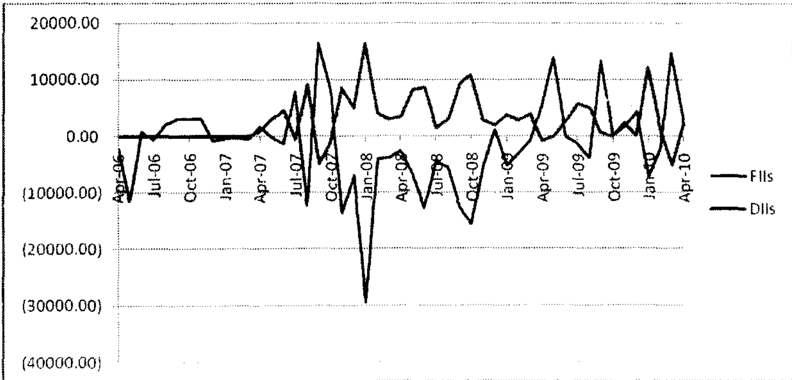
To maintain stability in the financial market the RBI monitors the ceilings on FII/NRI/PIO investments in Indian companies on a daily basis. RBI has fixed cut-off points at 2% lower than the actual ceiling limit, for effective monitoring of foreign investment. Once the aggregate net purchases of equity shares of the company by FIIs/NRIs/PIOs reach the cut-off point, RBI cautions all the designated bank branches not to purchase any more equity shares of the respective company on behalf of FIIs/NRIs/PIOs, without seeking prior permission from it. Following the directive, the banks have to send proposals to RBI, indicating the total number and value of equity shares/convertible debentures of the company they propose to buy on behalf of FIIs/ NRIs/PIOs. The RBI then gives clearance on first-cum-first served basis, till such investments in companies' reach10/24/30/40/49 percent limit, or the sectoral caps, or statutory ceilings, as applicable. The moment the aggregate ceiling is reached, the RBI advises all the designated bank branches to stop buying on behalf of their foreign clients. The Reserve Bank also issues press release, to inform the public of the 'caution' and 'stop purchase' in those companies.

Although the RBI Governor Y V Reddy while addressing the banker's conference on November 28, 2007 in Mumbai remarked, "Our banks with overseas presence have confirmed that they have insignificant exposure to the US sub-prime mortgage market," certain banks, like the State Bank of India and the ICICI Bank having overseas ventures, claimed having exposures to these US sub-prime mortgage market through Collateralised Debt Obligation (CDO). The exposure of ICICI bank to US investment Bank, Lehman Brothers Holdings Inc., dragged the bank's stock down by at least 10% on September 16, 2008 only to recover after clarification from chief financial officer Chanda Kochhar that the amount was negligible.

The liquidity crisis suffered by American International Group (AIG) following the downgrading of its credit rating activated the panic button in India as AIG has joint ventures in life and non-life insurance with the Tata Group, with 26% stake in the company. Tata

AIG reassured its investors by confirming its financial stability and it's compliance with the stringent regulatory and capital requirement. "AIG in US has a liquidity issue, but in India there is no solvency issue due to IRDA regulations. So there may not be a crisis in the Indian insurance market,: a company official of a leading insurance player said. The solvency margin of Tata AIG stood over 300% compared to the regulatory minimum of 150%, at August-end of 2008.

There is great dynamism in Indian market and its globalization strategy. Even with the financial crisis that has literally brought the world down to its feet, the Indian economy has so far balanced out all anomalies and proved itself to be a stable and efficient economy. When FIIs were making drastic withdrawals, Domestic Institutional Investors (DIIs) were encouraged to fuel the necessary funds to sustain the market. Propelled by buying interest on the part of domestic institutional investors, market began to stabilize, as people started to gain confidence on the strong fundamentals of the country. This can be seen from the graph given below. "DIIs too would fuel liquidity in the markets as they move to unwind the large stock pile of cash induced by global uncertainty. Now, with an increase in global risk appetite and stronger market sentiment, DIIs are waiting in the wings to deploy their cash in the markets," brokerage firm, Religare Hichens Harrison, said in its report.



www.moneycontrol.com *visited on 26th may 2010*

The mutual fund industry has decided to launch a major pan-India drive, to attract new investors with the Association of Mutual Funds in India (AMFI), asking fund houses to spread around the country in order to create investor's awareness. Such an initiative is expected to strengthen the DIIs in India. As a result, the country saw a growth in the corpus of Asset Under Management (AUM) 2009-10 fiscal year. The average AUM of the industry hit an all time high of Rs 8.07 lakh crores at the end of November 2009.

Retail Investors have also been encouraged to remain invested in the market, ensuring larger long term benefits that would accrue to them, considering the strong economic fundamentals of the country.

Conclusion

While the imperialistic policy of the government of British India during the Great Depression of 1930s devastated the Indian economy, the country remained relatively less affected during the recent economic crisis. Sound economic fundamentals due to: appropriate economic policy management and structural reforms, significant spending on infrastructure, efficient and productive capital management by Corporate India, vast domestic market of an increasing middle class population with substantial purchasing power, maintenance of stable interest rate through effective control of inflation rate by RBI has provided a solid foundation of sustained economic growth. Strong regulations and enhanced vigilance by RBI on the flow of international financial capital has helped to maintain stability in exchange rate to a considerable extent. Although the recent crisis resulted in job-cuts in India, it was much less in comparison with China, as India is less dependent on exports which accounted for only 13.92% of GDP in 2007-'08. Besides, India's diversification of trade links with China and European countries has protected it to an extent, from the economic slowdown, of the United States.

Although India has a liberal policy towards foreign investment and provides highest returns on FDI than any other country in the world, foreign capital still does not have equal access in all sectors of the economy. FDI inflows, in India, have been mainly in manufacturing and services. Financial and non-financial services, computer software, telecommunications, housing and construction have been the major areas attracting FDI during April 2000-March

2009.For enhancing inward FDI, there is a greater need for liberalization of foreign investment policies and providing access in agriculture and services which has so far been prohibited. Structural changes within the economy also points to a larger role of foreign investment in certain sectors like insurance, where the sectoral cap for foreign investors should be raised from the present 26% in order to attract more investment. There has been an increase in demand for equity market linked insurance products due to rising life expectancy and increased health care costs. Global insurance majors having diverse product portfolio can play an important role in this regard. Foreign capital need not only be used to provide the much needed finance, necessary to modernize agriculture and enhance productivity, but also to revive the aviation industry with funds and managerial expertise.

While the importance of foreign capital in development of the economy cannot be undermined, the unpredictable nature of investor behavior cannot be overlooked. Despite strong economic fundamentals, India can still be susceptible to liquidity crisis originating elsewhere. It is, therefore, necessary that the Reserve Bank, as the guardian of the financial market, should fully understand and analyse the actual flow of speculative money that contribute to liquidity crisis and provide the market infrastructure, regulation and monitoring systems that are resilient to such crisis.

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13

Global Economic Meltdown: Its Effect on Higher Education

B. B. Rymbai

Abstract

With the impact of the current economic melt down, the economic crisis has affected global higher-education in many ways. Many countries namely China, Australia, Japan, India feel that future of higher education is affected because of the current events. The repercussions can be called as global hard times in higher education.

With the growing force of globalization, higher education is now a necessity. It is said that good education provides a higher life time earnings and it contributes to a more holistic economic growth. It is a challenge ahead, with the global economic meltdown so as to bring equity and social justice.

Introduction

The global economic meltdown or also known as the great recession, which is an economic recession that began in the United States in December, 2007, but with a much greater intensity from September 2008 according to the National Bureau of Economic research. It spread so much that, it caused a pronounced declaration of economic activity.

The financial crisis was linked to reckless and unsustainable lending practices by government intervention and real estate mortgages

in the United States. Loan losses, rise in oil price at almost $100 a barrel in January 2008 and food prices. Banks in the US and Europe suffered heavy losses. This led to the drop in international trade which again led to rising unemployment, inflation in commodity in various sectors. Inflation had many causes eg agricultural failure, rising cost of imports from China, easy monetary policy in Asia, rising demand of food and commodities in the fast growing emerging markets.

It has also been debated that the root cause of the crisis is overproduction of goods caused by globalization. As a result GDP (Gross Domestic Product) was going down; this type of fall was not seen since the 1950's, capital investment and domestic demand was in decline.

The International Labour Organization (ILO) predicted at 20 million jobs lost by the end of 2009 mostly in construction, real estate and financial sectors - bringing world unemployment above 200 million of the first time. The countries most deeply affected, by measuring currency devaluation, equity market decline, and financial devastation emerges, are Ukraine, Argentina, Jamaica. Other severely affected countries are Ireland, Russia, Mexico, Hungary, the Baltic States, US and UK.

The least affected countries are China, Japan, India, Iran, Peru and Australia. India is now emerging as an economic giant looking at the growth rate of 2008-09.

Financial markets suffered immensely from 2007-2010 e.g., 21st January 2008 was called "black Monday" and referred to a global share crash. Its effects were largely felt in China and America. As 1% drop in US economic growth would lead to 1.3% drop in Chinas' growth rate.

The recession affected the world in every way possible. viz. Trade and industry, Pollution, Unemployment, financial markets, Travel, insurance, small - business lending, political instability, market, loans/ banks; and the education sector, especially higher education in a globalized way.

Effects of US financial crisis in Indian Economy

It is often said that when the United States sneezes the rest of

the world catches a cold. The US problem has spread globally. It clearly shows that how dependent we are on the economy of developed nations.

The global economic meltdown has had its impact on India, the demand in markets has slumped, productions have gone down, more job cuts and market has nearly gone to a stand still. India could still maintain its decorum, being an emerging economy believed in maintaining substantial foreign exchange reserves, have an updated and policy framework, healthy banking sectors and huge corporate balance sheets.

The recession has hit us, because we are a part of the global economy and the level of integration of India with the world economy determines the extent of impact of the crisis. India's financial integration into the global economy is deeper that it seems.

India's Corporate Sectors (various types – even higher education) is largely borrowed from developed economies, because they provided quality, standard and greater production, the funding was at a much lower cost than being available domestically.

The Capital inflows has been reduced, this shows the importance of external financing. Thus, it is seen that the crisis has hit India because of its integration into global economy. The Government and the Reserve Bank of India has closely worked to reduce the impact on our country, by maintaining a policy framework which sees to all the sectors, especially rupee-dollar value, foreign exchange, tightening privatized higher education sectors, reducing interest rates, etc., as this financial meltdown will indirectly affect the social meltdown for e.g. Job losses in many organizations, family break ups, depression etc.

It was reported that half a million jobs has been eliminated in recent months in the globalized sectors of the economy including higher education, textiles, jewelry, auto industries, business houses, IT sectors. India is the most important exporter of IT operations. This impact has hit the job market.

Though, India showed a growth of 9% GDP in the last 5 years, the cause of growth was definitely due to consumption in the domestic market eg – India's Corporate houses.

Impact on Higher Education

The future of any nation resides within the walls of the education system, which is nurturing an individual's intellect, character and value system which in turn mirrors the power of a great nation.

Global higher education has become indispensible, specially with the growing force of globalization. Higher education is now a necessity. It is said that better education provides a high life time earning and it contributes to a more holistic national income.

With the current economic meltdown, it is essential to look in depth on the effects it has on global higher education as a whole. It has affected higher education in many ways.

The future of global higher education has been altered according to the events of the present. We need to focus on the repercussions on global higher education, so as to prepare ourselves for the challenges ahead.

As Czinkota (2008) states that higher education "it is not immune to rules of economics, particularly when it comes to issues of supply, demand and money......and money is a key to resources."

Now, higher education is gaining momentum because of globalization. Globalization is a common phenomenon in the day to day life of any country. Globalization has distinctive features eg, the United Nations Development Programme (UNDP), Human Development Report (HDR) which has prescribed globalization as shrinking space, shrinking time and disappearing borders –

Globalization is the growing interdependence of people across the globe; it not only affects the economy but also culture, technology, higher education and governance. It has opened new and diverse opportunities for millions of people around the world, even India, including (1) Growing importance to knowledge society; (2) Development of new trade agreement that cover trade in education services; (3) Innovations related to information and communication technology (ICT); (4) Emphasis on the role of the market and economy.

Encyclopedia Britannica says that "globalization is the process by which the experience of everyday life.....is becoming standardized around the world". Contemporary globalization is also marked by

accelerated and intensified cross border mobility of people, commodity, trade and norms of policy and practice.

Higher Education has Two Distinct Meanings

It is a stage of education that succeeds secondary education. It denotes a system of education that provides professional course and also engages in research activities. In India, Britain and most other common wealth countries and European countries, universities are leading research institutes. Higher Education now is the most globalized of all sectors. It has a central function in the global knowledge system and Is important in communication, cultural exchange and extension.

Extension at present has a wider view; it is based on the expertise of the institution, utilization of local infrastructure facilities and exploitation of manpower resources to meet the demands. It is to concentrate on the disadvantaged population e.g. women, unemployed youth, semi skilled and skilled to upgrade their knowledge, information and skills which result in better production of goods and services; so that people can participate in the developmental processes including (i) Standing status competition especially in professional education - IT sectors/ engineering etc. and (2) Communication, which is of different modes and is sweeping the world with the latest gadgets.

Some Impact of Economic Crisis

Cuts in Expenditure:

The impact of economic crisis in higher education was reported mainly from countries in Asia, Mongolia, Japan, Taiwan and some other developing countries.

The countries who suffered the most are those who experienced rapid economic development in the last decade and as a result were more vulnerable due to the collapse of the international financial system. The developed countries tend to recover faster as they benefit from large scale stimulus packaged which also targets higher education.

The weaker and vulnerable countries depend increasingly on loans from international organizations (such as international monetary fund (IMF). Of late, due to conditionality tied to IMF loans, it has resulted in reduced government expenditure on Higher Education.

This has affected the teacher's salary, Research and development extension services between 2008-2009.

India approaches IMF for fresh loans, lifting up restriction on foreign investment market exchange rates, beginning the privatization process, which was a big economic boom for India.

In today's world, international education has become a big business. The GATT (General Agreement on Trade and Tariff) under the WTO (World Trade Organization) has accepted higher education in its multinational frame work.

Twenty seven countries have given their commitment of this. About 3 million students are studying their own countries involving a business of billions of pounds, Euros and dollars.

The WTO facilitates the implementation and operation of all the agreements and legal instruments negotiated in connection to various trades. It ushers a new era of global economic co-operation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system for the benefit and welfare of the people. India became a member of GATT in 1991. Since then higher education became broader, flexible and R&D sector was more established.

But the economic crisis has resulted in major cuts in higher education budget all over which has slowed down the inflow and outflow of students. A large number i.e. a lakh of India students are still seeking education in the US, UK, Australia and New Zealand. But, due to the economic crisis, job prospects are becoming fewer; this has in one way stopped students to move out to these countries.

In China, it is already predicted that fewer students would go out for further studies as a direct result of economic crisis. It is providing to be a decelerating effect on the Chinese economy. It is said that these Chinese students that study abroad out number those from all other countries. These students have been contributing to a 6 billion US $ a year in fees to higher education institutions.

Universities in Australia started cutting down on expenditures and staff members. Job employment is affected; foreign students are being turned down so that their own students get employment. Cutting down on skill based, crash courses, subsides etc. Even Japan is facing a similar breakdown, one of Tokyo's most successful and

private institution Komazana University is facing losses of 15.5billion yen(170million US dollars). In Britain, the encounter with crisis came in 2008, where several universities including Cambridge were affected. Even the wealthiest of universities in the U.S like Yale and Harvard has been hit hard in possible ways.

India too felt the crisis, when the student's inflow and outflow from abroad and India became lighter, quality and standard was affected, infrastructure, human resource, research and development, franchises, globalization and privatization were all affected. Smaller were received from the financial sectors. Therefore the Indian government came up with new policies and programmes and increased the budget of higher education in the 11th plan by 10 folds.

Three major reasons for unemployment were-

1. GDP began contracting from 2008-2009; also in higher education.
2. Capital investment was in a decline in higher education.
3. Domestic demand was in a decline.

They were also responsible for accumulation of products with no buyers – this was also in the case of higher education. In the US, in the year 2008 (September 2008 - December 2009), 2.6 million jobs were lost and in 2009 (January 2009 - December 2009), 4.2 billon jobs were lost. This also affected the Asians, in the higher education sector. Many Asian teachers, from Corporate to public sectors returned home jobless, and got absorbed in jobs which paid 10 times lower than what they received. This was a major draw back.

Infrastructure and Human Resources

The economic crisis also affected the infrastructure and human resources, in the higher education sector. Infrastructure like buildings, modern laboratory equipments and facilities, libraries, sports, music facilities, ICT, classrooms were all affected by the crisis. Especially at the professional streams research and development has indirectly been affected which is the pivot of higher education system.

Two main bases i.e. information and innovation, which is highly knowledge intensive has been affected, e.g., information and communication technology (ICT), economic units and institutions.

Where the focus is on adequate internal and external communication followed by emphasis on science and technology, skilled human resource with managerial capability, research and development system that adapts new technology to local needs, integrated structure of research and training and all kinds of new skill based programmes like exploratory skills, exploitation skills-to produce the resources efficiently, negotiating skills-to establish fair terms with trade with dominant partners, managerial skills-to manage products and services efficiently, conservation skills-to conserve resources and finally moral and ethical skills-to achieve just equitable and fair society.

All the above programmes cannot be installed if there is no financial stability. Regarding human resources teacher shortages in subjects like mathematics and science were felt in many countries like Germany, Ireland, Norway, and Russian Federation.

The teachers working conditions, salary, qualifications needed to be improved, to make teaching professions more attractive and to retain in service teachers. This was felt more so in India, Malta, Moldova, Netherlands, U.K, and Latin America.

Stimulus packages and education

Enhancing opportunities for professional development was also felt to be a necessity. Capacity building for higher education was felt in many developing countries.

India proposed an outlay for higher education in the 11th five year plan for Rs.84,743 crores. The 11th Five year plan document proposes an almost 10 fold increase in outlay for higher and technical education. The target is to attract 15% students passing out of Class XII into higher education by 2012 and 22% by 2017. It also talks about the need to reform higher education.

Public private partnership, autonomy to universities, expansion and quality improvement are some other aspects to be covered in the plan. The idea is to put up 30 new central universities, 7 IIT's and IIM's, 10 National Institutes of technology, 5 research institutes to be called Indian Institute of Science, Education and research. 20 IIT's, 2 schools of architecture and 330 colleges in educationally backward districts.

All these were felt to bring in quality and to attract both students

and teachers to theses institutes. The governments are trying their best to invest in higher education, more so with public calling and spending. Some developing countries like Mongolia, the government is negotiating loans from IMF.

Proposals and expectations

In many countries of Europe, North America, Africa, Asia pacific considers it essential that the government should protect jobs and secure investment, provide subsidies, scholarships, temporary layoff for teachers, increase in funding of education, update skills and competencies of teachers, come up with new policies.

Conclusion

Therefore, the above picture on global economic crisis in higher education shows that the down turn in the economy has affected universities everywhere indefinitely. Financially it has lessened activity in the market which in turn has lessened the income for government all around. As a consequence, this has forced governments to restrict their spending, particularly in higher education creating a significant impact on the future growth of global higher education. It is also important to understand the current state of economy for the obvious reason that it will affect he future state. It may create a path for the university. Higher education plays an important role for the future progress. In the current economic crisis we need to focus on a hopeful future, to face the current problem-universities, governments, ministries, academics, interested stake holders must take initiative not only to understand the current situation that is causing universities and institutions to shut down but also find ways to curtail this problem.

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Shaping an Emerging Paradigm: Role of BRICs hereafter

Lupamudra Gogoi
Surajit Sen

Introduction

Global Recession – A Change of Guard:

"Old order changeth yielding place to new" – the American age of ascendancy is fading and soon come to an end and a new constellation of Powers will take its place.

We are all aware of a well known saying that whenever the United States of America sneezes, the world catches cold. Though the efficacy of the saying could or may be debatable, yet in the context of the recent Global Recession, one would seldom have any grudges not to agree with it.

Medical researchers have often termed the source of some communicable diseases to "patient zero". The same term may be used in case of the recent economic crisis. The so called "patient zero" bought a house in Stockton, California, the USA, in 2003 after getting a subprime mortgage. He defaulted on that mortgage 39 months later. Economists blame the fall of the credit markets which ushered the recession on a drop in the USA housing prices and devaluing subprime mortgage-backed securities. The Wall Street gurus who masterminded these financial instruments failed to predict how swiftly

low-quality mortgages would default to some extent because the national value of housing had gone up for decades. But as the defaults rose, the value of these derivatives cascaded and the banks and other institutions which held them were required to take massive loses.

In 2007, mortgage default rates, especially among the subprime mortgage holders, began to climb at an unprecedented rate. Many home loans were given without credit check or income verification. The mortgages carried lone interest rates in the first few years, which rose with time. Home owners suddenly found their monthly mortgage payments spiking up and many found themselves unable to make these payments as employment fell across the US economy.

At that juncture, the original mathematical projection for the performance of mortgage-backed paper began to sharply diverge from the reality. With cash flow from many mortgage pools dropping quickly, the derivatives based on them began to lose a tremendous part of their value. Thus, with the defaulting of the "patient zero" in 2006, the flow of his payments into the mortgage pool lost the financial yield characteristics that it was supposed to have. Tranches began to change in value, one by one. Soon, a small snow ball turned into an avalanche. With each default that occurred, this drop accelerated.

By 2008, the US plunged into an economic recession caused by a massive slump in its subprime housing rent market. While the mortgage rates were rising, home loan defaults and repossessions hit an all time high. Much of the subprime debt were already repackaged and sold to other banks and investors around the world, being branded as low 'AAA' investments. However, when these collapsed, the banking industry was stunned and the world credit markets seized up overnight. As the credit crunch put pressure on the banks to run their day-to-day business, unemployment rates rose. The global stock markets reacted by plummeting around 40% during 2008.

Thus, the epicenter of the Global recession was the US, but the aftershocks were felt badly by Europe where the banking sector was the hardest hit. The genesis of this recession was the bursting of the housing bubble and economists opine that the current crisis is of over leverage and over spending and to counter it, effective steps were taken by Governments around the world, like regressive monetary and fiscal measures. The global economy met their respective bottoms

in all equity markets during the end of 2008 to early 2009. However, as for the recession, it will lose steam only after the housing market recovers.

It was during this period that the emerging market economies of the world, basically the countries comprising of Brazil, Russia, India and China came together to help each other overcome this global financial crunch. Over this period, the Finance Ministers of these countries have met on several occasions to discuss about this matter. It is here that we see the realization of BRIC from a mere concept or hypothetical theory. This can be marked as a change of guard from the so called market economies to the emerging market economies, whose creditability in the present global scenario stands unquestioned.

Rise of BRICs – A New Paradigm:

According to Jim O'Neill, Head of Economic Research at Goldman Sachs, who coined the term BRIC, the idea of clubbing these four nations was a direct aftermath of the 9/11 crisis in the US.

"Globalization is no longer synonymous with Americanization" as the emerging economies of the world are slowly transforming themselves as growth drivers of the global economy.

The BRIC research findings have argued that these economies could be larger than G-6 in less than 40 years. The consumer demand in the developed world is expected to slow down, but BRIC will provide marketers of consumer products and services with a growing market. This will enhance BRICs importance in the global economy, which is expected to return to an average annual growth of 4.2% in 2010 from 3.9% in 2008 and 3% in 2009.

So, we can envision that despite the global meltdown, the BRIC economies will stand together, fuelled by a strong domestic consumerism and a substantial foreign exchange reserve, which is on the agenda of the economies, will allow them to boost employment opportunities in those economies and, thus, combat global recession.

Role of BRICs hereafter

BRICs – Its Genesis:

The acronym, BRIC, was prominently used by Jim O' Neill in 2001 considering the economic potential of Brazil, Russia, India and

China (the first letter in the name of each country is taken to form the acronym BRIC) to form a commanding economic bloc.

According to Jim O' Neil, these developing countries have common characteristics and projections reveal these countries will present the highest rates of growth over the next 40 years. Among these characteristics are a stable political situation, manpower in the qualification process, recently stabilized economy and good reserves of mineral resources. Production levels and export growth, increase of GDP and the reduction of social inequalities are also part of the characteristics.

In its original report, "Dreaming with BRICs: The Path to 2050" published in 2003, Goldman Sachs says:

- China's economy will surpass Germany in the next few years, Japan by 2015, and the United States by 2041.
- India's growth rate will be the highest - not China's - and it will overtake Japan (today the world's second-largest economy) by 2032.
- BRICs' currencies could appreciate by 300% over the next 50 years, providing a big tailwind for investors in BRIC assets.
- Taken together, the BRICs could be larger than the United States and the developed economies of Europe within 40 years.
- By 2025, BRICs will bring another 200 million people with incomes above $15,000 into the world's economy. That's equal to the combined populations of Germany, France and the United Kingdom.

According to the paper published in 2005 , Mexico and South Korea are the only countries comparable to the BRICs but their economies were excluded initially as they were considered already developed. Goldman Sachs did not argue that the BRICs would organize themselves into an economic bloc or a formal trading association as the EU had done. Nevertheless, as of now BRICs has taken steps to increase their potential cooperation to influence the US and EU on major trade accords as a way of extracting political mileage and

concessions from the US such as the proposed nuclear cooperation with India.

"Looking to the future without the west" – the BRIC countries are of the opinion that there should be a new world order less dependent on the US Dollar - the existing reserve currencies had not performed their function ($, Euro, Yen, Sterling) and feel that it is time for change and countries should use their national currencies more for trade, since the four BRIC nations represent around 40% of the world's population, 15% of its GDP and 42% share of global currency reserves. BRIC is using its new influence to put pressure on the IMF to reshape its voting structure to better reflect the shift in economic power.

BRICs – Thesis and Vision 2050:

Goldman Sachs argues that the economic potential of Brazil, Russia, India, and China is such that they could become among the four most dominant economies by the year 2050. The thesis was proposed by Jim O'Neill, global economist at Goldman Sachs. These countries encompass over 25% of the world's land coverage and 40% of the world's population and hold a combined GDP (PPP) of 15.435 trillion dollars. On almost every scale, they would be the largest entity on the global stage. These four countries are among the biggest and fastest growing emerging markets.

The BRIC dissertation, as propounded by Jim O'Neill, recognizes that Brazil, Russia, India and China have changed their political systems to embrace global capitalism. Goldman Sachs predicts China and India, respectively, to be the dominant global suppliers of manufactured goods and services while Brazil and Russia would become similarly dominant as suppliers of raw materials.

The vision propounds that by 2025, the BRICs economies could account for over half size of the current G6 and in 2040 they could be larger. By 2050, the three largest economies are projected to be China, the US and India, ranked in that order. Of the other G6 countries, only Japan may still be among the six largest economies. Crucially, the shift in GDP that would result in this outcome would be most dramatic over the next 30 years, with an annual increase in dollar expenditure by BRICs overtaking that of the G6 countries by 2009. In consequence, the relative importance of the BRICs as an

engine of new demand and growth and spending power may shift more dramatically than expected.

BRICs – Its Strengths:

- The BRIC economies have built up a strong consumer demand. The consumer expenditure as a share of GDP in 2007 stood at 35% of GDP in China, 48% in Russia, 54% in India and 61% in Brazil.
- All BRIC countries have accumulated high levels of foreign exchange reserves, measuring in 2007 US $ 1,528 billion in China, US $ 464 billion in Russia, US $ 266 billion in India and US $ 179 billion in Brazil. This allows the respective governments to boost public spending in order to support the economy.
- The upgrades could improve the business environment and create jobs that could offset job losses from weaker exports.
- The BRIC nations are in the top half of the rankings for developing countries. Between 200 and 2005, the BRICs contributed roughly 28% of the global growth in US dollar terms, and 55% in Purchasing Power Parity (PP) terms. Their share of global trade continues to climb at a rapid rate. By 2005 it was close to 15 %.

BRICs – Meetings and Summits:

Political dialogue within BRIC format began in New York in September 2006, when the Foreign Ministers of the four countries met during the 61st UN General Assembly Meeting. Since then, the BRIC Foreign Ministers have met four times, including at a full-scale meeting in Yekaterinburg, Russia, on May 16, 2008.

Ties between the BRIC Foreign Ministers were completed by the meetings between their Finance Ministers in Sao Paulo, Brazil, on November 7, 2008 and then in London on March 13, 2009. The Finance Ministers adopted joint statements on their meetings, which reflected common views of global economic problems, including the reasons for and ways to weather the global financial crisis.

At the initiative of Russia, the four leaders had a short meeting on July 9, 2008, during the G8 Summit in Japan, to agree on drafting a full-scale BRIC Summit.

The inaugural summit of the BRIC Heads of State and Government took place in Yekaterinburg, Russia on July 16, 2009. A 16-point statement was announced which stated that the BRIC countries were committed to advance the reform of international financial institutions so as to reflect changes in the world economy. The statement attacked the role of the dollar as the primary international currency. The statement announced that the BRIC countries could play a vital role in the Copenhagen Climate Change Conference in December 2009 in influencing the conference in deciding the future course of the Kyoto Protocol which is scheduled to expire in 2012.

The second summit of the BRIC Heads of State and Government took place in Brasilia, Brazil on April 15, 2010. The meeting showed a collective assertiveness in global economic matters that is bound to make the West sit up and take notice. The BRIC countries demanded commitment from the West to reform the World Bank and International Monetary Fund (IMF). The leaders of these nations jointly opined that the IMF and the World Bank urgently needed to address their legitimacy deficits. They decided that they would study the feasibility of monetary cooperation, including local currency trade settlement arrangement between the four countries. The leaders expressed satisfaction at the emergence of the G20 as the premier forum for international economic coordination and their own contribution to the group.

The third summit of the BRIC Heads of State or Government will take place in Beijing, China in 2011.

BRICs – Edifying Improved Global Economics:

The year 2008-2009 has been a testing time for the global financial markets against the backdrop of one of the worst global financial crises witnessed so far. The collapse of the Lehman Brothers triggered a chain reaction of financial and economic distress. Corrective fiscal policies became crucial to initiate economic resurgence across the globe.

However, despite the global meltdown, the BRIC economies have stood together. All the four economies have shown a higher growth rate than what was originally assumed.

The world economy contracted by 1.1% in 2009, as per Goldman

Sachs, while the BRIC economies expanded at 4.8%. According to Goldman Sachs, India is expected to grow by 6.3% from 2011 to 2050, while China at 5.2%, Brazil at 4.2% and Russia at 2.8%, while the global economy is expected to grow at 3.3%.

IMF data shows that BIRC economies have grown 10.7% between 2006 and 2008.

According to Jim O'Neill, the fastest growing economies of BRIC with a population of 2.8 billion have become associated with growth, opportunities and change. The BRIC economies jointly hold 26% of the world's land mass and 42% of the world population. While Brazil and Russia are rich in natural resources, India and China have a large consumer base, i.e., a huge population. They can, therefore, mutually support each other. According to many, estimated emerging economies will be the driving force of the expected global economic recovery. Emerging economies are linked to the developed ones by currency and trade. International trade and global currency system are reportedly the two key reasons behind this unbreakable bond.

The need to reform the existing system of monetary management was a prime issue in the Yekaterinburg Summit. All BRIC nations put forth their own proposal about how to decrease the role of the weakened US dollar in trade and finance. One proposal was to boost the Special Drawing Rights (SDRs), an international reserve asset issued by the IMF. Another one was a broader use of regional reserve currencies and their combination or use of their own currencies for bilateral settlements. But all those participants were to tread very carefully where the dollar was concerned because they kept a large portion of their currency reserves in dollar denominated assets and no one wanted to depreciate their assets.

The following points ratify why BRICs is a strong and tangible economic bloc of the near future:

- Fast growing economies with the biggest source of labor. These 4 large countries account for more than 40% of the world's population and almost a third of the world's land mass. Long-term GDP forecasts for BRIC countries show that tomorrow's giants, China and India, seem set to take first and third place on a GDP basis by 2050 (with the US

in second place), shifting the centre of gravity of the global economy.

- They will soon change the consumption and production pattern in the world economy. The BRIC countries also have large, young populations to drive this growth, with many concentrated in major cities, wealth generators that this are. The growing prosperity of the BRIC economies will be largely down to a rapidly emergent and expanding middle class. Improving domestic consumption should complement export and investment strengths, and provide more long-term growth.
- As their influence on the global economy grows so do the risks for the sustainable world development. The numbers of BRIC residents whose incomes exceed $3,000 (consistent with entry into the middle class in the emerging markets region) should almost double between 2006 and 2009.
- By 2015, more than 800 million people across the four economies should have crossed this threshold - exceeding the current total population of the US, Western Europe and Japan combined. This should affect many industry sectors, including mobile-phone operators, computers, automobiles, etc. Rising incomes will also lead to increased numbers of high-net-worth individuals.
- Their role in the global policy is increasing as well the geopolitical importance for their regions and the world. In 2005 the emerging economies overcome developed economies by their share in the World GDP calculated at purchasing power parity. The BRIC countries were the main driving force for GDP growth of the emerging economies. Another factor supporting these markets is corporate profitability. Corporate profits in BRIC companies has been consistently positive over the past decade, driven largely by corporate restructuring, reduced levels of borrowing and improvements in the quality of corporate governance.

If anything, Goldman Sachs has become more bullish on the BRICs since it published its original report. The size of China's

economy overtook Germany's economy in 2008, a year earlier than expected, and will overtake Japan in 2010. Goldman Sachs now believes that the Chinese economy will overtake the United States by 2027. And with India accounting for 10 of the 30 fastest-growing urban areas in the world and 700 million people moving to cities by 2050, its influence on the world economy will be bigger and quicker than implied in 2003.

The BRIC countries have stepped onto the world economic stage with a newfound confidence. Shanghai hosting the World's Expo in 2010 highlights its aspiration to become a global financial center by 2020 -- investing twice what rival Beijing did when hosting the 2008 Olympics. Brazil is about to embark on its own infrastructure boom as it is hosting both the World Cup in 2014 and the Olympics in 2016. Two of the world's top five on the Forbes Rich list are from India. (Number one is from Mexico.) In 2010, Moscow has the second-highest number of billionaires in the world after New York City.

One reason why BRICs matters is that the world's most important country thinks they do, and is willing to rope them into decision-making. America's means of doing this is the G20. It pushed for the group's expansion to include the BRICs and declared the club the chief forum for dealing with international economic issues. The BRICs and the original group of seven rich countries (G7) form natural blocks within the G20. So far, the clearest expression of a coherent BRIC agenda—for reform of the international financial system and more domestic stimulus programmes—came on the eve of a G20 meeting in 2008.

A second reason why the BRICs matter is that all four giants have reasons for creating a new club of their own.

BRICs – Threats due to Global Recession:

It is clear that the financial crises are nothing new. As the mutual dependence of the various markets increases, crisis can more forcefully and quickly hit a growing number of economies at the same time. The crisis has probably passed its peak. Extensive efforts are underway around the world to design a regulatory and supervisory system that will reduce the risks of a new major financial setback.

In the world economy, the new reality is that the US is no longer the strong singular driving force in the global economy. Yet even with recent US recession and slow economic recovery, the US still remains the world's most important economy with a GDP of about 14 trillion dollars which is more than one quarter of the global GDP. The shift in the forces was that the US lost the title to the EU in March 2008.

Comparing the individual national economies, China is in the 2nd place and gaining ground on the US as the world's fastest growing economy but in terms of PPP the Chinese economy is just about one half (51%) of the US economy.

China's economic rise and EU's collective economic efforts along with 2008-2009 recession places the US economy at a very different point at the start of the 2nd decade of the 21st century than during most of the last century. The US economy experienced 20 months of recession from December 2007 to August 2009. The recession included nearly 4% decline in GDP, over 6% decline in employment and nearly 20% decline in industrial production and unemployment rate rose to over 10%. In contrast, China, India and Brazil are expected to experience double digit growth in 2010. The US's GDP share of the world's economy has declined about 5% since 2001 while the share of the BRIC countries are increasing at an accelerated pace.

The US's share of the world wide GDP has come down from 32% in 2001 to below 27%, while the BRIC nations combine GDP has increased by nearly 50% to about 12%, with China having the biggest increase of any nation. In terms of growth in real GDP from 2001 to 2008, the US economy's 18% growth was below the leading performers – China at 100% and India at 71%.

A key reason for the US economy alongside is its connections to world economy, which has been lower as a proportion of the overall economy and growing slowly than the BRIC economies and of the leading EU economies. In the year 2008, the exports of the US was 13% of the GDP, Germany and China together was over 60%, the UK was 30%, Brazil was 24% and India was 20% approximately.

The US economy has and is continuing to be the leader in the world economy along with China and other EU nations. After the

current recession woes, the US will enter a period of economic growth but the growth rates will be lower than the strongest performing economies such as China, India, Brazil and Russia.

The recession could have brought the following bad news for BRIC countries :

- Foreign investments from developed economies could slow. The exodus of foreign funds from BRIC stock markets in 2008 led to their sudden collapse. It is unclear how this will affect foreign direct investment (FDI) inflows, which have played an important role in fuelling BRIC growth. In Russia, for example, FDI inflows equalled 4.1% of GDP in 2007.
- Consumer demand in the developed world will be hurt by the recession. This is especially worrying for China, whose exports accounted for 35.8% of GDP in 2007. Exports to the developed world made up two thirds of China's exports in the same year.
- Brazil, whose main exports are iron ore and agricultural products such as coffee and soy, will suffer from the collapse of commodity prices due to the anticipated recession. Coffee prices fell by 36% between February and October 2008. Of Brazil's exports in 2007, 56.3% were destined to developed countries. The USA was Brazil's top export destination with 14.1% of exports.
- Russia is probably the most vulnerable of the BRIC countries, as its economy is the least diversified. Russia is heavily reliant on hydrocarbon exports, accounting for half of export revenues in 2007. Oil prices fell from US$147 per barrel in July 2008 to below US$70 in October 2008 amid the global economic slowdown. Additionally, Russia is considered more risky by foreign investors because of its summer 2008 war with Georgia and escalating tensions with the West.
- The combined effects could lead to job losses and slower growth for BRIC. This will affect domestic consumer spending, which is supposed to fuel BRIC economies during the global slowdown.

However, there are some key points to remember about the global financial crisis in the context of BRIC nations –

- The financial meltdown of October 2008 sent stock markets in BRIC economies tumbling as foreign investors fled. The notion that emerging economies were decoupled from the crisis in the developed world has proved wrong.
- As the global economy was set to slow in 2009, BRIC economies felt the consequences. China and Brazil saw weaker demand from the USA and Europe for their exports, while India's services sector, oriented towards developed economies, suffered. Russia was the most vulnerable of the BRIC countries as it was heavily reliant on the hydrocarbon sector, which was hit by falling energy prices.
- However, unlike other emerging economies, BRIC have large trade surpluses and foreign exchange reserves that made them more resilient to the crisis. Governments are set to use the reserves to increase spending and boost consumer demand.
- Growing consumer spending in BRIC countries helped them to withstand the crisis. While the pace of growth was excepted be to slow, BRIC would remain a huge and growing consumer market.
- The crisis is expected to remove the danger of inflation making life easier for BRIC consumers and allowing governments to ease interest rates, fuelling further growth.

For this, a background analysis is necessary. Upto September 2008, many believed that BRIC economies were isolated from the global financial turmoil.

- Brazil, Russia, India and China are the world's largest emerging economies. Between 2002 and 2007, annual real GDP growth averaged 10.4% in China, 7.9% in India, 6.9% in Russia and 3.7% in Brazil. Fast growth, strong economic foundations and large populations have made BRIC into the world's most promising markets. By 2041, the combined BRIC economies are expected to outstrip the G6 (Germany, France, Italy, Japan, the UK and the USA);

- In 2007-2008 the banking system of the developed world was rocked by the credit crunch, triggered by the collapse of sub-prime mortgages in the USA. Many believed the BRIC countries could emerge unaffected from the crisis;
- In August-October 2008 the crisis escalated into a financial meltdown in the USA, the EU and other advanced economies. Governments took unprecedented steps to prevent the financial system from collapsing;
- As the October 2008 financial crash is translated into large scale job losses, the USA and major eurozone economies are expected to enter recession in 2008-2009. Other advanced economies such as Japan and Canada are expected to grow at a much slower rate;
- Contrary to previous predictions, BRIC economies were almost instantly hit by the events in the developed world. Foreign investors fled the BRIC stock exchanges in fear of a global recession. The MSCI BRIC index, representing overall equity performance of the four markets, fell by 50% between July 2008 and October 2008. The fall was especially sharp in Russia and Brazil, prompting authorities to shut markets temporarily to prevent further losses.

As economies in the West braced themselves for a painful recession in 2009, it was clear that this would have implications for BRIC economies. However, their strengths would help them to withstand the crisis better than other regions.

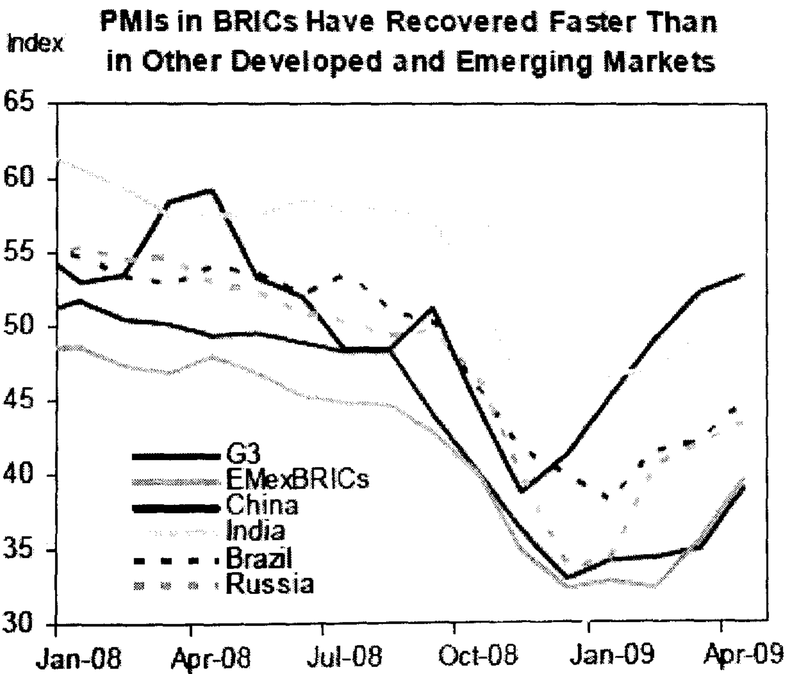
BRICs – Road to Global Recovery:

According to Goldman Sachs, the BRIC nations would be the first to lead the world towards recovery from the recession. The Goldman Sachs report published in May 2009 states that there are growing signs that the global business cycle has begun to stabilize. The report further assures that a resilient domestic demand growth from the emerging markets, particularly the BRICs, to be one of the driving forces of an export-driven recovery in advanced economies. As such BRICs will recover faster than the G3 nations.

The report further provides certain evidences as to how the BRIC economies will steer the path towards Global recovery –

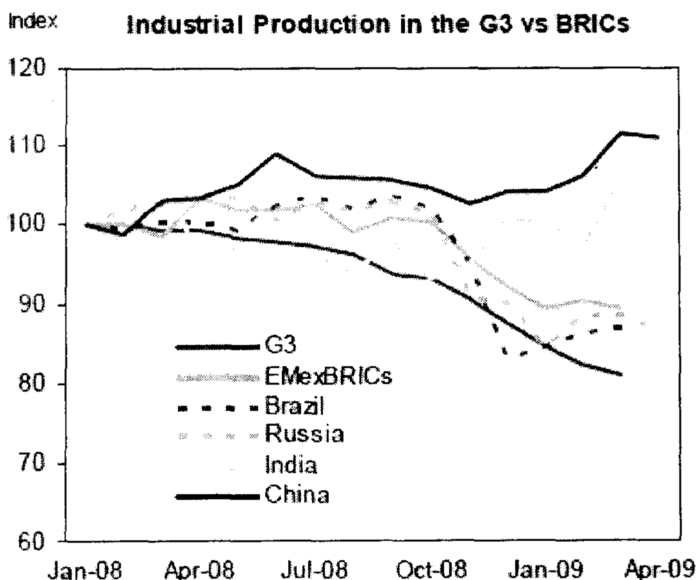
BRICs' PMI Recovery has Outpaced Rest of the World

➢ The BRICs have led the way. China's PMI bottomed in November, earlier or as early as any other economy, and has seen a strong recovery since. While the bottom in the PMI for Brazil and Russia lagged those in India and China, the rebound in each of the BRICs has outpaced that in other emerging markets and in the advanced economies.



Source: Haver Analytics, GS Global ECS Research

➢ Consistent with the improvement in headline, BRICs' new orders less inventories also bottomed earlier than in the G3. In particular, new orders less inventories rebounded strongly in April 2009, as the small increase in inventories was substantially outweighed by the increase in new orders.



Source: Haver Analytics and GS Global ECS Research

- This improvement in headline PMIs and their underlying components has also translated into signs of stabilization in the industrial production sector in emerging markets. IP in China improved dramatically in March to 8.3%yoy from 3.8%yoy in February. Although the 7.3%yoy IP growth in April 2009 was lower than the March 2009 figure, the latter had an exceptionally high base and April 2009s growth level is still significantly higher than the level in 1Q2009 as a whole (5.1%). We believe China's growth recovery remains intact and that the dip in April is likely to be temporary.
- For the other BRICs, the industrial production number is mixed: Brazil is showing signs of stabilization, while India and Russia continue to fall. However, an uptick is expected in India at the earliest.

Domestic Demand from BRICs/EM Key in the Recovery Process

- A resilient domestic demand growth from emerging markets is

expected, and in particular the BRICs, to be one of the driving forces of an export-driven recovery in advanced economies in the next couple of years. This is especially important because our economists envisage a contraction of -3.0%yoy in domestic demand growth in the advanced economies in 2009.

- With the key advanced economies contributing negatively towards domestic demand growth in 2009 and barely positively in 2010, the contribution from the BRICs, mainly China, will be instrumental in maintaining world domestic demand growth at -0.8% in 2009, better than the severity of the global recession would imply. In the same way, world domestic demand is likely to return to a healthy growth rate of 3.4%yoy in 2010, mainly on the back of a significant contribution from the BRICs.

BRICs Lead Developed World on the Road to Recovery

- The BRICs and the G3 economies have already bottomed, either in 2008Q4 or 2009Q1. In any economy, two important milestones on the road to recovery are the return to trend growth and closure of the output gap. On average, emerging markets as an aggregate are likely to see a return to trend growth about six months before advanced economies. EMs should close their output gaps almost two years on average before advanced economies.
- Of the BRICs, China is expected to lead the way, returning to trend growth by mid-2010, much earlier than any other country. India and Brazil should return to trend in 2011, also more rapidly than most other emerging markets. In addition, while the momentum is strongest in China, all three countries are poised to close their output gaps quickly. This rapid narrowing of output gaps is due to recent above trend growth as well as the relatively quick return to trend growth forecast for these countries. Russia lags the other BRICs as it is set to return to trend growth in 2012, close its output gap much later in 2016.
- Estimates of the timing of this process (especially the narrowing of output gaps) are subject to a wide margin of error. So we are more confident about the relative rankings of these transitions

than about absolute timings. The relative rankings indicate that the BRICs will both return to trend growth and close output gaps ahead of the developed world.

BRICs Consumers

- As consumers in developed countries are curbing their spending, BRICs represent a huge growing market with 2.8 billion consumers or 41.8% of the world's population in 2008 :
- In 2007 consumer expenditure for the BRICs countries amounted to US$3.2 trillion. China accounted for slightly more than a third of this figure;
- Strong economic growth since 2001 has increased disposable incomes, creating a large stratum of middle class consumers. In 2002 BRICs countries had 20.6 million households with an annual disposable income over US$10,000. By 2007 their number catapulted to 90.1 million households;
- BRICs consumers are hit less by the credit crunch as they are less dependent on mortgages and debt. Many consumers, especially in India and China, do not have a bank account. The limited level of debt has helped to minimize banks' vulnerability to the credit crunch.

Inflation

The expected decline in inflation as economic growth slows will help boost consumption and economic growth :

- Rising commodity and food prices, as well as the overheating of BRICs economies, have pushed consumer prices high in 2008. Annual Inflation for 2008 is expected to measure 6.4% in China, 5.7% in Brazil and 7.9% in India. In Russia annual inflation is forecast even higher at 14.0% in 2008 due to the overheating of construction and domestic consumption sectors;
- In the third quarter of 2008 commodity prices fell sharply, expressing the slowdown in the global economy. Prices of energy, raw materials and agricultural products declined. As a global economic slowdown looms, it is expected that commodity prices will remain low and the pressure on consumer prices will ease;

- Falling inflation will benefit consumers in BRIC countries, especially among lower and middle income households, who spend a greater share of their income on fuel and food than consumers in the developed world;
- As the threat of inflation recedes, central banks are able to cut interest rates, which will encourage growth and stimulate consumer spending. China reduced its basic rate by 0.27 percentage points in October 2008. Brazil, Russia and India are expected to follow.

Future Scenarios

BRIC economies will suffer from the 2007-2008 financial crises, yet they will be less affected than other countries :

- Domestic consumption and investment are expected to sustain BRICs growth, albeit at a lower level than previously anticipated. The IMF revised its projections for BRIC economies downwards in October 2008. In China, real GDP growth is expected at 9.7% in 2008 and 9.3% in 2009; in India, 7.9% in 2008 and 6.9% in 2009; in Russia, 7.0% in 2008 and 5.5% in 2009; and in Brazil 5.2% in 2008 and 3.5% in 2009. Developed economies, in contrast, are expected to approach or enter a recession over 2008-2009;
- As consumer demand in the developed world is expected to slow, BRICs will provide marketers of consumer products and services with a growing market. This will enhance the BRIC's importance for the global economy, which is expected to return to average annual growth of 4.2% in 2010, from 3.9% in 2008 and 3.0% in 2009;
- The global slowdown is expected to keep commodity prices below record levels seen in 2008. This would slow growth in commodity exporters Brazil and Russia, but will benefit all BRICs consumers, who will be spared the burden of rising consumer prices.

BRICs – Playing Politics:

BRICs countries underline their support for a more democratic and just multi-polar world order based on the rule of international law,

equity, mutual respect, cooperation, coordinated action and collective decision-making of all states. BRIC countries reiterate their support for political and diplomatic efforts peacefully resolve disputes in international relations.

BRIC have strongly committed themselves to multilateral diplomacy with the United Nations playing the central role in dealing with global challenges and threats. In respect, they reaffirmed the need for a comprehensive reform of the UN with a view to making it more efficient so that it can deal with today's global challenges more effectively. They reiterated the importance that attach to the status of India and Brazil in international affairs, and understand and support their aspirations to play a greater role in the UN.

BRIC countries have agreed upon steps to promote dialogue and cooperation among our countries in an incremental, proactive, pragmatic, open and transparent way. The dialogue and cooperation of the BRIC countries is conducive not only to serving common interests of emerging market economies and developing countries, but also to building a harmonious world of lasting peace and common prosperity.

BRICs – Economic and Trading Super Power:

The BRIC countries recognize the important role played by international trade and foreign direct investments in the world economic recovery. BRIC countries call upon all parties to work together to improve the international trade and investment environment. They urge the international community to keep the multilateral trading system stable, curb protectionism and push for comprehensive and balanced results of the WTO's Doha Development Agenda.

The poorest countries have been hit hardest by the financial crisis. The international community needs to step up efforts to provide liquid financial resources for these countries. The international community should also strive to minimize the impact of the crisis on development and ensure the achievement of the Millennium Development Goals. Developed countries should fulfill their commitment of 0.7% of Gross National Income for the Official Development Assistance and make further efforts in increasing assistance, debt relief, market access and technology transfer for developing.

The implementation of the concept of sustainable development, comprising, inter alia, the Rio Declaration, Agenda for the 21st Century and multilateral environmental agreements, should be a major vector in the change of paradigm of economic development.

BRICs – Social Concerns:

BRIC countries will enhance cooperation among our countries in socially vital areas and to strengthen the efforts for the provision of international humanitarian assistance and for the reduction of natural disaster risks. They take note of the statement on global food security as a major contribution of the BRIC countries to the multilateral efforts to set up the sustainable conditions for this goal.

The BRIC countries will cooperate among the member states in science and education with the aim, inter alia, to engage in fundamental research and development of advanced technologies.

The BRIC countries strongly condemn terrorism in all its forms and manifestations and reiterate that there can be no justification for any act of terrorism anywhere or for whatever reasons. They note that the draft of Comprehensive Convention against International Terrorism is currently under the consideration of the UN General Assembly and call for its urgent adoption.

BRICs – Energy Conscious:

The BRIC countries recognize that energy is an essential resource for improving the standard of living of their peoples and that access to it is of paramount importance to economic growth with equity and social inclusion.

BRIC countries stand for strengthening coordination among states in the energy field, including amongst energy producers and consumers and transit states, in an effort to decrease uncertainty and ensure stability and sustainability. They support diversification of energy resources and supply, including renewable energy, security transit routes and creation of new energy investments and infrastructure.

BRIC countries support international cooperation in the field of energy efficiency. They stand ready for a constructive dialogue on how to deal with climate change based on the principle of common but differentiated responsibility, given the need to combine measures

to protect the climate with steps to fulfill the socio-economic development tasks.

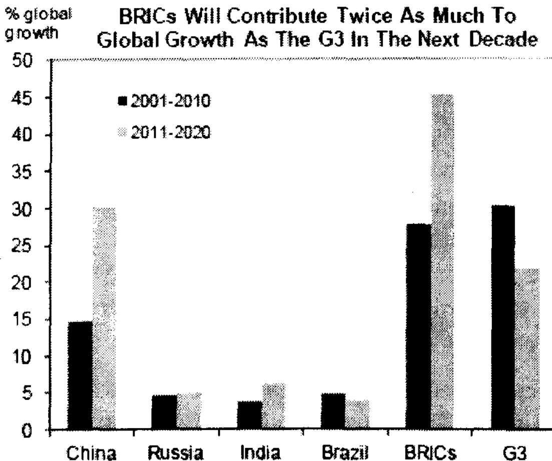
The BRIC countries are aiming to develop cleaner, more affordable and sustainable energy systems, to promote access to energy and energy efficient technologies and practices in all sectors.

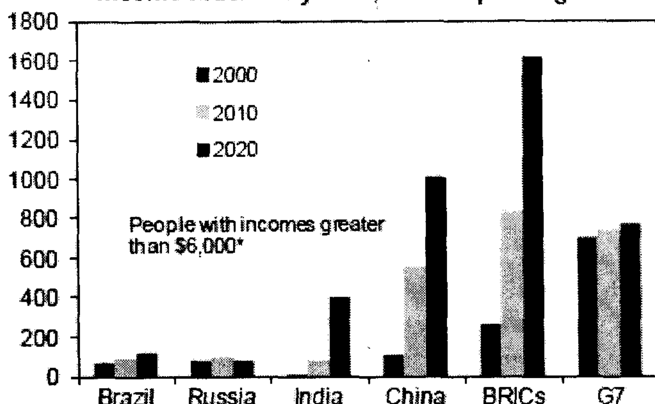
The BRIC nations recognize the potential of new, emerging, and environmentally friendly technologies for diversifying energy mix and the creation of jobs. In this regard BRICs would encourage, as appropriate, the sustainable development, production and use of biofuels.

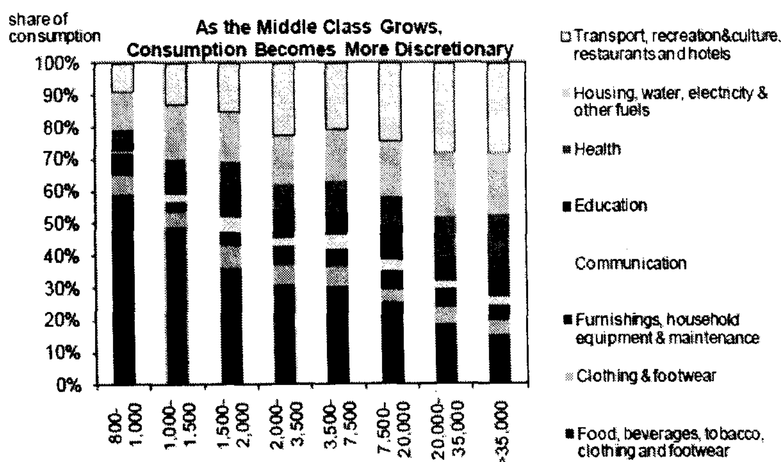
In accordance with national priorities, BRIC nations will work together to facilitate the use of renewable energy, through international cooperation and the sharing of experiences on renewable energy, including biofuels technologies and policies. BRIC member countries will cooperate with each other in training, R&D, Consultancy services and technology transfer, in the energy sector.

BRICs – In the Last Decade:

The last decade saw the BRICs make their mark on the global economic landscape. Over the past 10 years they have contributed over a third of world GDP growth and grown from one-sixth of the world economy to almost a quarter (in PPP terms).





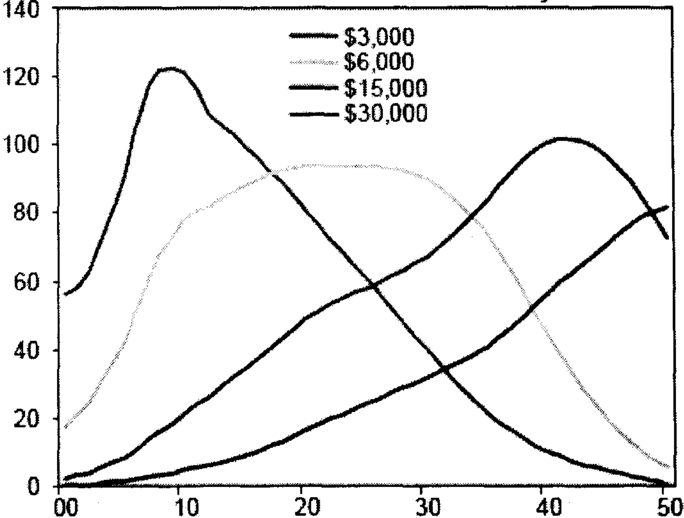


In the coming decade, the more striking story will be the rise of the new BRICs middle class. In the last decade alone, the number of people with incomes greater than $6,000 and less than $30,000 has grown by hundreds of millions, and this number is set to rise

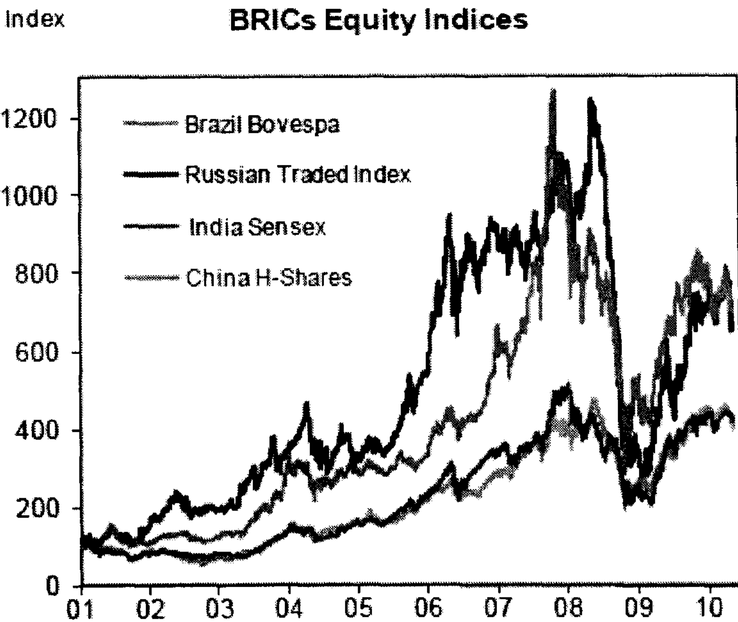
even further in the next 10 years. These trends imply an acceleration in demand potential that will affect the types of products the BRICs import-the import share of low value added goods is likely to fall and imports of high value added goods, such as cars, office equipment and technology, will rise.

BRICs (and other emerging markets) will also see a rising middle class in the next decade, and should also see a rising 'upper class' (incomes higher than $30,000).

With the explosion of the middle classes, spending patterns are likely to change leading to competition for resources. As countries pass through industrialization and GDP per capita raises to around US$1,000-$3,000, savings and investments typically rise. On the flipside, consumption (as a share of GDP) usually falls during this period. Over the past decade, China and India have for the most part stayed within this lower income range, characterized by a low share of consumption and high savings. As the share of exports to the BRICs is increasing in both developed and emerging countries, and this trend is likely to continue as demand from BRICs consumers rises in the next decade.

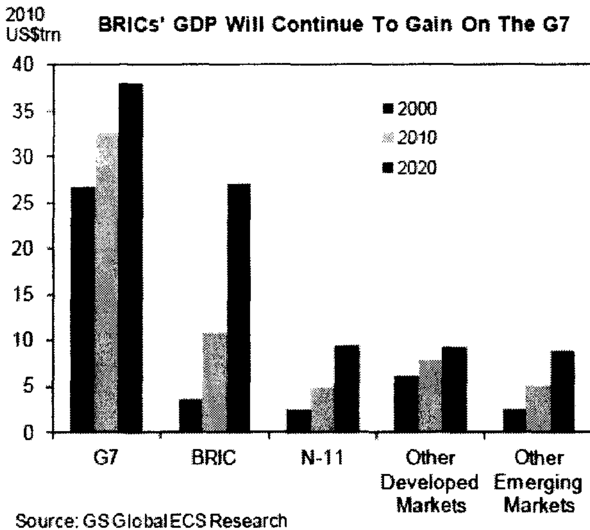


In the past decade, BRIC equity markets outperformed significantly because the strong growth of these economies surprised many and the BRICs themselves came into focus. At the same time, valuations were low relative to many major markets in 2000. The last decade was a BRICs' decade for stocks: the Russian traded index rose by a sizeable 884%, followed by China H-Shares (610%), the BSE in India (319%), and the Bovespa in Brazil (294%).

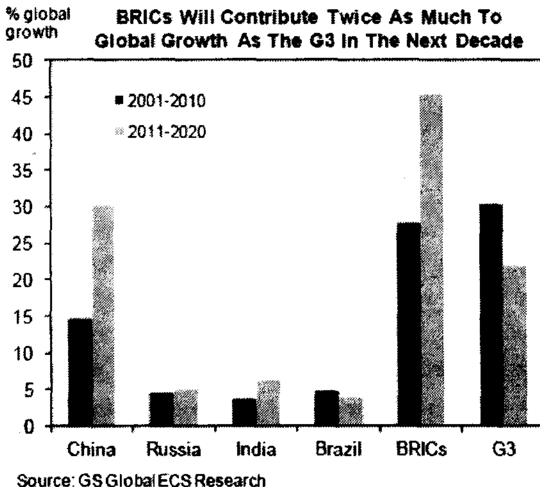


Source: GS Global ECS Research

BRICs have become well-known worldwide, and investors, politicians and many others have shifted their focus to these countries. As we look back on the last decade, it's clear that the BRICs have already begun to play a more significant role in the global economy and on the world political stage. The BRICs contributed 36.3% of world GDP growth in PPP terms (or 27.8% in USD) during the first decade of the century. They have also steadily increased their share of global output. Currently, they make up about a quarter of the global economy (in PPP).



BRICs, as an aggregate, will overtake the US by 2018. In terms of the size of the economy, by 2020, Brazil will be larger than Italy; and India and Russia will be individually larger than Spain, Canada or Italy. By 2020, we expect the BRICs to account for a third of the global economy (in PPP terms) and contribute about 49.0% of global GDP growth.

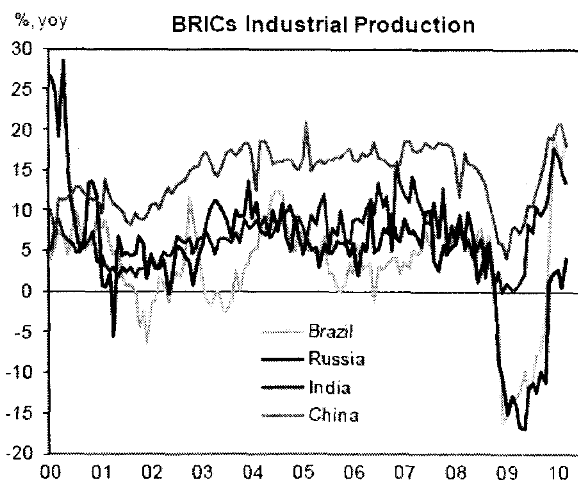


3. Conclusion

Why BRICs will continue to roll:

Fast growing economies with the biggest source of labour. These 4 large countries account for more than 40% of the world's population and almost a third of the world's land mass. Long-term GDP forecasts for BRIC countries show that tomorrow's giants, China and India, seem set to take first and third place on a GDP basis by 2050 (with the US in second place), shifting the centre of gravity of the global economy.

Industrial production in China and India moderated in March, while IP in Russia and Brazil both came in higher in yoy percentage terms.



- They will soon change the consumption and production pattern in the world economy. The BRIC countries also have large, young populations to drive this growth, with many concentrated in major cities, wealth generators that this are. The growing prosperity of the BRIC economies will be largely down to a rapidly emergent and expanding middle class. Improving domestic consumption should complement export and investment strengths, and provide more long-term growth.
- As their influence on the global economy grows so do the risks

for the sustainable world development. The numbers of BRIC residents whose incomes exceed $3,000 (consistent with entry into the middle class in the emerging markets region) should almost double between 2006 and 2009.

- By 2015, more than 800 million people across the four economies should have crossed this threshold - exceeding the current total population of the US, Western Europe and Japan combined. This should affect many industry sectors, including mobile-phone operators, computers, automobiles, etc. Rising incomes will also lead to increased numbers of high-net-worth individuals.
- Their role in the global policy is increasing as well the geopolitical importance for their regions and the world. In 2005 the emerging economies overcome developed economies by their share in the World GDP calculated at purchasing power parity. The BRIC countries were the main driving force for GDP growth of the emerging economies. Another factor supporting these markets is corporate profitability. Corporate profits in BRIC companies has been consistently positive over the past decade, driven largely by corporate restructuring, reduced levels of borrowing and improvements in the quality of corporate governance.

For the first time in recent history, BRIC nations are growing not by borrowing, but by investing. China has the world's highest savings rate. Brazil and Russia are sitting on huge foreign currency reserves, thanks to windfalls from oil profits. Even freewheeling Brazil is showing heretofore unseen discipline by running a fiscal surplus.

Second, soaring commodity prices have put more money in BRICs' pockets than ever before. That means much less danger of a financial meltdown like the ones Brazil and Russia had in the 1980s and 1990s.

Finally, higher credit ratings mean that BRICs today can issue debts in their own currencies. A decade after defaulting, Russia has a higher credit rating than the European Union economies of Greece and Portugal.

Challenge form NEXT-11:

The BRIC economies of Brazil, Russia, India and China may lay

claim to the world's economic future. But savvy investors know that to generate the biggest and best returns, you need to look beyond today's headlines. Investment bank Goldman Sachs compiled a list called the "Next-11" (N11) back in 2005 - countries it thinks can rival the BRICs in terms of investment prospects over the coming decades. Goldman Sachs' list included Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey and Vietnam. With the combined population of the N11 adding up to slightly less than that of China, no single country is likely to match that emerging economic superpower's impact on the global economy. That said, it is likely that a handful of the up-and-coming N11 countries like Indonesia, Vietnam and Turkey will put more money in your brokerage account than investing in China or the other BRIC countries.

Separating Myth from Reality in the BRICs Theory:

We never anticipated the impact that this research has had, especially the 2003 paper (Global Economics Paper No. 99: Dreaming with BRICs: The Path to 2050). The ideas implicit in these papers, and many of the concepts that have developed since have become hot investment themes over the past two years. A number of BRICs investment funds have been established and others are in the process of being launched. Many writers, academics and journalists have offered opinions about the BRICs concept, and we thought that it would be appropriate to address some of the issues most frequently raised. Our BRICs analysis made a clear distinction between potential and reality. Rather than forecasting that China will become the largest economy in the world by 2041 and that India will become the third-largest by 2035.or that the combined BRICs GDP size will become bigger than the G6 (G7 minus Canada) by 2041.we suggested that, if everything went right, then China could become the largest economy in the world by 2041, India the third-largest by 2035, and the combined BRICs GDP could exceed the G6 by 2041. The capacity of the BRICs to influence global dynamics turns on their ability to set and maintain growth-supportive policy settings. Linked to this growing influence, we see the BRICs as much more than a new emerging market theme. The BRICs are a key aspect of the modern globalised era. What distinguishes the BRICs from any other story of EM growth is their ability to influence, and be influenced by, the global economy and global markets in a broad fashion. The current and prospective

outlook for globalization has the BRICs nations at its core and the interplay between the BRICs economies and the G7 is a critical aspect of globalization and interdependence. The varied composition among the BRICs, the balance between resource-abundance and resource-dependence within the BRICs, and the global demographic tilt towards the BRICs allows these economies the chance to participate in an integral way in the world economy.

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15

Global Economic Crisis and Human Resource Management: Challenges and Opportunities for the Organizations

V K Shrotryia

"A crisis is an opportunity riding the dangerous wind."
A Chinese Proverb

Human resource management is one of the most important functional areas of management. Organizational resources are allocated and properly used through the decision of people in management. It is the human resource or people/employees that make all the difference in an organization. This is one of the most important reasons why human resource is considered as one of the most important asset for an organization, though off late this consideration has been questioned by Drucker (2002)[1] as well as Collins (2001)[2].

The organizations have to design policies to manage people effectively so that they can contribute better in the interest of the organization. Both internal as well as external environment provide the situational framework under which the organizations operate and manage their human resource. The strength of an organization has to be studied looking at its competencies and capabilities and the challenges

it faces from the external forces such as economic, social, political, cultural, technological environment. As the environment changes the organizations have to redesign their strategies to deal with their employees without compromising on its basic principles and without getting diverted from their organizational goal. This paper discusses some appropriate challenges and opportunities that generally the management faces while managing its human resources in the wake of the global economic crisis. The paper further brings out some such practices which were used as opportunities to the organizations for taking proper stock of the situation and take some pending crucial decisions related to the management of people.

Crisis is not a good word, especially when it is resulting in the changes in the economic conditions of a state. The economies of different nations have witnessed situations of crisis in different years. However the great depression of 1929 had lasted for more than 12 years with its after effects, its effect on Indian economy was not felt that badly. The recent crisis[3] disturbed the corporate structure and resulted in the closure of many financial institutions. We could again be saved because of very low integration levels as well as protection through regulations by the state. Interestingly crisis did become a good word for many organizations, especially when we study the management of people or human resource management practices in the wake of recent global economic crisis.

The impact of the economic crisis was witnessed when most of the big companies went in for huge job cuts in USA, UK and Japan. It affected the employees very badly as they were under severe stress during the period of the crisis. This posed a challenge before the organizations to deal effectively to improve the work environment stress free through proper dissemination of information and to make them aware of its relative impact on the organization. Human resource departments of affected organizations dealt with the stressors in such a way as to keep the spirit of motivation alive in them.

Generally the impact was also visible in the economic indicators of many countries where a fall in CDP was seen as a result of the crisis. As economic indicators were affected, similarly the financials of all kinds of organizations also got hit. The organizations which had strong base and developed the mechanism for responding to the crisis

were relatively not hit that badly. As a nation India was not hit directly, but indirectly the organizations which had their stake in their counterparts abroad, which had some integration and alliances located at locations where the economies were badly hit suffered. Many organizations had to resolve to salary cuts, freeze on the new jobs, retrenchment, unpaid leave provisions etc. The issue concerning their survival drove them to think, rethink and act accordingly so far as their effort to the management of their employees was concerned. This was a great challenge posing before corporate houses to strategize efficiently so that they are not left behind in their profitability, sustainability and responsibility to manage their future. The worst hit sector was service and further narrowed down to banking, insurance, and ITES (Information Technology Enabled Services). As reported by ILO in their report[4] 51 countries for which data are available, at least 20 million jobs have been cut since October 2008 when the financial crisis started.

The role of the CEO became more crucial as he/she had to take some very unpleasant decisions. It's not easy being the boss during a downturn. Your natural impulse is to focus on your own well-justified concerns, but your people are watching your every move for clues to their fate... By making tough times less traumatic, you'll equip your organization to thrive when conditions improve - and earn the loyalty of individuals who will remain in your network for years to come (Sutton, 2009 p 132)

The organizations had to redesign their strategies in order to develop survival strategies to be followed during the turbulent times and to get prepared for similar occurrences in future through proper provisions. The mode of operation changed from being offensive to defensive and further to set new priorities in the changed or changing economic conditions. This challenge was also met by the organizations through orienting their employees towards the organizational goal and reiterating their concern towards the welfare of the employees. As Drucker (2002) had put very aptly in one of his papers - Employees may be our greatest liability, but people are our greatest opportunity (p 77). A sharp decline in headcount resulted in such a way that the size was maintained at the minimum level. Organizations as many as 37%[5] of them globally (across all jobs and locations) had to resolve to salary freezing. NetApp, declared number one in Fortune's "100

Best Companies to Work For" for 2009, announced it was cutting loose 6% of its employees less than a month after the ranking appeared. Google, top-rated by Fortune in 2008, has shed hundreds of full-time employees. (Sutton 2009, p 131-132). The organizations reviewed and revised their salary management systems, performance appraisal system, training systems, welfare schemes, etc apart from restructuring that happened in the wake of the crisis.

In a way global economic crisis also gave them an opportunity to devise better systems and crisis became a blessing in disguise to many of the organizations which suffered the aftermath. As Rumelt (2009) puts it - If hard times have a good side, it's the pressure to cut expenses and find new efficiencies. Cuts and changes that raised interpersonal hackles in good times can be made in hard ones ... Take advantage of hard times to buy the assets of distressed competitors at bargain basement prices. The best assets are competitive advantages unwisely encumbered with debt and clutter. The crisis played a role of a catalyst between the resources, problems, excuses and intentions of the organizations to get prepared for the better times. This gave an opportunity to the organizations to take stock of things properly. This time worked as a time during which many organizations sharpened their saws through identification, allocation and proper use of organizational resources. The systems were developed in such a way that the efficient workers were retained and the ones who were not efficient and somehow were becoming a burden to the organizations were shown the door on the excuse of the crisis. Efficient employees at the lower level were identified and given important responsibilities. In this way it did help the organizations to concentrate on their best talent pool and develop a great network of knowledge management systems to concentrate on the future prospects and to expect a better ray of hope in the times to follow. This is what Rumelt (2009) mentions as - Focus on employees and communities which you will keep through the hard times. Good relations with people you have retained and helped will be repaid many times over when the good times return.

Martin and Schmidt (2010) provide convincing suggestions as to how organizations can retain their top talent. They suggest that you do not need to assume that all your rising stars are engaged, their current high performance might not really reflect on their future

potential, the line managers should not be delegated with talent development task, the stars should not be shielded rather their talent should be used, these stars deserve proper recognition and differentiated compensation, and lastly the young stars must be shared with the future strategies and the organizations need not to keep them in dark.

Donald Sull (2010) poses 7 Questions for Preparations in one of his papers which deals with the crisis situation and provides recipe through addressing these 7 questions as - do you miss opportunities that others spot, are your hydraulics broke, do you reward mediocrity and call it teamwork, are your core values a joke, are you talking about the wrong things, have your vikings become farmers, and do you rely on heroic leadership? These questions address the issues related to the capabilities of the organizations in order to respond back to the situations in the times of crisis.

The economic crisis as it resulted kept the whole financial sector of almost all economies of the world under its influence, less or more, depending on its nature. Though all the sectors of economy and all functional areas of management within a business organization were affected by this, the people i.e., the employees felt the pinch more. On one side it posed a great challenge to the organizations to deal with this in such a way that the life span of the organization does not come to a halt and on the other side it did provide an opportunity to them to get into some introspection and to put the house in order so that the future becomes better. Good exist because there is bad. Crisis per se is not bad as it does provide some opportunities to rethink on the priorities of the organization and to devise proper mechanism to overcome similar such problems in future. It puts a check on the performance of the organization. As the basic premise of a business organization is to earn profit and maintain profitability, the organizations can't afford to isolate themselves from the thought of only welfare. Hence it can be concluded that the organizations can learn from all situations and conditions to develop a positive work culture within the organization so that their goal of sustaining profit and serving the society get served. Alls well that ends well.

End Notes:

1. Peter Drucker wrote a paper in Harvard Business Review entitled 'They're not employees; they're people' where he argued that after

retirement the people become liabilities for the organizations, so if the organizations have to plan things accordingly they have to depend more on temporary employees.

2. Jim Collins wrote one the bestselling books, Good to Great: why some companies make the leap... and others don't, based on the data collected of many US corporations. He mentions in his book: People are not important assets, but right people are. The argument is that it is not that each employee is an asset, however the right persons who perfectly fit into the organizational fabric, are the real assets.
3. The global economic crisis (recession) which emerged primarily in the year 2007, hit the economy of the western countries badly in 2008 throughout and early part of 2009, was caused by the liquidity deficit by the banks and financial institutions due to non-payment of housing debt.
4. See ILO report for 2009, retrieved from http://www.ilo.org/public/english/bureau/inst/download/summ_09e.pdf
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16

Understanding Impacts of 2007 Version of Global Financial Melt-down on Indian Economy

Philip Mody
Manjung Mossang

Abstracts

World economy has to struggle with a severe financial crisis due to the global financial meltdown, 2007. The fresh but, bitter experiences that ever world economy has felt would always be evocative for not only for advanced but, also developing economies too making marked headline in World Economic History. Global economic meltdown 2007 has been a good message in understanding revulsions of being engaged in excessive speculation, improper credit rating, granting high-risk loans, faulty government policies and evils of boom and bust in the housing market. It has also sent warning tone not to repeat the same mistake in the future or about preparedness to mitigate tactfully if, it repeats.

Providentially, impact of the global crisis on India has not been as prickly as in other Asian economies due to her espousal of almost closed economy like characters. Nevertheless, India has also many reasons to worry about the global financial meltdown that has taken root in United State of America. Global financial catastrophe version, 2007 has tremendous impact on Indian Economy touching Indian banks, Service and Production sector, Real Estate sector, Stock market, Foreign Exchange Reserve, I.T Sector, Export Trade, Labor market, Exchange Rate Depreciation and Economic Growth respectively, sending message of high alerts to go for both remedial and precautionary measures for it.

In this paper, an attempt has been made to review historical background of 2007 version of global financial crisis, and also to discuss its positive as well as negative impacts on Indian economy.

Background Of Financial Meltdown-2007

Since world war-II, in 2007, the United States, Europe and Japan and other advanced countries reeled under financial crisis. Several other emerging-economy countries were also in recessions. The unemployment rate has risen to record 9.4% snatching jobs of 6 million people in U.S.A alone. Financial meltdown-2007 was considered by many economists to be the nastiest and longest economic downturn since the great depression of the 1930s. The news has been equally grim around the world. In Spain, the unemployment rate shot up to 17.4% as a record 4 million people were without jobs. Britain's economy contracted by 1.9% and reduced China's share in Global export in the last two months of 2008. Real shortfall in Liquidity in the U.S banking system has triggered global financial crisis of 2007 and large financial institutions in U.S.A went busted, resulting into "bail out" of banks by national governments and downward spiral in stock markets around the world. A higgledy-piggledy contraction in wealth and money supply in the market is the prime cause of liquidity shortfalls which is known as a credit crunch. The global crisis started with the collapse of the banks and financial institutions, real estate markets, derivatives and commodities markets in America.

The present crisis has been linked to the sub-prime mortgage business, in which US banks gave high-risk loans to people with poor credit record. The excessive sub-prime lending i.e., giving loans to non credit worthy people aiming speculative profit lead to collapse of real estate prices and unprecedented crisis in the real estate sector. The participants in an economy lose confidence in having loans repaid by debtors, leading them to limit further loans as well as recall existing loans. The leading investment banks in USA which has a long history such as Lehman Brothers (1880), Goldman Sachs (1869), Merrill Lynch (1914), Bear Sterns (1923) and Morgan Stanley (1935) had collapsed. The world largest insurance company namely American international Group (AIG) which has 1.16 lakh workers and 740 lakh customers and operating in 130 countries also collapsed. The other

reasons for the global crisis, 2007 were because of weakening traditional banks, growth of a huge parallel financial system consisting of investment banks, mortgage banks etc, providing loans to speculative investment in share, derivatives and commodity markets, negative saving rate of the economy, huge public debt of the US government (more than 10 trillion dollars), massive expenditure on war on Iraq and Afghanistan, steep increase in the price of petroleum products, depreciation of American dollar etc. Following the financial crisis of America a large number of banks and financial institutions in UK, Spain, Switzerland, Belgium, Germany, Netherlands, and Japan etc., also collapsed. As America is the financial capital of the world and American Dollar is considered as world currency so, the American crisis became a global crisis.

Negative Impacts On Indian Economy

The atrociousness of this worst worldwide financial catastrophe can be better seen in our minds' eye by looking at the unprecedented fiscal and monetary policy actions which have been unleash across the world to combat the crisis. At the dawn of this global economic cataclysm, Indian Economy was supposed not to be affected by American meltdown as decoupling hypothesis advocated that developing economies would remain unaffected by financial crisis on the ground of their sufficient reserves of foreign exchange, strong financial performance of companies, healthy banking sector and improved policy framework. However, integration and interdependency of India with global economy made Indian economy too got burns of the crisis. Fortunately, due to India's strong fundamentals and adoption of nearly closed economy, the degree of off-putting impact on Indian economy was not so much as compared to other countries. Moreover, Indian banking sector had little exposure to the sub-prime lending and mortgage-backed securities that saved her from being-swayed over at a time. Gradually, India has also started experiencing economic slowdown in different rooms of economy owing to global financial meltdown that is discussed under following heads:

1. **Impact on Transport and Energy Sectors:** During 2008, world has an experience of swift increase in crude oil price which has created severe tribulations in the entire transport and energy sectors of India. Amazingly, India's share of imported crude oil

in domestic consumption exceeded 75%. The steep rise in crude oil price in international market has drastically increased the oil price in one hand and cost of transportation in other hand in India.

2. **Impact on Banking Sector:** No wonder, financial meltdowns has taken birth in the United States but the Indian government had to worry, as there was a potential negative impact of the crisis on the Indian banks. For instance, Lehman Brothers and Merrill Lynch had made substantial amount of investment in Indian banks, and Indian bank in turn, had invested the money in derivatives, that even made derivate market victimized by global financial crisis. Public Sector banks of India like Bank of Baroda had significant exposure towards derivatives and burnt up badly by this crisis, ICICI faced the worst hit as with Lehman Brothers having filed for bankruptcy in the US. ICICI, even received a rumor during the crisis which argued that the giant bank was slated to lose $80 million (Rs 375 crores), which had been invested in Lehman's bonds through the ICICI's subsidiary at United Kingdom. Axis Bank was also affected which came under the fire of global financial meltdown.

3. **Impact on the Service and Industrial Sector:** Indian prime growth engine for the last five year i.e., service sector which accounts for about 57% of India's GDP has been experiencing slow down especially, in transport & communication, construction, electricity, hotels, and restaurants sectors. In addition to this, the index of industrial production has started exhibiting negative growth and demand of investment in this sector is on decrease. The slowdown in industry could be attributed to the combined impact of a fall in exports followed by a decline in domestic demand. Also, rise in cost of inputs and cost of credit reduced manufacturing margins and profitability. The growth of the electricity sector growth was hampered by capacity constraints and unavailability of coal. The performance of six core industries comprising crude oil, petroleum refinery products, coal, electricity, cement and finished steel grew at 2.7% as compared to 5.9% in 2007-08. There was a decline in growth of cement and finished steel. Construction is another industry which was adversely affected. The industry consists of

different segments like housing, infrastructure, and industrial construction, commercial real estate etc. The industry that exhibited a boom in pre-global crisis period met sober problems because of increase in cost of construction triggered by escalating price of inputs like steel, cement and interest costs. Moreover, constant rise in interest rate and slow down in housing loans were also responsible for decline in demand for houses and its construction thereof, in India.

4. **Impact on the Real Estate Sector:** The real estate sector in India was also affected due to Lehman Brother's real estate partner having given Rs 7.40 crores to Unitech Ltd., for its mixed use development project in Santa Cruz. Lehman had also signed a MoU with Peninsula Land Ltd, an Ashok Piramal real estate company, to fund the latter's project amounting to Rs. 576 crores. DLF Assets, which holds an investment worth $200 million, is another major real estate organization whose valuation was affected by the Lehman Brothers dissolution.

5. **Impact on Stock Market:** The fall in foreign institutional investment (FII) and the sale of stocks owned by FII also resulted in the downward movement of share prices and exchange rates. The Sensex fell from its closing peak of 20,873 on January 8, 2008, to less than 10,000 by October 17, 2008. These developments have resulted in extreme fluctuations in stock market prices, exchange rate and inflation levels in 2008. India received the most dreadful and adverse experience of American financial meltdown on 10th October, 2008 when the Indian stock market lost Rs. 2,50,000 crores in a single day because of the sudden huge withdrawal from the Indian stock market by Foreign Institutional investors. Withdrawals were made, as they need to retrench assets in order to cover losses in their home countries, thus, being forced to seek havens of safety in an uncertain environment. The withdrawal by FIIs also led to a sharp depreciation of the rupee. Thousands of investors, big and small, have been hurt by the downward plunge of the Indian stock market. The outflow of huge foreign institutional investments from the Indian equity market has been one of the worst memory that global financial crisis has given to Indians.

6. **Impact on Foreign Exchange Reserve:** Compression of remittances, grants, aids, to India on one hand and withdrawal of NRI deposits and foreign institutional investment from India on other hand leaded to gradual declination of Indian foreign exchange reserves that reminds Indian about the same crisis felt in 1991. Infact, foreign exchange reserves of India was on increase over past few years but, it had been starting falling after June 2008.

7. **Impact on I.T Sector:** In India, IT companies, with nearly half of their revenues coming from financial and banking service segments, were close monitors of the financial crisis across the world. The IT giants which had Lehman Brothers and Merrill Lynch (ML) as their clients are Tata Consultancy Services (TCS), Wipro, Satyam, and Infosys Technologies which caught on fire of financial crisis. However, HCL escaped the loss to a great extent because neither Lehman Brothers nor ML was its client. The impact of the global financial crisis, rooted in the United States on the Indian IT sector can be easily gauged from the fact that approximately 61% of the Indian IT sector's revenue were from clients in the US. Moreover, top five Indian players who account for 46% of the Indian IT industry's revenues were from US clients.

8. **Impact on Export Trade:** Saga of Indian exports has been running under hard times especially for textile, leather, gems and jewellery, marine products and tourism. Shipments of Indian natural pearls, precious and semi-precious stones, and pharmaceutical products, all recorded a decline causing Indian exports to the US to drop by 22.63% to $5.22 billion of total exports of 2009. The Indian Gems and Jewellery sector was significantly affected by the reduced demand in the United States and Europe. Exports of cut and polished diamonds dipped 8.24% to $13.02 billion. Indian export has already fallen by 9.9 percent in November, 2008 as US has been leading partner. In October 2008, India registered its first every year-over-year decline in exports (of 15%), following growth of 35% in the previous five months. Indian shipments declined 33.3% in March from previous year, the biggest fall since the last 14 years. Goods exports dropped 33% from a year earlier to $11.5 billion in April 2009.

This was the biggest fall since April 1995. India's exports, which account for 15% of the economy, grew 3.4% to $168.7 billion in the fiscal year ended March 31, missing a $200 billion target set by the government, before the collapse of the Lehman Brothers Holding Inc. In the first quarter of 2009, trade between India and the United States declined by 23.47% in value to $8.2 billion, as compared to $10.69 billion as compared to the last year. The global crisis has adversely affected the exports, imports, current account deficit and resulted in the fall in foreign exchange reserves during 2008-09. The export growth fell from 28.9% in 2007-08 to 3.6% in 2008-09. The imports fell from 35.4% to 14.4% during the period. Current account deficit increased to 4.1%.

9. **Impact on Labor Force:** Labor force demand has gown down leaving many workers jobless. Fascinatingly, reverse migration i.e., movement of labor from urbanized to rural area has already been seen which might create more pressure on rural economy. E.g., The Indian Gems and Jewellery sector was significantly affected by the reduced demand in the United States and Europe. Overseas sales of India's gem and jewellery items expanded at a seven-year low rate of 1.45% and stood at $21 billion in 2008-09, as exports contracted sharply in the last six months of the year. This lead to about 200,000 job losses in the sector, especially of artisans engaged in polishing diamonds.

10. **Impact on Exchange Rate Depreciation and Economic Growth:** Unprecedented outflow of foreign institutional investments from India made India's rupee to depreciate against dollar, which has negative impact on India's balance of payment and foreign exchange reserve. Global financial crisis has been pulling down Indian gross domestic product. The economic growth rates were 9.3 and 7.3 percent in 2007 and 2008 respectively. It was projected to be 7 percent for 2009 and IMF projection was at 5.1 percent. However, Real GDP growth has moderated to 6.6% only and same rate was projected in 2009-10. So, growth rate is constantly falling by every year. Reduction in growth rate has been attributed to decline in India's industrial production, declining performance of trade and service sector along with collapse of Indian stock and derivative market.

Reasons For Mild Impacts Of Global Financial Crisis- 2007 On Indian Economy

Because of the indispensable strength of the mixed economic system of India having public and private sectors, no bank or financial institution in India collapsed due to the global crisis. Moreover, there had been effective regulation or market intervention in most of the economic and financial sectors in India. The impact of the global crisis was mild in India in comparison to USA, UK, Japan and other developed countries owing to the following factors:

- Existence of public sectors in Indian economy like railways, roads, electricity, drinking water, and communications are in the public sector. Supply of petroleum has been made through public sector companies and government of India fixes its prices.
- The large scale public investment through the various social welfare schemes such as National rural employment guarantee scheme, Debt Waiver Scheme for farmers and other schemes also proved to be an effective device to combat recession that has increased rural consumption and consumer demand in India.
- Key financial institutions and Banks are under the public sector governance.
- Predominance of an effective central banking system to control and regulate the activities of all public and private sector banks and other non banking financial institutions in India.
- Presence of strong central regulatory bodies to control and regulate the activities of share market, private insurance companies etc and derivative markets.
- Existence of centralized planning machinery to plan and co-ordinate the development activities of the country.
- Food grains and other agricultural products are procured and minimum support prices are offered for a number of agricultural commodities in India.
- India's growth process has been largely domestic demand driven and its relevance on foreign savings has remained around 1.3%

- Comfortable level of foreign exchange reserve (252 Billion US dollar in March, 2009) to combat financial crisis in India.
- Fairly comfortable domestic savings (37.7% of GDP).

Positive Impacts On Indian Economy

It has been wisely said that, behind every dark cloud there is a silver lining. No matters, global financial meltdown has spelled rain of disaster for US and the European economies in particular and the world economy in general. Astoundingly, in the time when developed economies were nerve-racking from financial crisis, the developing countries like India and China were still spending money in many developmental projects giving comprehensible testimony of rather looking for opportunities out of it when developed countries were crying. Behind this saga of global financial crisis we being, the rational creature has got something to unearth some positive impacts in addition to its negative impacts on one's economy. Notable positive impacts of 2007 episode of global financial crisis on Indian Economy are discussed as follows:

1. **Testimony of Superiority of Developing Economy over Developed Economy:** Surprisingly, this may possibly the first time during such crisis, India had made huge investment in developmental projects like launching of Chandrayaan-1 when, developed economies like US and European nations were worn-downing to overcome that situation. India has at least demonstrated that developing countries have some special strengths when world reels under financial crunch. In USA Lehman Brothers has filed for bankruptcy, Merrill Lynch has merged with Bank of America, Washington Mutual Operations was being apprehended by FDIC and Wachovia was being auctioned by Citigroup. In such terrific conditions, India was in a better place than developed countries. It is worth underlining that we have a number of companies reporting successes at then time. This happened because of little exposure of India to the new and innovative financial instruments that triggered the meltdown.

2. **Reduction in Headline Inflation:** Despite, bitter experience on

global financial meltdown, India has yet, many special advantages to be addressed as global financial crisis has reduced sharply headline inflation as measured by the wholesale price index, the prime factors behind the disinflations have been the falling of commodity prices. Decline in inflation has also been reviving consumer demand and reducing corporate input costs.

3. **Real Estate Market Price Cut:** Two mega builders association with around 3500 members each across the country namely, Confederation of Real Estate Developers Association of India (CREDAI) and National Real Estate Development Council (NREDC) have pleaded their members to cut prices of their properties. Builders felt that cutting down prices would spur buyers and restore confidence in them. This development would enable middle-class families to think of having their own homes which had become their distant dream because of unrealistic rise in real estate properties. Development of middle-class families would surely and positively affect Indian economy in long run. Because in comparison to any other country Indian middle-class families are significantly improving in monetary measures.

4. **Reformation of Wage and Salary Administration in IT Industry:** This financial crisis has a positive impact on the IT industry. There had been unprecedented rise in salaries and increments exhibited 25% to 30% salary hike per annum in Indian I.T industries. IT professionals were changing jobs frequently leaving bad impact on the job culture and reducing overall productivity of the industry. Since, Global financial crisis has touched Indian I.T sector making it to slowdown would ensured better quality of work, prevent attrition, reduced spending on recruitment, training and development and enhanced efficiency in this sector . Today, the IT professional will think twice before changing their jobs.

5. **Performance Appraisal is gaining ground:** With increasing customer expectations, global competition, costs of goods and services and above all because of global financial crisis, many companies struggle to meet profit forecasts making many companies to rely more heavily on quality human capital to increase consumer demands while decreasing operating costs.

So, Performance Appraisal is gaining its ground day by day in Indian corporate sector. As a result, everyone is ready to give 100% to his job because of fear of losing the job. Now as this financial crisis arises everyone is trying to save one's job. Deploying employee performance appraisal programs lead to measurable improvements in employee performance providing quality human capital in Indian industries.

6. **Opportunity for Cost Cutting:** Financial Crisis 2007 has made Govt. sectors and big private corporate sectors to follow the advice of Warren Buffet of austerity, advocating cost cutting to be the sole solution. Big MNCs and Indian corporate sector started to take second thought before spending reckless spending for employees' luxuries to promote their business. Financial crunch has forced the Indian companies to eliminate all forms of wastage and follow an austerity regime. It is now trying to tackle the issue of panic resulted out of depression by pumping massive amount of liquidity and confidence into the system.

7. **Opportunity of Indian Economy to hike FDI limit:** Financial crisis version 2007 has opened up opportunity to increase foreign direct investment in Indian banking and insurance sectors as multinational insurers and bankers are willing to invest more in India because of Indian unique economic governance that save her from being swayed away during financial crunch of 2007. India has now the best time and opportunity to increase FDI limit in insurance sector to 49%. Because of Indian's high credibility, Indian banks have opportunity to expand retail and other businesses abroad during this period of financial crisis.

8. **Top destination for Outsourcing:** As Obama's Govt. hold views that, American priority would be given to curb costs, which would include cutting wage expenditure and thereby, increasing outsource work to India. India continues to be the best place or top destination for outsourcing when developed nations reeled under financial crisis. Two important factors made India for best outsourcing destination. Firstly, Indian salary costs are exceptionally competitive. Secondly, Indian outsourcing firms have now matured into true global companies that can offer best services at competitive prices. India has been coming under top

outsourcing destinations with China, Brazil, Mexico, Malaysia and Chile. India has also the second lowest BPO salary base of $7,500-$8500 followed by China. Moreover, India is one of the largest producers of English-speaking graduates including management and engineering graduates that would definitely result in offering higher value-added services to the customers.

9. **Opportunities for International Trade:** In the arena of International Trade, India has huge opportunities for international trade. Today, countries all over the world are interested to trade with India may be because of losing confidence over developed nations after financial meltdown- 2007 and gaining confidence on Indian unique economic governance. Imports are expected to shrink more than exports; which will keep the current account deficit at modest levels. It will have a great impact on our foreign fund reserve and forex market.
10. **Higher Private Transfer, Software Earnings, Non-Resident Deposit Flows and Foreign Direct Investment:** India has experienced positive development on private transfer and software earnings. In addition, there has been growth in non-resident deposit flows and foreign direct investment into Indian economy. Higher FDI flows in 2008-09 were the reflection of the growing confidence of foreign investors in development prospects of the Indian economy.

Conclusion

The global financial crisis episode of 2007 has been sparked by excessive speculation, high risk loans and defective lending practices, boom and bust in the housing market, securitization, improper credit Rating, faulty government policies. Despite, bitter experience on global financial meltdown, India has yet, many advantages as global financial crisis has reduced sharply headline inflation, revived consumer demand, reduced corporate input costs, reduced imports etc,. The negative impact of the wealth loss affecting capital markets that have normally plagued the developed countries would not affect India because majority of Indians populace stay away from asset and equity markets. Interestingly, institutional credit for agriculture would also remain unaffected because of India's mandated priority sector lending. Indian agricultural sector would remain unaffected from the crisis due to the

government's farm waiver package. In addition to this, social safety program over the years would also remain outside the ring of fire of global financial crisis e.g, the genuis rural employment guarantee program would protect the poor and migrated indian from the adverse effects in the rural sector. Moreover, Indian rural area are not much closely integrated to industrial areas as in the case of developed countries that eventually, saved rural sector from being burnt up of this financial tragedy.

Therefore, once the global economy begins to recover, India's turn around will be sharper and swifter, because of its strong financial system and regulatory norms. However, Indian agricultural and rural economy may be caught under the fire of global financial crisis for which India needs well preparedness keeping special attention on formulation of sound economic policies, fiscal measures, monetary policy, and should create job opportunities and enhance income of the people. Thus, it is the crucial time for India to take lesson and to be alert and see that such crisis never takes place in India. Fortunately, India is taking both, conventional and unconventional measures to heal up the sore caused by the global financial crisis 2007 and even, well prepared to encounter harshness of such future financial crisis in the years to come.

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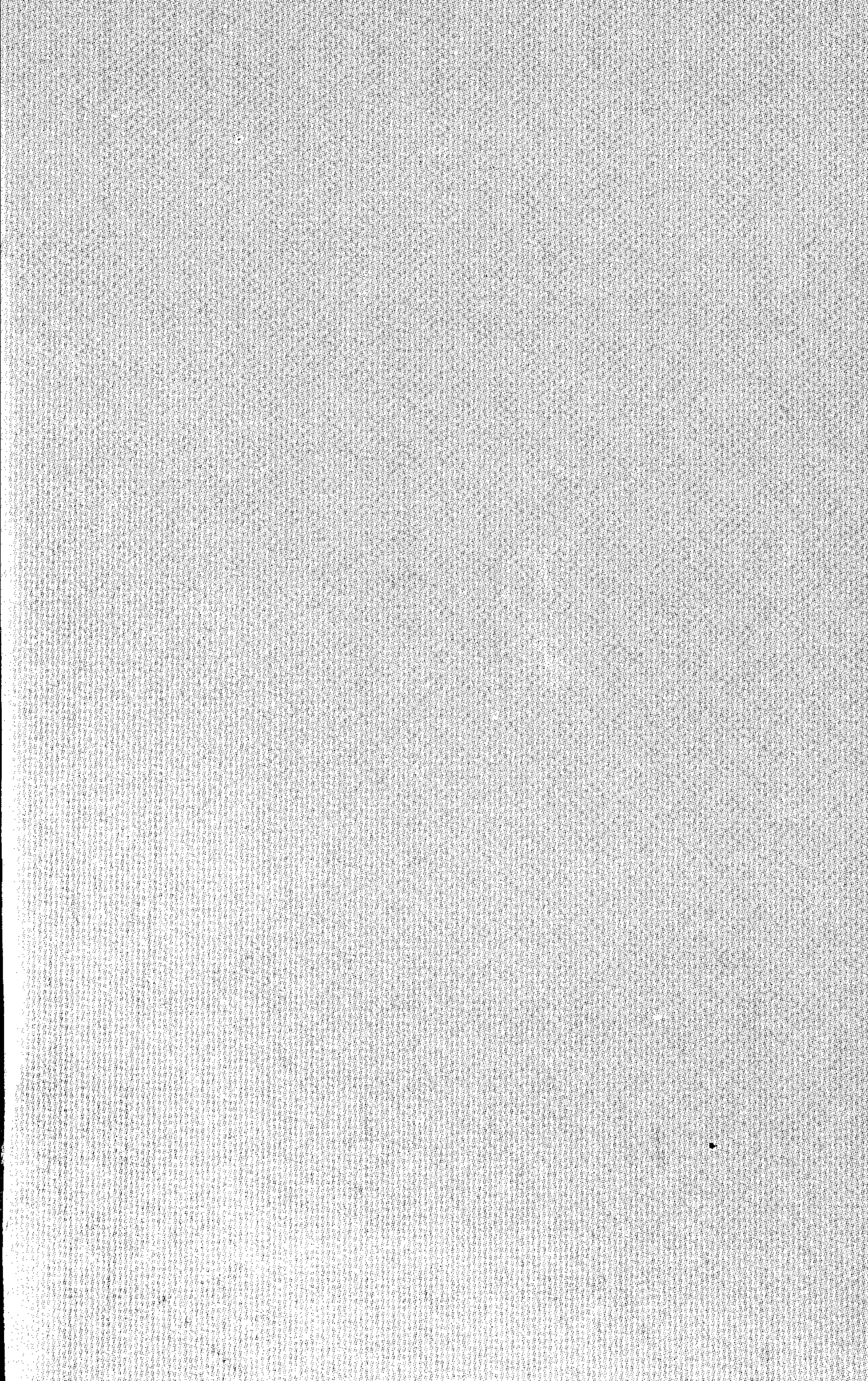

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The present volume is certainly directed to reflect these and many other hitherto unexpected areas based on scientific observation and empirical data. The papers included in this volume, depict the emerging social problems of the world, India and Northeast India and offer pragmatic views to establish a truly democratic society for promotion of total human welfare and create a scientific dialectical society.

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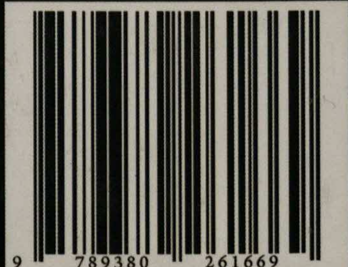

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