

# Budget TRACK

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## Foreword

The ongoing global economic recession, a direct fallout of the financial crisis that originated in the US, has affected not only the developed countries but also many developing and emerging economies across the world. The extent of the impact of this recession has varied across economies depending on their linkages with the global economy. However, it is now being recognized unanimously as the worst ever crisis of capitalism since the Great Depression of the 1920s and 1930s. Consequently, measures to deal with the recession have acquired centrality among the policymakers across the globe. In India too, one of the major challenges for the next Government at the Centre would be to tackle the impact of the economic recession on our economy. While our policymakers have been responsive to the demands of the private corporate sector affected by the economic downturn, many progressive thinkers, policy analysts and activists have raised concerns about their willingness to address the needs of the disadvantaged sections of India's population who have been hit hard with the recession.

In this backdrop, the present issue of *Budget Track* focuses on some of the important aspects of the impact of the global economic recession on India. The first article, *Tracking Policies and Budget of the Union Government*, scans the important developments relating to legislation, policies and budget at the level of the Union Government over the last few months. The second article, *Time to Tame Free Finance*, develops a perspective on the need for government regulation of the financial services sector, since the genesis of the ongoing recession has been in the unregulated financial sector of the developed economies which, over the last two decades, has spread to developing and emerging economies across the world. In India, the impact of the global recession has been felt both in the financial sector and the real sectors of the economy. The most glaring evidence of the latter has been a huge number of job losses in the country, which is highlighted in the third article, *Job Losses in the Wake of Economic Recession*. The fourth article, *Implications of the Recession on Public Resources and Expenditure*, draws our attention to the impact of the recession on Union Budget, which in turn could weaken many of the existing government interventions for socio-economic development in the country. The Union Government has introduced a number of policy packages, known as 'fiscal stimulus packages', since December last year to deal with the economic downturn. The fifth article, *Fiscal Stimulus Packages in India: An Assessment*, briefly examines these policy packages from the perspective of the disadvantaged sections of our population who have been worst hit by the recession. The sixth article, *G-20 and the Economic Recession: Where does India stand?*, presents an overview of the policy response to the recession advocated by some of the developed countries and India's position with regard to the same. The Guest Column by Prof. Jayati Ghosh, *The Economic Geography of Recession*, emphasizes the urgent need for policy measures to address the acute problems faced by farmers and migrant labourers who have been hit hard with the recession. The last piece in this issue, *The Economic Crisis from a Feminist Perspective*, is an international declaration for structural, sustainable, gender equitable and rights based responses to the ongoing global economic recession.

The articles included in this issue not only discuss some of the important facets of the impact of the global economic recession on India, they also present policy recommendations for the Union Government at the current juncture. We hope our effort would be useful in raising some of the pertinent concerns relating to the ongoing economic recession in the public domain.

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**T**his article tracks some of the important developments relating to legislations in Parliament, significant policy related developments in the Union Government and those pertaining to the Union Budget over the last few months.

### I. SOME IMPORTANT BILLS IN PARLIAMENT: OPPORTUNITIES GAINED AND LOST

The UPA government, during its five year-tenure, brought into existence some crucial legislations such as The National Rural Employment Guarantee Bill, 2005, The Right to Information Bill, 2005,

The passing of the crucial Unorganised Sector Workers' Social Security Bill, 2007 has been a landmark development, which had been long overdue and much awaited. This legislation would enable Central and State Governments to provide schemes for the social security of workers in the unorganised sector and entitle the unorganised sector workers, comprising almost 94 percent of the country's labour force, to some social security benefits.

However, several opportunities for legislation have been lost in the 14<sup>th</sup> Lok Sabha, since a number of relevant Bills have lapsed. These include the Scheduled Castes and the Scheduled Tribes

# Tracking Policies and Budget of the Union Government

-Trisha Agarwala

The Scheduled Tribes and Other Traditional Forest Dwellers (Recognition of Forest Rights) Bill, 2006, The Protection of Women from Domestic Violence Bill, 2005 and more recently The Unorganised Sector Workers' Social Security Bill, 2007. In the last few months, starting from October 2008 up to February 26, 2009 (last session of the 14<sup>th</sup> Lok Sabha), the important legislations which have been passed are as given below in Table 1.

**Table 1. Bills Passed Recently by Parliament (during the term of the 14<sup>th</sup> Lok Sabha)**

#### Some of the Bills Passed from September 2008 – January 2009

The Constitution (Scheduled Tribes) (Union Territories) Order (Amendment) Bill, 2007
The Collection of Statistics Bill, 2007
The Code of Criminal Procedure (Amendment) Bill, 2006
The Gram Nyayalayas Bill, 2008
The Unorganised Sector Workers' Social Security Bill, 2007
The Central Universities Bill, 2009

(Reservation in Posts and Services) Bill, 2008; The Rehabilitation and Resettlement Bill, 2007; The Land Acquisition (Amendment) Bill, 2007; The Workmen's Compensation (Amendment) Bill, 2008, and The Employees State Insurance (Amendment) Bill, 2008 (Table 2.) This shows that some of the crucial legislative issues, having a significant bearing on the disadvantaged sections of our population, have been pushed to the background yet again; the marginalized sections, the landless, the tribal communities and labourers have been overlooked as always.

The Rehabilitation and Resettlement Bill, 2007 and The Land Acquisition Amendment Bill, 2008 were referred to a Group of Ministers (GoM) of the Union Government, since these Bills were complex in nature. They were introduced in the Parliament in December, 2008. The Standing Committee on Rural Development had submitted its recommendations on both these Bills in October 2008. The new government at the centre must take up these Bills in its Parliament Session.

**Table 2. Bills Lapsing in Lok Sabha at the end of its term**

### Bills Lapsing

The Scheduled Castes and the Scheduled Tribes (Reservation in Posts and Services) Bill, 2008

The National Commission for Minority Educational Institutions (Amendment) Bill The Employees State Insurance (Amendment) Bill, 2008

The Workmen's Compensation (Amendment) Bill, 2008

The Rehabilitation and Resettlement Bill, 2007

The Land Acquisition (Amendment) Bill, 2007

The National Commission for Minorities (Repeal) Bill, 2004

Source: PRS Legislative Research

Another significant cause of disappointment is the repeated failure of the Parliamentary Committee on Women's Reservation Bill to come up with a decision on the issue of 33 percent reservation for women in the Central and State legislature. The Women's Reservation Bill was cleared by a Joint Parliamentary Committee in 1996, and introduced in the Rajya Sabha in December 2008, having survived a long history of bitter and varied opposition. Further action on it would follow once the said Committee submits its report, which seems unlikely before the upcoming general elections.

The Bills pending in Rajya Sabha (at the end of the term of the 14<sup>th</sup> Lok Sabha) are given in Table 3. One of the significant opportunities lost by the outgoing government has been its failure to pass The Right of Children to Free and Compulsory Education Bill, 2008. It was only in 2002 that education was made a fundamental right (for all those between 6 and 14 years of age), in the 86<sup>th</sup> amendment to the Constitution. In 2004, the National Democratic Alliance (NDA) drafted a Bill but lost the election before it could be introduced. The Model Bill drafted by the United Progressive Alliance (UPA) was then tossed back and forth between the Centre and the States, mainly over matters of funding and responsibility. The Union Cabinet finally cleared the Right to Education Bill in December 2008. However, we must take into account the fact that the introduction of this Bill had come after several futile efforts for the enabling legislation without which the fundamental right, enacted in December 2002, cannot come into effect. Besides giving every child, between 6 to 14 years of age, the right to free and compulsory education, the Bill also seeks to develop norms and standards

for primary education; complete with minimum qualifications for teachers, pupil-teacher ratio, and a ban on private tuitions by teachers. Only time will tell whether this crucial Bill gets passed in the next session which is after the general elections.

The other Bills that are pending are The Plantations Labour (Amendment) Bill, 2008, The Communal Violence (Prevention, Control and Rehabilitation of Victims) Bill, 2005, The Provisions of the Municipalities (Extension to the Scheduled Areas) Bill, 2001 and The Drugs and Cosmetics (Amendment) Bill, 2007. All these Bills, if passed, could have had a direct bearing on the health, security and economic status of a vast majority of our population.

**Table 3. Bills Pending in Rajya Sabha at the end of the term of the 14<sup>th</sup> Lok Sabha**

### Bills Pending

The Right of Children to Free and Compulsory Education Bill, 2008

The Plantations Labour (Amendment) Bill, 2008

The Communal Violence (Prevention, Control and Rehabilitation of Victims) Bill, 2005

The Provisions of the Municipalities (Extension to the Scheduled Areas) Bill, 2001

The Drugs and Cosmetics (Amendment) Bill, 2007

The Insurance Laws (Amendment) Bill, 2008

The Life Insurance Corporation (Amendment) Bill, 2008

Source: PRS Legislative Research

A noteworthy indicator of the functioning of Parliament is the number of sittings it had in a year. Up till end of 2008, both the houses had met for around 50 days only; which was the lowest in its history. This happened in a year which witnessed a number of serious economic, social and political issues; and there was a strong expectation from the Members of Parliament to meet more frequently for cohesive thinking in order to deal with those issues. In fact, there has also been a political consensus that Parliament should meet for a minimum of 100 days in a year.

We must note here that on December 24, 2008, the Lok Sabha passed 8 Bills in 17 minutes, without debate, clearly displaying the bleak state of affairs in our Parliament. The Bills that were passed in such a hurried manner pertained to the Post-Graduate Institute of Medical Education and Research, Chandigarh; amendments to the

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“on December 24, 2008, the Lok Sabha passed 8 Bills in 17 minutes, without debate, clearly displaying the bleak state of affairs in our Parliament”

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Prevention of Corruption Act; Agricultural and Processed Food Products Export Development Authority Amendment Bill; Compensatory Afforestation Act; Constitution (Scheduled Tribes) UT Order (Amendment); South Asian University Bill; Code of Criminal Procedure Amendment Bill and Collection of Statistics Bill. Some experts have attributed this inconsistency to political blockades and also the keenness of the government to avoid, in some cases, the possibility of a no-trust vote being moved by the opposition. In 2009, Parliament reassembled in February for a five-day session prior to the forthcoming elections. The five-day session included the announcement of the Interim Budget 2009-10, which would be discussed briefly later in this article.

### II. IMPORTANT POLICY RELATED DEVELOPMENTS IN THE UNION GOVERNMENT

#### a) Government recognizes the need for improving its Financial Management and Programme Delivery

An International Conference on "Public Financial Management for Improving Programme Delivery" was held from October 20 to 22, 2008 in New Delhi. It was organised by the Controller General of Accounts, Government of India, in an effort to provide a common platform to the public financial managers and various stakeholders for learning, dissemination of information and assimilation of the latest international experiences on the subject of public financial management. In the Indian context, public financial management generally includes budget planning and preparation, appropriations (from the Consolidated Fund of India) by the executive, expenditure monitoring and control, financial reporting, audit and evaluation.

Mr. V.N. Kaila, the Controller General of Accounts (CGA), observed that reforms in public financial management to streamline public delivery systems are extremely crucial. He added that several initiatives have been taken towards improving efficiency in areas of public financial management in the Government of India, which were started by the CGA. He opined that performance monitoring, making the executive accountable through a transparent system, and mapping of results are important issues to be deliberated upon.

The Comptroller & Auditor General (C&AG), Mr. Vinod Rai, emphasised that efficient

management of financial resources is vital for ensuring improved programme delivery. Allocating priorities, encouraging financial accountability, focusing on outcomes, improving financial management and accountability in Centrally Sponsored Schemes, addressing distortions in financial position and integration between project planning and budgeting were some of the important issues highlighted by Mr. Rai.

The Deputy Chairman of the Planning Commission, Mr. Montek Singh Ahluwalia, said that even a perfect financial tracking system does not tell us whether a scheme is optimally designed; which can be done only by audit. But, he added that, even then it is difficult to draw a connection between the scheme aimed at improving certain indicators and the actually observed improvements in the indicators being directly attributable to the scheme. This, he observed, is because the improvements in the indicators could be due to the scheme or due to other factors unconnected to the scheme. He also pointed to the fact that plan categories do not match with the budget categories and there is a need to bring plan/programme details in line with budgetary classifications so that the budgetary flow of funds can be easily tracked.

The Conference brought to light the significance of financial management in programme delivery and the importance of tracking fund flow in an attempt to measure outcomes. However, one is yet to see to what extent this would be applied in practice or whether it was just another occasion in the government's yearly calendar of events!

#### b) Comptroller and Auditor General (C&AG) criticizes the lack of transparency in Government's Accounts

In a Report on Union Government Accounts for 2007-08 (Compliance Audit, Report No.13, C&AG), the C&AG has commented on the opaqueness of government's accounts. Scrutiny of Union Government Finance Accounts 2007-08 has disclosed that a sum as high as Rs. 20,273.52 crore was classified under the Minor Head '800-Other expenditure' in the accounts constituting more than 50 percent of the total expenditure recorded under the respective Major Heads (under a total of 28 Major Heads of accounts representing different functions of the Government). This shows that the existing structure of the Government Accounts does not truly reflect the current activities of the Government in a number of Ministries/Departments. It has been, therefore, recommended by the C&AG that the Government may conduct

"the existing structure of the Government Accounts does not truly reflect the current activities of the Government in a number of Ministries/Departments"

a comprehensive review of the structure of Government Accounts to address this deficiency for ensuring greater transparency in financial reporting.

**c) C&AG highlights the low reliability of expenditure figures in Centrally Sponsored Schemes**

The C&AG (in its Compliance Audit, Report No.13, for Union Government Accounts for 2007-08) has pointed out that there are numerous Centrally Sponsored Schemes (CSS) for poverty alleviation, health care, education, employment and sanitation etc. in which the Central share of funds used to be transferred earlier through the State Governments' Treasury, but now, the Central share of funds in these schemes is being transferred directly to the bank accounts of State/district level autonomous societies, bypassing the State Budgets and State Governments' Treasury. In many cases, these autonomous societies (who are implementing the CSS) show funds disbursed to the next level as expenditures even though a part of the funds disbursed might be remaining unspent in the bank accounts at some level. Hence, the C&AG notes that the expenditure figures for these CSS, as reported by the Central Government Ministries, may not be accurate, rather they might be overstating the actual expenditures.

**d) Performance Appraisal of NREGS**

The C&AG undertook a Performance Audit of the implementation of National Rural Employment Guarantee Scheme (NREGS) in 558 Gram Panchayats (GPs) in 141 blocks spread across 68 districts in 26 States from February 2006 to March 2007. The highlights of the C&AG findings (as reported in C&AG's *Performance Audit Report No. 11, 2008*) are as given below:

- The figures for employment demanded and that provided as reported by the Ministry of Rural Development are not very reliable and verifiable, since record keeping at the GP level was found to be very poor. There were chances that only a part of the demand for work under NREGS had been captured in the government records.
- The maintenance of basic records at the GP and Block levels was poor, as a result of which the authenticity of the figures of employment demanded, employment provided, number of days of employment generated, entitlement for employment allowance etc. could not be verified in audit. Significant

deficiencies were also noticed in maintenance of Muster Rolls.

- There were significant delays in affixing of photographs on job cards, which is meant to be an important control against fraud and misrepresentation.
- The eligibility of rural households for unemployment allowance was unverifiable in cases where applications for demand for work were not documented or dated.
- There were several cases of delayed payment of wages for which no compensation was given. There were also cases of non-payment of unemployment allowance.
- At the Block and GP levels, full-time Programme Officers and Gram Rozgar Sewaks were not appointed showing insufficient deployment of human resources for the scheme. This had an adverse impact on record maintenance at GP level, which made it difficult to verify compliance with the legal guarantee of 100 days of employment on demand.
- There were deficiencies in the preparation of the 5 year District Perspective Plans (DPPs).
- Most States had not prepared District-wise Schedule of Rates and had adopted the Schedule of Rates of PWD/Rural Development Department instead; this may not ensure minimum wages for seven hours of work by women labourers.
- The systems for financial management and tracking were found to be deficient. Many instances of diversion, mis-utilisation of funds and non-rendering of Utilisation Certificates and expenditure details were noticed.
- The status of inspection of works at the State, District and Block levels was poor. Most States had not designated State and District Quality Monitors and in most cases, Gram Sabha was not held twice a year to conduct Social Audit Forums.

**e) Performance Appraisal of Mid Day Meal Scheme**

The performance audit of National Programme for Nutritional Support to Primary Education (Mid Day Meal Scheme) was taken up by the C&AG to examine the implementation of the scheme and suggest ways whereby the delivery of the scheme

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“the C&AG notes that the expenditure figures for these CSS, as reported by the Central Government Ministries, may not be accurate, rather they might be overstating the actual expenditures”

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can be improved and direct and indirect outcomes can be measured and evaluated. The highlights of the C&AG findings (as reported in C&AG's *Performance Audit Report No. 13, 2008*) are as given below:

- Although the scheme has been running for more than a decade now, there is still a lack of clarity regarding the objectives to be achieved by it. Since September 2006, there has been a qualitative shift in the focus of the scheme from education to nutrition and health.
- Ministry of Human Resource Development (of the Central Government) had not assessed the impact of the scheme in terms of increase in enrolment rates, attendance and retention levels of children which may have been influenced by the scheme.
- The Ministry has been unable to establish a system of reliable data collection and reporting by the States. Many states resorted to over reporting of the enrolment while projecting the requirement of funds under the scheme. There was no system of cross checking the data of enrolment furnished by the State Governments.
- The Ministry had not collected data on the nutritional status of children covered under the scheme even after the objectives were revised in 2006, nor were its linkages with the Ministry of Health and Family Welfare for the health check ups followed up. In most States, the children were not administered micro nutrient supplements and de-worming medicines.
- Weak internal controls and monitoring in the implementation of the scheme was found across the country. The Steering and Monitoring Committees set up by the Ministry to monitor the scheme at national and State level did not meet regularly. This irregularity was found to be more serious at the State level.
- In the schools covered within C&AG's sampling, regular inspections to ensure the overall quality of mid-day meal served were not carried out and nor were basic records on issue and receipt of foodgrains and evidence of community participation (through village education committees and parent teacher associations) maintained.
- At the level of scheme implementation, States pointed out leakages, deficient infrastructure, delayed release of funds and

inflated transportation costs etc. as the problems.

- In many instances, teachers had to spend significant time in supervising the cooking and serving of meals which resulted in loss of teaching hours.

### f) Performance Appraisal of Accelerated Rural Water Supply Programme

A performance audit of the implementation of Accelerated Rural Water Supply Programme (ARWSP) in 26 States, covering the period from April 2002 to March 2007, was carried out by the C&AG between June and October 2007. The highlights of the C&AG findings (as reported in C&AG's *Performance Audit Report No. 12, 2008*) are as given below:

- Although, public investment worth more than Rs. 66,000 crore has been made in the rural water supply sector since the First Five Year Plan, problems like slip back of fully-covered habitations and re-emergence of problem habitations persist in this sector even now.
- Significant deficiencies in the 2003 National Habitation Survey carried out in the States have adversely affected the reliability of the survey data and its utility for planning purposes.
- Annual Action Plans (AAPs) in many States were not based on any detailed and comprehensive habitation-wise analysis. Consequently, targets were fixed in an ad hoc manner, which adversely impacted the coverage of problem habitations under the programme.
- There were several instances of deficient financial control, besides instances of inadmissible expenditure and diversion of ARWSP funds in several States.
- Numerous deficiencies in execution and implementation of works were found such as time and cost overrun, non-completion/delayed completion of works, non-functional/defunct works, incorrect prioritization of works and other cases of wasteful and unfruitful expenditure.
- States were not paying adequate attention to water quality, with inadequate infrastructure for testing at the district level and non-compliance with the periodic testing requirements. Distribution and utilization of field testing kits at the village level was also poor and projects under the Water Quality

Sub-Mission were often delayed or non-functional.

- Many States did not take adequate measures for ensuring sustainability of water resources, especially ground water. The proportion of schemes relying on ground water sources was very high.
- There were significant deficiencies in the implementation of the Swajaldhara scheme, which is designed to be demand-driven and participatory. In many cases, the beneficiary contribution, which is at the core of Swajaldhara, had not been fully received. Further, there were numerous cases of non-execution and delayed execution of Swajaldhara schemes.

### III. UNION GOVERNMENT'S RESPONSE TO THE ONGOING ECONOMIC RECESSION

The financial crisis, which had originated in 2007 in the United States, has led to a full scale economic recession across the globe. The impact of the global economic recession has been felt in India not only in the financial sector but also in the real sectors of the economy. Subsequent articles in this issue of Budget Track deal with some of the important aspects of the impact of this economic recession on India and the response of the Union Government to the same.

Here, we present a brief overview of some the measures taken by the Union Government over the last few months in response to the recession:

- The Union Government has introduced three Fiscal Stimulus Packages during December 2008 to February 2009 in order to deal with the recessionary impact on Indian economy (a detailed analysis of these packages is presented in one of the subsequent articles of this issue).

Other steps taken by the Union Government since October 2008 (as reported by the Press Information Bureau in January 2009) are the following:

- Additional plan expenditure to the tune of Rs. 20,000 crore in the fiscal year 2008-09, mainly for critical rural, infrastructure and social security schemes such as Pradhan Mantri Gram Sadak Yojana (PMGSY), Jawaharlal Nehru National Urban Renewal Mission (JNNURM), National Rural Employment Guarantee Scheme (NREGS), Indira Awaas Yojana (IAY), Accelerated Irrigation Benefit Programme (AIBP) and National Social Assistance Programme (NSAP).

- Several measures to support exports; housing; Micro, Small & Medium Enterprises (MSME); and textile sectors.
- Authorizing India Infrastructure Finance Company Limited (IIFCL) to raise Rs. 10,000 cr. to refinance bank lending for infrastructure projects.
- To help maintain the momentum of public expenditure at the State level, State Governments have been allowed to raise additional market borrowings worth 0.5 percent of their Gross State Domestic Product (GSDP), estimated to be about Rs. 30,000 crore, for capital expenditures in 2008-09.
- The Union Government would encourage State Governments to release land for low income and middle income housing schemes.
- Government would try to expedite the pace of expenditure under all of its programmes and schemes. It would set up a fast track monitoring committee to ensure speedy approval and implementation of central projects.

### IV. UNION GOVERNMENT'S INTERIM BUDGET 2009-10

The Interim Budget for 2009-10 has been presented at a crucial juncture, when the country is grappling with the wide-ranging consequences of the global economic recession and it is also gearing up to elect the next government at the Centre. Although the proposals made in the Interim Budget 2009-10 would be applicable only for a period of two to three months, starting April 2009 (i.e. until the next Union Government presents and enacts the full budget for 2009-10), the figures/ estimates have been presented in this Interim Budget for the whole of the financial year 2009-10.

The Interim Budget has estimated the total expenditure for fiscal year 2009-10 to be at Rs. 9,53,231 crore, which includes a provision of Rs. 2,85,149 crore under Plan and Rs. 6,68,082 crore under Non-plan expenditure by the Union Government.

The Union Finance Minister, Mr. Pranab Mukherjee, has said that the Plan allocations under various heads (provided in the Budget Estimates for 2009-10) were limited to the allocations made in the Budget Estimates for 2008-09, plus additional amounts on account of the fiscal stimulus packages announced in 2008-09. These additional expenditures on fiscal stimulus packages have also got reflected in the Revised Estimates for 2008-

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“The government has relied mainly on infrastructure projects and a significant number of these are proposed to be through Public Private Partnership (PPP)”

“Many progressive economists and organisations like CBGA had earlier pointed out the arbitrariness of the targets set under FRBM and sought to scrap the Act”

09. It also reflected a modest increase in Central Assistance to the States to enable them to complement their budgetary resources. The 2009-10 Budget Estimate of the total Gross Budgetary Support (GBS) for the Plan, at Rs.2,85,149 crore, is 17.2 percent higher than the 2008-09 Budget Estimate for the total GBS for Plan.

The increase in the GBS for Plan in 2009-10 (BE), as compared to the 2008-09 (BE), is mainly for programmes/ schemes under Department of Rural Development, Department of Road Transport and Highways, Ministry of Railways, Ministry of Power, Department of Industrial Policy and Promotion, and Department of Information Technology. This, according to Mr. Mukherjee, has been proposed in order to maintain the momentum of increased public spending by the Union Government to deal with the economic recession and meet the requirements of rural and infrastructure development.

It has been pointed out that instead of significantly stepping up public spending to generate demand, the Union Government, has focused more on bailing out the private sector with the hope that it will contribute to the growth in the medium term. The government has relied mainly on infrastructure projects and a significant number of these are proposed to be through Public Private Partnership (PPP). The PPP mode of investment cannot be expected to safeguard the interests of the marginalised sections of India's population.

With the Interim Budget, the UPA has cleverly dumped the Fiscal Responsibility and Budget Management (FRBM) Act targets to cope with the huge decline in revenue collections for the financial year 2008-09. This is in complete contrast to their eagerness to implement the FRBM targets over the last five years, during which there was a significant increase in tax revenue collections and Union Government's spending on social sectors could have been stepped up substantially if only the government

had ignored the FRBM targets for deficit reduction. Many progressive economists and organisations like CBGA had earlier pointed out the arbitrariness of the targets set under FRBM and sought to scrap the Act.

The Interim Budget has made no proposal to increase spending on social sectors. The allocations for flagship schemes like Sarva Shiksha Abhiyan (SSA) and National Rural Health Mission (NRHM) have remained stagnant as compared to 2008-09 (RE). The promise to increase public spending on education to 6 percent of the GDP has remained as elusive now as it was in 2004-05. The government has failed to enact the Right to Education Bill that was recognized as a fundamental step towards ensuring universal quality education for all children in the 6 to 14 years age group. The total public spending on health has hovered around 1 percent of GDP in the last 5 years, while the UPA had promised in its National Common Minimum Programme (NCMP) that the same would be increased to the level of 2 to 3 percent of GDP. Even after 5 years, the UPA has failed to ensure food security to a majority of the population. The much needed Central food subsidy has shown a decline of 2.6 percent in 2009-10 (BE) as against the allocation in 2008-09 RE. There have been substantive reductions in the already meager allocations for women in Budget 2009-10. Allocations in 2009-10 (BE) for schemes on “women's welfare”, under the Ministry of Women and Child Development, are lower than those in 2008-09 and some of these schemes have seen a steep decline of 50 percent in their allocations. The overall allocations made under the Ministry of Minority Affairs for implementing various schemes have declined steeply by 35 percent in 2008-09 (RE) as compared to the 2008-09 (BE). Thus, a close look at the UPA Government's spending on social sectors and on programmes/ schemes meant for some of the disadvantaged sections of the population reveals the deficiencies in their policy priorities.

The recent crisis in global financial markets has clearly demonstrated the shortcomings of a deregulated financial regime. The crisis, although it erupted in the core of the capitalist system, has severely impaired the health of all economies. Indian economy, which was initially thought to have remained unscratched from this crisis, has witnessed a tailspin after the meltdown of the world financial system in September 2008 (although sobering tendencies could be observed from the beginning of the previous year itself). Almost all indicators of economic activity— GDP growth rate, exports, employment— have deteriorated in the last few months.

and its resources were channelled to priority sectors like agriculture and small industries. To ensure that the system was internally consistent and the bulk of the savings were channelled to the banking system, wide array of controls were imposed on the financial instruments available to savers. This, in turn, meant restricting the size of the stock and bond markets. Needless to say, control over speculative foreign investment flows was an integral part of this strategy.

Financial liberalisation is a catchall phrase for policies that result in dismantling of government control over financial sector and increase the space for private players within the financial

# Time to Tame Free Finance

-Vineet Kohli\*

What are the channels through which global crisis has affected the Indian economy? Exports, needless to say, shrank as a result of contracting world demand. At the same time, India's integration with the world financial system led to massive deflation of domestic stock prices as foreign investors dumped equity on Indian stock markets to make good their financial losses caused by the sub-prime crisis. Exodus of foreign institutional investment (FII) eroded the value of rupee and led to liquidity crunch in the economy. The risks were higher this time since financial institutions (such as mutual funds and Non-Bank Financial Companies or NBFCs) that faced liquidity crisis are not regulated by the Central bank. The crisis has thus highlighted the risks posed by sudden outflow of foreign investment, the accompanying crunch in domestic liquidity and the activities of unregulated financial entities. These risks have arisen because of the developments in the financial markets under the rubric of financial liberalisation.

## UNDERSTANDING FINANCIAL LIBERALISATION

Prior to initiation of economic reforms in 1991, Indian financial sector was designed to meet the overall goals of planned development. For this reason, the banking system was publicly owned

system. This means that with financial liberalisation, banking system faces less control on the assets it can acquire and savers have greater choice to invest in instruments like stock, bonds, derivative products etc. This also means sanctioning new financial institutions like mutual funds and non-bank finance companies that virtually face no restrictions on their choice of asset portfolio. At the same time, firms have a greater menu of liabilities to choose from; in particular they can scout for funds outside India through External Commercial Borrowings (ECB) and American Depository Receipts (ADR) route. The most talked about element of financial liberalisation in India has been the opening up of Indian economy to hot money flows in the form of foreign institutional investment (FII).

Financial liberalisation in a developing country like India can be attacked on two fronts. Firstly, as has been widely acknowledged, financial liberalisation leads to squeezing of credit to small borrowers and petty producers. The drying up of institutional credit in rural areas has forced farmers to rely on higher cost credit from exploitative money lenders and has significantly contributed to agrarian distress and peasant suicides throughout the country. Secondly, financial liberalisation, especially the free play of thinly regulated non-bank institutions and volatile

\* Economist, IDEAS, New Delhi. These are author's personal views and should not be ascribed to the organization he works for.

## Time to Tame Free Finance

“As foreign investors deserted the Indian stock market, stock prices fell and the value of rupee came under considerable pressure”

“Particularly drastic is the reduction in FII whose contribution has turned from a large positive in 2007-08 to a significant negative in 2008-09”

capital flows, increase the fragility of the financial system and expose it to dislocations that can have serious real implications. It is this second aspect of Indian financial sector that will detain our attention in the following.

### GLOBAL CRISIS EXPOSES THE FRAILTY OF THE INDIAN FINANCIAL SYSTEM

Although the origins of the recent crisis can be traced to summer of 2007, the crisis reached its peak in September 2008 when some of the biggest investment banks in US finally admitted that they could not continue in business any further. Some went bankrupt, others became bank holding companies and still others had to be put on government lifeline. The downfall of large investment banks sent shockwaves throughout the US financial system. Distrust between market participants grew so much that credit markets in the US virtually froze. Unable to meet their requirements for funds from credit markets, investors were forced to sell assets. Since portfolios of large investors usually include assets from across the world, forced sale of assets resulted in a fall in asset prices in many countries. Particularly affected through this channel were emerging markets like India that had been successful in attracting short term foreign investment prior to the crisis.

As foreign investors deserted the Indian stock market, stock prices fell and the value of rupee came under considerable pressure. To illustrate this point, we have taken some figures on net capital

flows from the Reserve Bank Bulletin (Table 1).

It emerges from these figures that almost all forms of foreign investments have suffered due to the crisis. Particularly drastic is the reduction in FII whose contribution has turned from a large positive in 2007-08 to a significant negative in 2008-09. In the third quarter of 2007-08, for example, India received FII worth \$ 14,851 million. The corresponding figure for 2008-09 is an outflow worth \$ 5,794 million. Such massive and sudden outflow of foreign capital had several implications for the Indian economy.

Firstly, stock prices received unprecedented hammering and this affected everyone including domestic financial institutions, brokers and households with significant exposure to stocks.

Secondly, as foreign investors tried to convert rupees into dollars on their way out of the country, they increased the demand for dollars and its value in terms of rupees. In other words they caused, what is known in economics as depreciation of rupee. Clearly, the Reserve Bank of India (RBI) does not like to see rupee depreciating too much. There may be many reasons but at least two seem rather straightforward- if more rupees are to be shelled out for one dollar, imported goods (that have to be paid for in dollars) become more expensive in rupee terms; therefore, depreciation of rupee exposes the economy to a possible inflationary threat that the RBI is supposed to check. Moreover, depreciation also increases the rupee value of foreign debt. Companies that take debt outside India through

Table 1: Net Capital Flows (US\$ million)

Item	April-June		July-September		October-December	
	2007-08 (PR)	2008-09 (PR)	2007-08 (PR)	2008-09 (PR)	2007-08 (PR)	2008-09 (P)
	2	3	4	5	6	7
1. Foreign Direct Investment	2,736	8,989	2,128	5,564	2,041	820
Inward FDI	7,457	11,891	4,709	8,782	7,873	6,684
Outward FDI	4,721	2,902	2,581	3,218	5,832	5,864
2. Portfolio Investment	7,542	-4,211	10,899	-1,310	14,851	-5,820
of which						
FIIs	7,089	-5,177	8,419	-1,438	8,964	-5,794
ADRs/GDRs	316	999	2,477	136	5,597	7
3. External Assistance	241	351	468	518	565	992
4. External Commercial Borrowings	6,953	1,480	4,210	1,751	6,247	3,883
5. NRI Deposits	-447	814	369	259	-853	1,042
6. Banking Capital excluding NRI Deposits	-472	1,882	6,274	1,872	1060	-5,998
7. Short-term Trade Credit	1,962	2,397	4,627	1292	4,130	-3,142
8. Rupee Debt Service	-43	-30	-2	-3	0	0
9. Other Capital	-680	-549	4,182	-2,091	2,976	4,540
Total (1 to 9)	17,792	11,123	33,155	7,852	31,017	-3,683

P: Preliminary. PR: Partially Revised.

Source: RBI Bulletin, April 17, 2009

the ECB route will find that the value of their debt has increased without any increase in the value of their assets. Such erosion in the quality of balance sheet of companies can deter their investment plans with serious implications for economic growth.

Thirdly, there were implications of the RBI intervention to check depreciation of rupee. Specifically, RBI tried to arrest the depreciation of rupee by selling dollars in the currency market. Since dollars are sold against rupees, the amount of dollars that the RBI infuses into the system is equal to the amount of rupees that it sucks out of it. RBI's intervention in the currency market created "shortage of rupees". As a result, interest rate in call market, in which banks with surplus cash provide short term lending to deficit banks, hit the stratosphere. On some days in September and October, this short term interest rate was as high as 20 percent. Not surprisingly, with such high short term interest costs, banks found it difficult to borrow from each other and to lend to borrowers outside the banking system. In this manner, problems shifted from banking system to the rest of the financial sector.

Many channels may have been at work here but the one that attracted considerable attention was the influence of falling credit (or even the perception of such a decline) on corporate behaviour. In the recent years, corporates have invested their short term cash surpluses in fixed income mutual funds. These mutual funds allow withdrawal of investment at short notice but invest in securities with significantly longer maturity. As uncertainty regarding the availability of credit from the banking system developed, corporates and other businesses decided to withdraw surplus cash invested in mutual funds. But invested in significantly longer term assets, these institutions found it difficult to redeem their liabilities. Some mutual funds even responded to the situation by putting a cap on the amount of redemptions. Investors began to doubt whether mutual funds are simply facing shortage of cash or whether their asset portfolios have become non-performing. This suspicion was not unreasonable (although the realisation came late) since mutual funds face virtually no restriction on their assets. They can invest any amount they want in real estate, capital markets etc. All in all, with massive redemptions, the business model of mutual funds has gone kaput. For the period April to December of 2008, mutual funds have witnessed a net outflow of Rs 30,432 crore<sup>1</sup>.

But with mutual funds facing difficulties, another set of unregulated financial entities namely non-

bank finance companies (NBFCs) got into trouble. NBFCs are similar to banks in that they are in the business of lending. On the liability side, they rely on retail deposits and commercial paper sold to both banks and mutual funds. But with mutual funds getting into problems, NBFCs found it difficult to obtain funds to continue business. The problem with NBFCs is that like mutual funds, their assets are of a significantly longer maturity than their liabilities. More than 50 percent of NBFCs' borrowings have maturities of less than one year, while most of the assets have tenures of about three years<sup>2</sup>. As funding dried up, NBFCs found it increasingly difficult to continue in business and to hold on to their longer-term assets. Moreover, as in the case of mutual funds, doubts were raised about the quality of assets held by these institutions. Needless to point, these institutions face no restrictions on their asset holdings. They were exposed both to capital markets through loans to investors as well as to the risky real estate sector. As a result of funding problems, disbursements of NBFCs suffered heavily leading to significant squeeze of credit for sectors dependent on NBFCs for credit.

All in all, the recent crisis has exposed the frailty of Indian financial system on various fronts. There are risks posed by sudden outflow of FII on the value of currency and domestic credit availability. There are risks posed by the dependence of mutual funds and NBFCs on maturity mismatch (the practice of using short term debt to finance acquisition of longer term assets) and their investments in risky sectors like real estate and capital markets.

Some clear lessons follow from the previous discussion on the need to re-regulate the financial sector. Firstly, India's vulnerability to hot money flows needs to be curbed. To this effect, some degree of capital controls should be implemented. In the aftermath of the crisis there has been a tendency on the part of some policymakers to undermine the risk posed by such flighty foreign capital. Their complacency stems from the large foreign exchange reserves held by the RBI. But foreign exchange reserves are large because capital started flowing out in 2008 after the country had received large inflows for almost four years since 2004. The situation would not have been as rosy had inflows started later, say sometime in 2007 and reversed soon thereafter in 2008. In event of such a scenario, RBI would not have enjoyed the reserve cushion it enjoys today and the economy would have been teetering on the brink of a serious external crisis. The conclusion that some degree of capital controls has become necessary is thus inescapable.

## Time to Tame Free Finance

"the recent crisis has exposed the frailty of Indian financial system on various fronts"

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## Time to Tame Free Finance

“ Instead of controlling capital flows, it has responded to the crisis by liberalising foreign investment regulations further”

Secondly, the crisis has highlighted the need to regulate non-bank entities. Non-bank entities run the risk due to the maturity mismatch. Commercial banks also run this risk since deposits are freely withdrawable but loans are longer term. However, commercial banks are better regulated in this regard; they are mandatorily required to hold reserves in cash and near-cash forms, their deposits are insured and most importantly they can fall back on the Reserve Bank for funds whenever other sources of funds dry up. These cushions are not available to non-bank entities so the risk is much greater. An obvious regulatory conclusion is that non-bank entities should be regulated in the same manner as banks; at the very minimum they should be asked to hold some form of their assets in cash and securities that are easily convertible into cash<sup>1</sup>. Secondly, in spite of the maturity mismatch, public confidence in commercial banks stems from the fact that their exposure to sensitive sectors like capital markets and real estate is much smaller (although much larger when compared to pre-reform years) compared to non-bank entities. Therefore, caps on exposure of these non-bank entities to sensitive sectors needs to be introduced. Reserve

requirements, by imposing costs in the form of idle cash holdings, and caps on sensitive sector investment, by reducing their ability to assume risks, will reduce the potential of these entities to generate returns superior to commercial banks and limit their future growth. But if their growth is not checked now, such institutions may become so large in future that their failure will have serious implications for the stability of the entire financial system.

The above proposals to re-regulate the Indian financial system require the government to go back on the policies of financial liberalisation. The government, however, seems ideologically wedded to the agenda of financial liberalisation. Instead of controlling capital flows, it has responded to the crisis by liberalising foreign investment regulations further<sup>2</sup>. Moreover, the government remains wilfully ignorant of the risk posed by thinly regulated non-bank entities. The need of the hour is to bring issues of financial stability and regulation within public discourse and to build suitable pressure on the government to make Indian financial system both safe and equitable.



<sup>1</sup> “Macroeconomic and Monetary Developments”, *Reserve Bank of India*, Jan 26, 2009.

<sup>2</sup> “Business model of NBFCs being questioned as crisis intensifies”, *Livemint*, November 25, 2008.

<sup>3</sup> Non-bank finance companies that take public deposits are indeed required to hold some reserves but this regulation does not cover NBFCs that do not issue deposits but rely on other forms of short term financing like commercial paper and certainly does not apply to mutual funds.

<sup>4</sup> In October 2007, SEBI had prohibited FIIs from issuing Participatory Notes if the underlying security was a derivative. This rule was scrapped in October 2008. The Participatory Note limit of 40 percent of the total assets under custody of FII was also done away with. This move has allowed unknown and unregulated entities to increase their exposure in the Indian stock markets. It has also diluted norms for raising finance through ECB route. Specifically, the maximum amount that the Indian companies can borrow from this route and the interest rate they can offer on these borrowings has been increased. Participatory Notes are instruments that allow foreign investors to invest anonymously in Indian stock markets. Typically in a participatory note transaction, foreign client deposits funds with a registered FII and directs it to invest this money in a certain portfolio. The FII would then issue participatory notes to the client entitling it to the ownership of the underlying portfolio. Since participatory note holders remain anonymous, they can manipulate stock prices without fear of inviting sanction from SEBI.

*“Unemployment is rising. The crisis continues to batter economies and individuals across the world. The number of working poor is increasing. And there is a growing chorus of concern over the balance, fairness and sustainability of the current model of globalization.”*

— Juan Somavia (Director General, International Labour Organisation).

It is now being recognized unanimously that the world is passing through one of the most serious crisis of capitalism since the Great Depression of the 1920s and 1930s. The crisis in the housing sector that erupted in the United States in 2007 has been regarded as the first major symptom of the larger financial crisis, although initially it was considered only as a routine financial turbulence. The crisis conditions accelerated gradually to reach a full-fledged recession and it was officially declared as

Organization (ILO) cautioned in early 2009 that open unemployment will increase by as much as 50 million individuals by 2010, bringing the total unemployed to 230 million, or to 7.1 percent of the global labour force. Apart from that, it would exacerbate the already existing trend of increasing wage inequality across countries and may also widen the wage gap between men and women and between top and bottom wage earners (Global Wage Report 2008/09, ILO).

# Job Losses in the Wake of Economic Recession

-Sakti Golder

a major financial crisis in the United States and the United Kingdom only in the last quarter of 2008.

The crisis that emerged in the US financial sector has gradually become a full blown real economic crisis which seems to have spared no corner of the world. The crisis, firstly, has demolished “the fantasy tales of ‘free’ trade, ‘liberalized’ finance, and ‘flexible’ labor markets where the motive for private profit seeking was taken as the unabated single rule for efficient allocation of resources leading to high incomes, human rights, civilization, prosperity, and so on” (Erinc Yeldan, 2009). Secondly, the hypothesis (Decoupling Hypothesis), prevailing in some circles, that emerging economies will remain unscathed because of their substantial foreign exchange reserves and improved policy framework along with their robust corporate balance sheets and relatively healthy banking sectors has also been shattered and simultaneously it has been established that in a globalized world no country can isolate itself from the crisis.

The global economic crisis is expected primarily to take a heavy toll on heavily indebted and foreign finance-dependent economies and the labouring masses. The International Labor

However, our government continues to show complacency, which has been reflected in the Budget Speech (in Interim Budget 2009-10) of the Union Finance Minister. It is worth emphasizing here that in spite of the rapid growth rate we have achieved during the last few years, around 77 percent of total workforce live on Rs. 20 per capita per day and majority of these workers are engaged in the unorganized sector.

Presently, in India, only 7 percent of the total workforce (which was estimated to be around 457 million in 2004-05) is engaged in the so called formal or organized sector. The National Commission for Enterprises in the Unorganized Sector (NCEUS) estimates that even in the organized sector 45 percent workers have no employment and social security cover; i.e. their nature of work is like that of the workers employed in the informal or unorganized sector. In the wake of a crisis, these people are the most vulnerable and first to lose jobs in the formal sectors. As a direct impact of the ongoing crisis, the unemployment in this sector is on the rise. Additionally, it is well known that during the downturn a section of the formal employment may turn contractual and casual, which is empirically proved through different cross country evidences.

## Job Losses in the Wake of Economic Recession

“there is also ample evidence that the informal sector workers suffer more during economic downturns through various routes”

“The survey found that at least 5 lakh jobs were lost with the employment declining on an average at 1.01 percent per month during October to December 2008”

Therefore, it might create an added pressure on unorganized sector where 94 percent of the country's workforce is engaged.

Furthermore, there is also ample evidence that the informal sector workers suffer more during economic downturns through various routes viz. the direct changes in the international economy and in the formal sector, changes in domestic demand, flow of credit and many other ways. As a direct impact of the crisis, some section of workers might be affected more than the others depending on the nature of industries they are engaged in. For instance, major sections of workers who are employed in the labour-intensive export linked industries have been severely affected due to the fall in the demand for exports and consequently either they have lost their jobs or they are being subjected to cuts in pay, changes in their job conditions from regular to casual or contractual employments. It would certainly lead to a sharp deterioration in the quality of their already difficult lives.

### JOB LOSSES IN INDIA

There is no debate about the fact that the global financial and economic crisis has led to a huge amount of 'job losses' in the Indian economy, which was already experiencing a process of 'jobless growth' over the last few years. A reliable aggregate estimate of the extent of increase in unemployment is not yet available from the official statistical system in the country. However, very recently, the Labour Bureau had conducted a sample survey covering eight sectors (mining, textile & textile garments, metals & metal products, automobile, gems & jewellery, construction, transport and the IT/BPO industry) to arrive at an estimate of job losses. The survey covered 2,581 sample units in the organized sector, with the sample being drawn from 20 centres across 11 States and Union Territories.

The survey found that at least 5 lakh jobs were lost with the employment declining on an average at 1.01 percent per month during October to December 2008. The total employment in all these sectors had come down from 16.2 million in September 2008 to 15.7 million by December 2008. A comparison of employment in export and non-export units indicates that employment declined at an average monthly rate of 1.13 percent in the case of the former, as opposed to 0.81 per cent in the latter, pointing to the direct role of the global economic slowdown in causing job losses in India.

Contract workers in the organized sector have taken a bigger hit than those on the payroll; services of 3.88 percent of the contract labour

force were terminated during the said quarter (October to December 2008), while permanent employees' strength was cut by only 0.63 percent.

The survey also found that workers in the gems and jewellery sector have suffered the most. Units in this sector trimmed their workforce by 8.43 percent during the period. Job losses in the automobile and transport sectors stood at 4.79 percent and 4.03 percent of the workforce, respectively. Metal and textile companies fired 2.6 percent and 1.29 percent of employees from their rolls, respectively. Surprisingly, the IT and BPO sector increased employment, although by a marginal 0.33 percent, against the common belief that people in this sector were losing jobs as most of the overseas clients of IT companies were in losses.

The eight sectors, covered in the above mentioned survey by Labour Bureau, had experienced an average 3.45 percent decline in earnings during October to December 2008. Overall capacity utilisation had reduced by 1.32 percent per month during the period, with automobile sector witnessing a monthly decline of 7.05 percent.

Except this survey, different industry groups and trade unions have also estimated job losses in different industries or sectors. The president of the Federation of Indian Export Organizations, A. Sakthivel, says many importing companies in the West have cancelled orders since the downturn in the global economy began last year and it has had a severe negative impact on the industrial employment in India.

The Gems and Jewellery Export Promotion Council (GJEPC) has already petitioned the Central Government seeking a 'bailout package'. A fall in consumer demand and the problems resulting from inventory build up has led to the closing down of approximately 2000 factories in *Surat* itself, with a job loss of around 2 lakh during the six months starting from September 2008.

Small traders and exporters who are dependent on export market have been hit hard. These sectors are now reeling under the impact of shrinking markets, higher input costs due to the sharp depreciation of the rupee and lack of availability of export credit. Officials and export organizations say that, since September last year, an estimated **one million** workers have lost their jobs. **Another half a million** workers are likely to be laid off by March 2009 as units across the country scale back production.

Of the 3070 large textile mills in the country, Tamil Nadu accounts for 1912, with 813 of them in Coimbatore district. Besides, the State has 30,000 small and medium enterprises (SMEs),

organized and unorganized, engineering and non-engineering, of which 12,000 are located in Coimbatore district. These 12,000 SMEs employ about 5 lakh people. "These units have reported a 40 to 50 percent drop in business as also a 25 percent loss of jobs because of the present crisis" said K. Ilango, President, Coimbatore District Small Industries Association (as cited in Frontline, March 13, 2009). The textile industry group fears that more than 7 lakh workers may lose their jobs if the present situation continues. The Gurgaon Industry Association estimated that around 3000 people had lost their jobs in Gurgaon garment industry. A major chunk of urban women workers, around **6 million** (as per National Sample Survey data), are employed in the **leather, garments or textiles industries, precisely in the industries that face a serious crisis now**. So, in the wake of the slowdown in these industries, women workers would be more affected than men. In *Tirupur* itself, 40,000 garment industry workers, most of them women, have already lost their jobs.

Employment in the construction sector had grown rapidly in the last few years, but it has shrunk significantly within a very few weeks of the economic crisis. Trade unions estimate that in the wake of the crisis, **more than 20 lakh job losses** have occurred in the unorganized sector and most of those have been in the **construction sector**. A vast number of rural migrant workers, who were employed in this sector, have lost their jobs.

Thus, in the wake of the ongoing economic recession, along with the direct job losses in the organized sector, domestic demand for employment and services of the unorganized sector has also fallen. The latter is both due to the slow down in the organized sector, which provides for about a third of the demand for unorganized sector's services, as well as the downturn in the economy as a whole. The situation might worsen further if proper policy measures are not taken immediately.

## THE WAY FORWARD

- As regards the policy interventions needed to counter the crisis, the Union Government had initially focused mainly on the financial sector. However, it has announced three fiscal stimulus packages since December 2008. But, some observers feel that the magnitude of these stimulus packages is tiny compared to the depth of the crisis. The only noteworthy measure directed towards the employment-intensive units in exporting sectors like textiles, garments and leather is a small reduction in the interest rate on export credit. Additionally, some small tax concessions have been given to these sectors. But it is grossly

inadequate compared to the effect of big losses of export orders for these sectors as their major export markets are shrinking. "What was required was a more serious and systematic attempt to allow these industries to keep producing at technologically efficient levels and shift demand to other markets", said Prof. Jayati Ghosh (Macroscan, 2009).

In order to tackle the problem of job losses caused by the economic recession, the government must take a comprehensive set of measures with a special focus on the unorganized sector.

- A large boost should be given to pro-poor public investment. Rural infrastructure, consisting of rural electrification, roads providing connectivity, housing, drinking water, sanitation, and rural production infrastructure can be expanded at this juncture, with public investment.
- Employment generation through government programmes like National Rural Employment Guarantee Scheme (NREGS) and Jawaharlal Nehru National Urban Renewal Mission (JNNURM) should be expanded. It would also be useful to move beyond the (arbitrary) 100 days of employment specified in the NREG Act.
- Like NREGS, an Urban Employment Guarantee Scheme should be introduced by the Union Government.
- In order to address the problems persisting in the agriculture sector, government interventions are urgently needed; which should be in the form of price stabilization schemes for farmers facing very volatile international prices, and significantly enhanced public expenditure on crucial areas like agricultural research, sustainable irrigation practices and improvement of soil fertility etc.
- Since the food crisis has persisted (due to unabated inflation in retail food prices), much higher public expenditure on ensuring a vibrant and efficient Public Distribution System (PDS) should be put in place.
- Self employment should be expanded by providing microfinance to assist both farm and non-farm workers, who are likely to face reduced prospects of employment in the wage market, to take up income earning opportunities.
- As per some of the early reports, in the Agricultural Debt Waiver and Debt Relief Scheme for farmers, the total debt waiver and debt relief so far amounts to Rs. 65,300 crore

## Job Losses in the Wake of Economic Recession

"Trade unions estimate that in the wake of the crisis, more than 20 lakh job losses have occurred in the unorganized sector and most of those have been in the construction sector"

## Job Losses in the Wake of Economic Recession

covering 3.6 crore farmers. However, in the Interim Budget 2009-10, only around Rs. 15,000 crore has been allocated for this scheme. The debt waiver and debt relief scheme of the government would certainly provide relief to the farmers to some extent. But, given the high extent of farmers' indebtedness (around 50 percent of the loans by the small and marginal farmers are raised from the informal lending sector) and the continuing problem of farmers' suicides, government needs to take bold steps in providing relief to these communities through appropriate policies and programmes.

- In the present credit scenario, there is a distinct possibility that small producers will be rationed out of the credit market. While the government has initiated steps to ensure

the overall flow of liquidity and credit, no steps have been taken as yet to ensure that credit to the unorganized sector is maintained and stepped up.

In order to step up credit and developmental effort for this sector, a dedicated developmental financial institution for the unorganized sector, called the National Fund for the Unorganized Sector (NAFUS), has been created. This Fund must be fully operationalized and its activities expanded soon.

- The skill development programme that is proposed in the 11th Five Year Plan should be implemented.
- Social Security measures for the unorganized workers must be implemented as soon as possible.

It has been widely acknowledged that the world economy has never witnessed an economic crisis of such mammoth proportions as the current one in the last seventy years or so. Consequently, India, with a liberalised economy, has not been immune to the vagaries of this unprecedented economic downturn, which originated in and is playing havoc with the industrialised and more developed economies of the world. The immediate fallout on the Indian economy is acute in terms of diminished export demand resulting in the closure of many small and medium scale enterprises, stagnating growth of the services sector (e.g. IT enabled services, financial services, hotels and tourism etc.) leading to job losses and a pessimistic outlook for the economy within investors, producers and consumers alike.

During the first half of the fiscal year 2008-09, India witnessed a high price rise accompanied by a sharp rise in food prices and prices of petroleum products, which in the second half of 2008-09 culminated into the currently ongoing economic recession. With the recession setting in, the Union Government announced several counter recessionary measures starting with several monetary measures to inject liquidity within the economy and following these up with fiscal measures announced on December 7, 2008 and January 2, 2009 as pre-budget fiscal stimulus. On February 24, 2009, the Union Government announced the third fiscal stimulus package soon after presenting the Interim Budget for the fiscal year 2009-10.

India is a mixed economy, where state assumes enormous responsibilities in provisioning of public

# Implications of the Recession on Public Resources and Expenditure

-Nilachala Acharya and Kaushik Ganguly

## WHAT IS ECONOMIC RECESSION?

An economy, unaided or left unabated by the government, follows a cyclical path usually referred to as the 'Business Cycle'. Naturally, this cycle faces periodic phases of economic boom or economic downturn. Periods of economic booms are characterized by high economic growth, high private consumption, expansion in new and existing investments and increased employment generation. On the other hand, an economic recession is usually characterized by low economic growth, declining private consumption expenditure, low investor confidence, thereby leading to a decline in private investment in productive sectors and a rise in unemployment. In a globalized world, an economic recession in one country can easily spread to others by means of reduced demand for export of goods and services, higher price of essential importables like oil and food, withdrawal of foreign capital etc. A protracted and more severe economic recession affecting several countries is referred to as a 'Depression'.

goods alongside a freely operating market for various essential services. The state is also responsible towards provisioning for socio-economic development, in terms of delivery of basic public services like health, education, food security and infrastructure development, livelihood security and income and environmental protection

etc. The state is also responsible for the general administration, maintenance of law and order, national security and various other services which are essential for the sustenance and smooth operation of the economy and strengthening of the polity.

To ensure public provisioning, the state needs to

## Implications of the Recession on Public Resources and Expenditure

raise resources to finance its activities, and major sources of these are taxation and borrowings. In India, both the means, i.e. taxation and borrowings, are adopted to augment resources for provisioning of public goods. In a situation of economic recession, to create additional demand for goods and services within the economy, government has to expand its expenditure basket through increased public investment in selected sectors on the one hand, while, on the other, it may also provide tax sops and concessions to boost the consumption demand.

### REVENUE MOBILIZATION IN TROUBLED TIMES

The major sources of tax revenue for the Central Government are Corporation taxes, Personal Income taxes, Union Excise, Customs and Service tax. The gross tax revenue of the Central Government as a proportion of GDP (Gross Domestic Product) had been estimated at 13 percent in 2008-09 Budget Estimates (BE). The first half of the fiscal year 2008-09 witnessed a growth of 25.3 percent in gross tax receipts over the same period in the previous fiscal year. Given the recessionary trends during second half of the fiscal year 2008-09, gross tax receipts were 11.6 percent lower than that compared to the same period of the previous fiscal year. This has brought down the overall growth in tax receipts during the first three quarters of the fiscal year 2008-09, as compared to the corresponding period in the previous fiscal year, to 9.6 percent. It is likely that the estimated gross tax revenue of Rs. 6,87,715 crore would not be realized during 2008-09 and, therefore, this has been revised to Rs. 6,27,949 crore for 2008-09 Revised Estimates (RE) amounting to 11.6 percent of GDP. Hence, the total tax revenue that could not be realized for the economy for the fiscal year 2008-09 comes to around Rs. 60,000 crore. Further, in view of the prevailing uncertainty in the world economy and its impact on Indian

“the total tax revenue that could not be realized for the economy for the fiscal year 2008-09 comes to around Rs. 60,000 crore”

**Table-1: Key Indicators of the Fiscal Performance of Central Government**

(Figures in Rs. Crore)

Year	Gross Tax Revenue	Total Expenditure	Revenue Deficit	Fiscal Deficit
2007-08	593147	712732	52569	126912
As % of GDP	12.56	15.90	1.11	2.69
2008-09 BE	687715	750884	55184	133287
As % of GDP	12.67	13.84	1.02	2.46
2008-09 RE	627949	900953	241273	326515
As % of GDP	11.57	16.60	4.45	6.02
2009-10 BE	671293	953231	238534	332835
As % of GDP	11.15	15.83	3.96	5.53

Source: Receipts Budget and Expenditure Budget Vol. I, various years, Ministry of Finance, Government of India.

economy, during 2009-10, the gross tax revenue is estimated to show lower buoyancy and is estimated at Rs. 6,71,293 crore, which would be 11.1 percent of GDP. This represents only a 6.9 percent growth over the corresponding figure for 2008-09 (RE).

Direct tax receipts, which constitute a major source of revenue for the Central Government, are estimated at Rs. 3,80,000 crore in 2009-10 BE (6.3 percent of GDP). In June 2008, looking at the buoyancy in tax collections, the Finance Ministry had revised the target for direct tax receipts upward by Rs 30,000 crore, from Rs. 3,65,000 crore in 2008-09 BE to Rs. 3,95,000 crore. However, after the onset of the economic recession, the Finance Ministry revised this same figure downward to Rs. 3,45,000 crore in 2008-09 RE, which necessarily reflects the reduced buoyancy in collection of direct taxes owing to a slowdown in the economy.

Since the beginning of the third quarter of fiscal 2008-09, the combined effects of recession in the western economies and a slump in demand in the domestic economy have started affecting the Indian companies. As highlighted in the previous article (in this issue of Budget Track), a survey carried out by the Ministry of Labour, Government of India, covering eight organized sectors, suggests that these selected sectors had experienced an average of 3.45 percent decline in earnings during October to December 2008. Hence, with firms reporting lower earnings over the past few months, direct tax receipts are bound to take a hit.

**Table 2: Major Revenue Resources of the Central Government**

Year	(Figures in Rs. Crore)			
	Corporation Tax	Taxes on Income other than Corporation Tax	Customs Deficit	Union Excise Duty
2007-08	192911	102644	104119	123611
As % of GDP	4.08	2.17	2.20	2.62
2008-09 BE	226361	138314	118930	137874
As % of GDP	4.17	2.55	2.19	2.54
2008-09 RE	222000	122600	108000	108359
As % of GDP	4.09	2.26	1.99	2.00
2009-10 BE	244200	135373	110187	110604
As % of GDP	4.06	2.25	1.83	1.84

Source: Compiled and calculated from the base data given in Receipts Budget, various years Ministry of Finance, Government of India.

On the other hand, receipts from indirect taxes are estimated at Rs. 2,91,293 crore (4.8 percent of GDP) in 2009-10 BE, showing a growth of 2.9 percent over 2008-09 RE. A week after the presentation of the Interim Budget 2009-10, the Central Government came out with its third fiscal stimulus package in which further tax cuts were

announced, with an estimated cost (in terms of shortfall in tax receipts) worth Rs 29,100 crore (around 0.5 percent of GDP). The service tax was cut by 2 percent from the prevailing level of 12 percent and excise duty was reduced by a similar magnitude for items presently subject to 10 percent duty. Hence, indirect tax collections (collections from central excise, customs and service tax) are also under stress mainly due to the dip in excise and customs collections since October 2008.

Thus, due to the impact of the economic slowdown, there has been an overall downward revision of the gross tax revenue of the Centre in fiscal year 2008-09. As per the Interim Budget 2009-10, the Central Government may end up with a shortfall in tax revenue collection amounting to Rs 60,000 crore against the target for Gross Tax Revenue which had been set for the fiscal year 2008-09.

### PUBLIC EXPENDITURE: BATTLING RECESSION?

Given that the tax-GDP ratio in India is quite low compared to many other countries, tax incentives during times of recession may have minimal effect on boosting demand within the economy. In fact, large sections of the population in India eke out a living at the margins of the economy and are outside the tax net. Comparatively larger government investments on income transfer schemes, social security programmes, development of rural infrastructure and investment in agricultural activities may be more effective in generating demand and boosting consumer as well as investor confidence within the economy.

On the government expenditure front total expenditure from the Union Budget as a proportion of GDP had declined from 15.9 percent in 2007-08 to 13.8 percent in 2008-09 BE, but it rose to 19.6 percent in 2008-09 RE. The revised estimate of total expenditure for 2008-09 is higher than the budget estimate for the same year by almost 20 percent; and it is estimated to be Rs. 9,53,231 crore in 2009-10 BE showing an increment of only 5.8 percent over the RE of the fiscal year 2008-09. The additional expenditure made during 2008-09 RE is primarily due to increased provision for subsidies, implementation of Sixth Pay Commission's recommendations on pay revision and for National Rural Employment Guarantee Scheme (NREGS) in 2008-09. In addition, the government also enhanced outlays marginally for several flagship schemes. Except a few, it is not surprising to note that Central Government has not taken any serious measures within the Interim Budget

for the fiscal year 2009-10. The additional expenditures earmarked in the Interim Budget 2009-10 would hopefully provide necessary stimulus to the economy to counter the recessionary impact. The budget also saw a rise in the fertilizer and oil subsidies to provide stimulus for fertilizer and oil companies, though the merit of these subsidies is largely a debatable issue. An ever contentious issue with United Progressive Alliance's (UPA's) performance has been that it has repeatedly failed to deliver on the promises for sectors like health, education, food security and other social security measures. Expectedly, the UPA's latest and the last budget has been a dampener on these. Apart from the debt waiver and debt relief scheme which was announced in the Union Budget 2008-09, the agricultural sector, being the most crisis-ridden lately, has received scant or no additional fiscal incentive from the budget.

Table-3: Public Expenditure from the Budget of Central Government

Year	Total	GDP at Expenditure	Expenditure market	Expenditure on Economic Service
2004-05 (in Rs. Crore)	498252	3149412	31470.81	177751.17
2005-06 (in Rs. Crore)	505738	3580344	39765.66	210178.29
Growth over previous year (in %)	1.5	13.7	26.4	18.2
2006-07 (in Rs. Crore)	583387	4145810	45762.11	273179.21
Growth over previous year (in %)	15.4	15.8	15.1	30.0
2007-08 (in Rs. Crore)	712732	4723400	61814.11	265084.13
Growth over previous year (in %)	22.2	13.9	35.1	-3.0
2008-09 RE (in Rs. Crore)	900953	5426277	84734.24	452872.06
Growth over previous year (in %)	26.4	14.9	37.1	70.8
2009-10 BE (in Rs. Crore)	953231	6021426	89610.16	336801.49
Growth over previous year (in %)	5.8	11.0	5.8	-25.6

Source: Compiled from Annual Financial Statement, various years, Ministry of Finance, Government of India.

With the general elections in the offing, allocations have been increased substantially in some of the more visible sectors like rural employment, rural roads, rural housing and similar other schemes. Hopefully, the concerns echoed above will be addressed in the upcoming full

### Implications of the Recession on Public Resources and Expenditure

“ due to the impact of the economic slowdown, there has been an overall downward revision of the gross tax revenue of the Centre in fiscal year 2008-09”

“ Except a few, it is not surprising to note that Central Government has not taken any serious measures within the Interim Budget for the fiscal year 2009-10”

## Implications of the Recession on Public Resources and Expenditure

“with decline in the resources from central divisible pool, poorer States which have huge expenditure requirements and are more dependent on Central Transfers, are more likely to be hit hard”

budget of the new government along with a reprioritization within the lopsided expenditure pattern.

### IMPACT OF RECESSION ON RESOURCE DEVOLUTION TO THE STATES AND UTs

Out of the total government expenditure (Centre and States combined) in India, State Governments incur around 50 percent of expenditure while they have limited revenue raising capabilities. Evidently, the States have to depend on financial transfers from the Central Government to fund a bulk of their expenditure. Given the scenario outlined in the earlier section on resource mobilization and the present architecture of fiscal federalism in India, the declining share of resources transferred to the State Governments from the Central divisible pool is quite inevitable, thereby severely compromising on the public service delivery at the State level. Due to the economic recession, growth rate of the States' share in taxes and duties under the Central Government is negative during 2008-09 RE in comparison to 2008-09 BE. During 2008-09 BE the share (States' share in taxes and duties) was Rs. 1,78,765 crore and that has been reduced to Rs. 1,60,179 crore with a decline of amounting Rs. 18,565 thousand crore in 2008-09 RE. Direct consequence of this is that less amount of resources would be available to the State Governments to make budgetary

provisions for meeting their expenditure. As a whole, net resources transferred to State and UT governments have been estimated (2008-09 RE) to be Rs. 2, 93,361 crore which has a shortfall of Rs. 11, 599 crore from what it was estimated during 2008-09 BE. However, on the other hand, the Central Government allowed State governments to raise additional resources through market borrowing to the tune of 0.5 percent of their Gross State Domestic Product (GSDP), amounting to about Rs. 30, 000 crore, for capital expenditure during the fiscal year 2009-10.

Inevitably, with decline in the resources from central divisible pool, poorer States which have huge expenditure requirements and are more dependent on Central Transfers, are more likely to be hit hard. A decline in the Central Transfers in the form of States' share in taxes and duties and non-plan grants has been offset partly by allowing the States to borrow from the market. On the other hand, it needs to be observed that Central Assistance for State and UT (with legislature) Plans have increased substantially by around 25 per cent from 2008-09 BE to 2008-09 RE, and by 21 percent from 2008-09 BE to 2009-10 BE.

However, in the absence of any substantial increase in the transfer of untied funds from Centre to States on the one hand, and the

**Table 4: Fiscal Devolution to State Governments since 2005-06 (Rs. in Crore)**

Items	2005-06 RE	2006-07 RE	2007-08 RE	2008-09 BE	2008-09 RE	2009-10 BE
States' Share of Taxes and Duties	94402	120377	151837	178765	160179	171197
Growth rate over previous Year/estimates	—	27.5	26.1	17.7	-10.4	6.9
Grants						
Non-plan Grants and Loans	30498	36254	36520	43383	38510	46716
Central Assistance for State and UT Plans (with legislature)	33891	42926	55211	59858	74703	72718
Assistance for Central Plan Schemes and Centrally Sponsored Schemes.	14360	15378	20534	25620	21977	23176
Total Grants and Loans	78749	94558	112265	128861	135190	142610
Less Recovery on Loans & Advances*	7977	2666	2503	2666	2008	2661
Net Resources transferred to State and UT Governments	165174	212269	261599	304960	293361	311146
Growth rate over previous Year/estimates	—	28.5	23.2	16.6	-3.8	6.1
Direct Release of Central Asst. for State/UT Plans to implementing Agencies (MPLAD etc.)	1745 1580	1795	1754	1733	1580	
Direct Release under Central Plan to State/District level autonomous bodies /implementing Agencies	0	45166	51260	59272	87054	80925
Investments made from National Small Savings Fund in Special State Government Securities	89800	61600	16000	26000	10500	22500

Note- \* The figure is net of amount equivalent to waiver of loans to State Governments  
Source: Budget At A Glance, Various Years, Ministry of Finance, Government of India

mounting pressure on States for implementing pay hikes along the lines of the Sixth Pay Commission on the other, State Governments may find it difficult to maintain the buoyancy of their expenditure on crucial sectors. More importantly, one should note that allocations in the form of direct transfers to State/District level autonomous agencies has increased substantially by 47 percent from 2008-09 BE to 2008-09 RE and the projected increase is 36 percent from 2008-09 BE to 2009-10 BE. These transfers under centrally sponsored schemes, bypassing State Budgets, are outside the purview of States' Treasury and they put a lot of pressure on the already overstressed human resources of the State Governments, which in turn affects their resource absorption capacity. The State Governments would have definitely been better off with more untied funds at their disposal to effectively deal with the ongoing recession.

### CONCLUDING REMARKS

The impact of recession on the Indian economy has not been as intense as it has been on some of the developed countries. A major reason for this has been that India did not undergo the *full capital account convertibility* which would have enabled international finance capital very easy entry and exit vis-à-vis the Indian financial sector and would have made it much more prone to speculative movements of global finance capital. However, the recession has indeed affected most of the real sectors of the economy like, real estate and infrastructure, export-driven manufacturing industries, the Information Technology Enabled Services (ITES) sector and the hospitality industry. Tax incentives provided by the Union Government to these sectors implies that the government will forego enormous amount of revenue resources

although these measures can have only minimal effect on the real economy given that consumer confidence is already quite low and industries are unlikely to pass on the benefits to the consumers. On the other hand, monetary measures like downward revision of Reserve Bank of India (RBI) lending rates to commercial banks were expected to increase credit off-take and money supply within the economy thereby increasing investment in real sectors by investors, and asset acquisition by individuals. However, investor confidence in the economy already being low and commercial banks being reluctant to pass on the benefits of interest rate cuts to potential borrowers, impact of these monetary measures have also been muted.

Under these circumstances, a fast retrieval of the economy from the slump would require higher government investments directly in infrastructure creation and provisions for social security. Importantly, government needs to focus on small infrastructure creation in the rural sector, which will also lead to an increase in the productivity and income generation within the rural economy and provide gainful employment opportunities for a large number of rural unemployed. Besides, there is an urgent need to address the ongoing agrarian distress by increasing capital investment in this sector, providing subsidized institutional credit to small and medium (size of holding) farmers and provide them price support against volatile global prices of agricultural produce. To sum up, the government at the Centre has taken some measures to counter recession, but any fiscal stimulus formulated by the government needs to take into account the enormous deprivation that exists in the rural sector of the economy and the potential it holds to align the economy to a high and yet sustainable growth path.

### Implications of the Recession on Public Resources and Expenditure

“The State Governments would have definitely been better off with more untied funds at their disposal to effectively deal with the ongoing recession”

“a fast retrieval of the economy from the slump would require higher government investments directly in infrastructure creation and provisions for social security”

*"Now more than ever we must be bold. In this time of crisis, when we tempted to look inward, it is precisely the time when we must move pursuit of the common good to the top of the agenda. While recently we have heard much in United States how problems on Wall Street are affecting innocent people on Main Street, we need to think more about those people around the world with no streets"*

– Ban Ki – moon, (Secretary General of the United Nations)

**O**ver the last two decades, the world has seen a rapid growth in deregulation of financial markets and speculative lending activities in the same. This situation has led to an unprecedented increase in the global liquidity and risk appetite of financial companies, an indicator of which is activities like sub-prime lending and mortgage-backed securities in the United States and Europe. The default on part of borrowers has created the global financial crisis encompassing the banking sector, securities and currency markets, institutional as well as individual

The overall performance of manufacturing, services and real estate sector has been dismal due to decline in demand for our goods and services in the world market. In January 2009, there was a drop of 0.05 percent in growth rate of the manufacturing sector against a growth rate of 6.2 percent last year. While in February, production in the manufacturing sector shrank by 1.2 percent, registering a negative growth for the first time in last the 15 years. These are also well demonstrated by a very recent survey conducted by Ministry of Labour and Employment covering

# Fiscal Stimulus Packages in India An Assessment<sup>1</sup>

-Jawed A. Khan

investors in most part of the world. Most importantly, the impact of financial crisis affected the growth of US economy and consequently its global spillovers to other countries through international trade and finance market.

The external demand in terms of merchandise exports accounts for around 15 percent of the GDP (Gross Domestic Product) of India. The Indian economy started experiencing the impact of the economic recession (i.e. general slowdown in economic activity) in the United States, Europe and elsewhere in the world from second quarter of fiscal 2008-09. The Indian economy grew at a slower rate of 5.3 percent in the third quarter (October- December) as the global economic crisis reduced the demand for our products and consequently the low volume of exports. The major impact of recession has been seen in the export sector mainly from October 2008 onwards which led to a decline in income and employment especially in the small scale sector, along with the manufacturing and IT (Information Technology) sector.

eight major sectors. It has been found that about half a million people lost their jobs in India between October and December 2008. Further, the Federation of Indian Export Organization (FIEO) had recently stated that over 10 million workers have lost their job till now due to the downswing in the exports.

It would certainly have a significant negative impact on Indian's employment scenario, where already more than 93 percent workforce is employed in the informal sector. with inadequate social security provisions despite the government having passed the Unorganized Sector Workers Social Security Bill, 2007. It is apparent that due to the economic recession, this sector will be hit badly in terms of decline in income, output and employment. Worse still, even in the organized sector, 45 percent of total workers have no such social security cover (i.e. their nature of work is similar to informal sector). This would mean that a deceleration in the demand for goods and services consumed by the informal as well as the formal sector would have a negative multiplier effect on the economy.

<sup>1</sup> The author is grateful to Abinash Dash and Richa for their valuable comments and suggestions.

The situation of economic downturn in Indian economy has necessitated some kind of government intervention to make course correction for those sectors of the economy that have been badly hit. Government of India has taken some corrective measure in terms of fiscal and monetary stimulus to revive the economy. The central government announced three stimulus packages (December 7, 2008, January 2, 2009 and February 24, 2009) to boost the demand side of the economy through tax cuts and direct public spending especially for creating infrastructure projects. The RBI has taken monetary measures to strengthen the supply side of the economy to boost the investment demand by pumping more liquidity in market with low interest rates.

The objective of this note is to assess the extent, nature and possible impact of the three stimulus packages announced by government in reviving the Indian economy hit by global economic recession. It would also discuss the role of fiscal stimulus packages on social sector development programme.

### POSSIBLE IMPACT OF FISCAL STIMULUS PACKAGES ON INDIAN ECONOMY

Since, all stimulus packages were announced very recently (in the third and fourth quarter of 2008-09); the actual impact of these fiscal stimulus packages on the economy cannot be immediately captured in terms of quantitative and qualitative data. It would take at least two quarters for these measures to make a visible impact in the economic system. At present, only the policy direction of the government, the nature and the possible impact of the fiscal stimulus packages in addressing the problem of economic downturn can

be assessed. Before discussing the fiscal stimulus packages, the current outlook of Indian economy is presented below.

The Government of India has been concerned about the possible impact of economic recession on the Indian economy. It was an opportunity for the government to reform and restructure polices and institutions required for tackling the current situation. Moreover, this was an opportunity to step up investment in areas of agriculture, infrastructure and social sector development. These areas have a large “development deficit” and have huge potential for demand creation.

The decline in demand due to economic slow down along with moderation in the pace of revenue growth has adversely hit the financial health of governments, both Union as well as the States, in the financial year 2008-09. After the Interim Budget 2009-10, the Centre has announced further cuts in indirect tax rates as part of the fiscal stimulus package, which could have an impact on revenue collections (RBI).

Since the economic recession has originated from the global financial crisis, the government accorded priority to assure people about the financial system in general and safety of bank deposit in particular. To this end, some measures were taken to infuse liquidity into the banking system. Also, emphasis was laid on addressing the problems faced by Non-Banking Financial Institutions. Having assured the stability of the financial system, the Government of India focused on assessing the impact of the crisis on the real economy and effective demand.

However, in India, the economic growth and demand are largely domestically driven but at the

### Fiscal Stimulus Packages in India An Assessment

“ It was an opportunity for the government to reform and restructure polices and institutions required for tackling the current situation. Moreover, this was an opportunity to step up investment in areas of agriculture, infrastructure and social sector development”

#### Box1: Post Recession Economic Outlook for India

##### Negative Side of economy

Economic growth has declined

Slow down in economic activities

Exports dipped since October 2008

Services sector production decelerating

Investment demand declined

Corporate margins dipped

##### Positive side of economy

Inflation rate declined

Lower crude prices will yield fiscal space

Current account deficit will be modest

Financial markets are functioning normally

Comfortable forex reserves

Agricultural credit and social safety net system provides fall back in distress period

Source: Based on speech of RBI Governor published in Indian Express on 27 March, 2009.

### Box 2: Broad Policy Measures taken by Government

- Supporting particular industries especially the labor intensive and Medium, Small and Micro Enterprises (MSME) which are critical for employment generation.
- Ensuring the liquidity in the financial system to cater to investment demand.
- Encouraging investment in the infrastructure for creating demand
- Reducing the tax rate in manufacturing and services sector to boost consumer demand

same time, are not totally immune to external factors like linkages with global financial institutions and international trade. In this respect, the government and the RBI have put concerted efforts by relaxing fiscal deficit target, reducing Cash Reserve Ratio (a certain percentage of commercial banks deposits with RBI in cash

form), Repo Rate (indicative lending rate by RBI to commercial banks) and Reverse Repo Rate (indicative borrowing rate by RBI from commercial banks). The following tables highlight the main features of the three stimulus packages announced by the Government.

### HIGHLIGHTS OF THE THREE STIMULUS PACKAGES

#### Box 3: First Stimulus Package

- **Additional Plan Expenditure:** Additional plan expenditure of Rs 20,000 crore has been allocated in the last 4 months of 2008-09 for critical rural, infrastructure and social security schemes.
- **Reduction in Cenvat:** To encourage spending, an across the board cut of the ad valorem cenvat rate for current financial year on the all the products except petroleum where the current rate is less than 4 percent.
- **Measures to Support Exports:** I) Pre and post – shipment credit for labour intensive products, II) additional funds of Rs. 1100 crore to ensure refund of Terminal Exercise Duty /CST , III) additional allocation for export intensive schemes of Rs. 350 crore, IV) government backed guarantee to ECGC of Rs. 350 crore for exports to difficult markets/ products.
- **Housing:** RBI announced a refinance facility of Rs. 4000 crore for the National Housing Bank. In addition to that, public sector banks gave a package for home loan to borrowers.
- **MSME Sector:** RBI announced refinance facility of Rs. 7000 crore for SIDBI which will be available to support incremental lending either directly to MSME or indirectly via banks, NBFCs and SFCs. Loan for this sector will be extended from Rs.50 lakh to Rs.1 crore.
- **Textiles:** An additional allocation of Rs. 14,000 crore for this sector. All items of handicrafts will be included under Vishesh krishi & Gram Udyog Yojna.
- **Infrastructure Financing:** In order to implement large number of infrastructure projects in Public Private Partnership (PPP) mode, government had authorized India Infrastructure Finance Company Limited (IIFCL) to raise Rs. 10,000 crore through tax free bond by 31/03/2009. These funds will be used by IIFCL to refinance bank lending of longer maturity to eligible infrastructure projects. Depending on need, IIFCL will be permitted to raise further resources of Rs 100000 for highway sector.

The Government of India and the RBI announced a second stimulus package in January 2009 by further easing of liquidity and relaxing of various rules and regulations to boost the spending and investment demand.

**Box 4: Second and Third Stimulus Packages****Second stimulus Package :**

- The Repo Rate under liquidity adjustment facility cut by 150 basis points from 5.5 percent to 4 percent.
- Reduction in reverse Repo Rate by 50 basis points from 4 percent to 3.5 per cent with immediate effect.
- Reduction in the cash reserve ratio of secluded banks by 50 basis points from 5.5 percent to 5 percent.
- Foreign Institutional Investment (FII) investment limit in rupee denominated corporate bonds in India would be increased from \$ 6 billion to 15 billion.
- Special Purpose Vehicle (SPV) will be designated to liquidity support against investment grade paper to NBFCs. The scale of liquidity availability through this window is Rs. 25,000 crore.
- Arrangement through public sector banks to provide a line of credit to NBFCs.
- Credit targets of public sector banks are being revised upwards as per needs of the economy and close monitoring on fortnightly basis.
- Holding Special monthly meetings of state level bankers meeting to oversee the resolution of credit issues of MSME.
- Duty drawback benefits on certain items (fabrics, bicycles, agricultural tools and yarns) with retrospect effect from September 2008.
- EXIM bank obtained a Rs. 5000 crore line of credit from RBI for pre-shipment and post shipment credit.
- Fiscal deficit target revised to 5.9 percent of GDP from 2.5 percent.
- Allowing state governments to raise additional market borrowings of 0.5 percent of their GSDP, amounting Rs. 30000 crore for capital expenditure in the current year

**Third stimulus Package :**

- Reduction in rate of service tax by 2 percent, now it shall be charged at 10 percent instead of 12 percent.
- Central excise rate reduced by 10 percent, now the Central Excise Tax shall be levied at 8 percent instead of 10 percent.

**ASSESSING THE NATURE AND EXTENT OF FISCAL STIMULUS PACKAGE**

The above mentioned first two fiscal stimulus packages injected the liquidity of Rs.3,90,000 crore in the economy which comes around 3 percent of GDP. These included additional public spending, government guaranteed funds for infrastructure, cut in excise duties, expanded guarantee cover for credit to MSME and more support to exporters. This is a huge amount which could stimulate the badly hit sectors of the economy. But looking at monetary figure of both the stimulus packages, it appears that government has included its already announced measures such as loan waiver and implementation of sixth pay commission, which might not to be considered as part of stimulus packages. Here, before looking at positive and

negative side of impact of stimulus packages, it would be appropriate to assess the nature of these stimulus packages in terms of monetary and fiscal policy as well as the extent of sectoral outreach to revive the economy.

In the given recessionary situation, a major question that comes up is what could be the appropriate method to revive the economy - fiscal measure (tax cut, direct public spending) or monetary measure (through infusing liquidity in the market) or a mix of both. If we go by the fiscal measure, the tax cut will have impact on reduction in the prices of goods and services, consequently, the effective demand will increase. While the direct public spending will create disposable income in the hands of people and it will lead to generation of effective demand. The monetary measure mainly focuses on infusion of liquidity in market through

Fiscal Stimulus Packages in India An Assessment

“The government increased its spending mainly on the flagship schemes like Bharat Nirman and National Rural Employment Guarantee Scheme (NREGS) without extending the coverage of beneficiaries”

“given the nature of economic crisis, it is not easy to create effective demand and revive the economy in the short run through cut in indirect tax”

cut in CRR as well as reduction in interest rate. These will increase borrowing capacity of borrowers; which will have impact on the investment demand and ultimately lead to increase in the economic activity and effective demand.

To contain the recessionary situation, the government and the RBI undertook simultaneously a mixed policy initiative covering both fiscal and monetary measures in terms of stimulus packages. First stimulus package talks (more or less) about strengthening the fiscal side of the economy in which a clear emphasis was given to create effective demand through direct public spending. An additional plan expenditure of Rs 20,000 crore has been allocated in the last 4 months of 2008-09 for promoting critical rural, infrastructure and social security schemes. Apart from that, emphasis was given to creation of special projects in port and highway sector by authorized company, India Infrastructure Finance Company Limited (IIFCL). The company was to raise Rs. 10,000 crore through tax free bond by 31/03/2009. On the supply side, RBI announced refinance facility of Rs. 7000 crore for SIDBI which would be available to support incremental lending either directly to MSME or indirectly via banks, NBFCs and SFCs. The loan for small scale sector was to be extended from 50 lakhs to 1 crore.

The government increased its spending mainly on the flagship schemes like Bharat Nirman and National Rural Employment Guarantee Scheme (NREGS) without extending the coverage of beneficiaries. These schemes are being implemented with the help of State governments along with some contribution made by states. While the special infrastructure projects are going to be implemented through public private partnership mode, where the States governments have not been given any role in the process of implementation, there is a possibility that excluding the State governments in this process will lead to poor implementation and monitoring of these projects and might have low impact in terms of employment creation. Besides that it is not clearly mentioned whether these special infrastructure projects would cater to the needs of rural economy and if it would, then to what extent.

The second fiscal stimulus package is focused on the measures taken by RBI to boost the supply side of the economy. The objective was to provide easy liquidity in market to create investment demand. The important measures taken by the RBI include reducing Repo Rate from 5.5 per cent to 5 per cent and Revers Repo Rate by 50 basis points from 4 per cent to 3.5 per cent with immediate effect. There was a reduction in the Cash Reserve Ratio of secluded banks by 50 basis points from 5.5 per cent to 5 per cent. Further, the FII (Foreign Institutional Investment) investment limits in rupee denominated corporate bonds in India were increased from \$ 6 billion to \$ 15 billion. As far as

the monetary policy is concerned, it takes a longer time lag to have an impact on the economic system, particularly when confidence of the people is low.

There are some good initiatives taken by the government, such as revising the fiscal deficit target to 5.9 percent of GDP from 2.5 percent by the Union government. Centre has allowed the state governments to raise additional market borrowings of 0.5 per cent of their GSDP, amounting Rs. 30,000 crore for capital expenditure in the current year. This policy measure has relaxed the public expenditure conditionality of Centre and States put by Fiscal Responsibility and Management (FRBM) Act. It is expected that higher fiscal deficit will increase the expenditure capacity of Centre and States and could be instrumental in the process of economic revival.

In the third stimulus package, focus was on reducing the prices of consumer goods and services in the situation of falling income through cut in indirect taxes like service tax and excise duties. It was an indirect step towards creating effective demand in the market by putting additional income in the hands of consumer which will ultimately boost demand for services and manufactured sector. The services tax rates reduction will give relief to sectors like telephone, airlines ticket, tour packages, health clubs, and transport of goods, insurance and banking sector. which constitute more than 50 per cent of our GDP. A cut in central excise duty will boost demand for television set, washing machines, refrigerators, air conditioners, soaps, detergents, cars and commercial vehicles. The manufacturing sector contributes about 30 per cent to the total GDP. Tax cuts in services and excise are estimated to reduce the revenue of the government by 0.5 per cent of GDP for the current year.

However, given the nature of economic crisis, it is not easy to create effective demand and revive the economy in the short run through cut in indirect tax. Since, in the given tax system, it is not clear whether the benefits are being fully passed to consumers by producers. The measures of cutting the service tax and customs duty would only partially benefit the workers of informal sector; it is largely going to benefit middle/ upper income groups of the society. Further, the impact of tax cut might not lead to high increase in the demand of consumer goods in the short run due to low propensity of consumption by middle/ upper income groups.

In such a context, Indian government should initiate the measures related to increase direct public spending. The decline in the production of manufacturing sector, deceleration in the demand of export, job losses and stagnation in agriculture requires direct public spending to create more employment and more demand. It is argued that fiscal stimulus is better served by direct increase

in public expenditure rather than tax cuts because the impact of former is more direct and it is easier to target the affected sectors and group of population.

Further, none of the stimulus packages made any financial provision to develop the social sector schemes such as Sarv Shiksha Abhiyan (SSA), National Rural Health Mission (NRHM), Integrated Child Development Programme (ICDS) and National Child Labour Project (NCLP). These schemes still have huge deficit in terms of infrastructural facilities such as class rooms, Anganwadi Centres, Health Sub Centres and human resource. Thus, in this respect, the government did not avail a very good opportunity through provisioning of additional funds in the interim budget for these schemes to create public infrastructure.

### ROLE OF CIVIL SOCIETY IN TIMES OF CRISIS

In the wake of global economic recession, the role of civil society has also become important in India in terms of policy research and advocacy. Firstly, studying the issues and policies of government as well as analyzing the impact of the ongoing crisis

on India's development. Secondly, in terms of identifying the voices of the most vulnerable groups at the margin of economy (such as youth and women) and affected sectors and making them heard by the government. Thirdly, assessing the impact of the crisis on the economy and influencing government for announcing an inclusive policy response by involving various stakeholders. Lastly, facilitating the policy dialogue between government and civil society organizations.

### POLICY IMPLICATIONS

The impact of global financial crisis in India has not been as sharp as in other countries like US, Europe, Japan and other Asian economies. This is due to the relatively better regulatory mechanism in place in our economic system. The affected sectors particularly the manufacturing and services sector can be revived through a good policy mix of fiscal and monetary measures taken by government. In addition to that, some specific focus on sectoral targeting, direct public spending for employment creation and more allocation for social sector schemes could be very useful to supplement the above policy mix.

## Fiscal Stimulus Packages in India An Assessment

“ Indian government should initiate the measures related to increase direct public spending”

**T**he global financial crisis which began in early 2007 arguably with its roots in the US submortgage crisis has engulfed not just the developed countries but even the so called emerging economies and other developing countries, India being no exception. This article discusses the response of the G-20 to the financial turmoil in terms of the actions suggested by the group, their future course of action and India's stand on the ongoing dialogue of G-20.

#### WHAT IS G-20?

G-20 is an international body comprising the G-8 nations, emerging economies including India, China, Brazil, Argentina, Turkey, Indonesia, Saudi Arabia, Indonesia, Mexico and South Africa, Australia and European Union. It was constituted after the Russian and the Asian crisis of 1999. The main objective of this body was to encourage stability in the international financial system. The body played a marginal role till the recent financial crisis forced it into some sort of action.

into account the nature of the crisis, a Leaders' Summit on Financial Markets and the World Economy was planned in Washington on 15 November, 2008 in order to discuss global solutions and agree on a common set of principles.

The G-20 Leaders' Summit in Washington recognized at the outset that measures to support the global economy and stabilize financial markets should continue and foundations should be laid for reform to ensure that such a global crisis does not happen again in future. Some of the steps identified at the Summit include:

- Efforts and further actions (as necessary) should continue
- Monetary policy support
- Fiscal measures to stimulate domestic demand
- Assist emerging and developing economies in gaining access to finance
- Encourage multilateral development banks to use their full capacity in support of their development agenda

The G-20 leaders agreed on five principles for reform on the basis of which policies will need to be implemented:

# G-20 and the Global Recession: Where does India stand?

-Bhumika Jhamb & Divya Singh

A meeting was held in March 2008 where the G-20 Deputies set up a Study Group to report on the global credit disruptions. The report provided a global perspective of the crisis; attention was paid to transmission of the effects of the financial crisis around the world and the effects on emerging market economies and newly industrialized economies in particular. This was followed by another meeting of the Finance Ministers and Central Bank Governors of the G-20 convened on 8-9 November, 2008 in Brazil where they discussed the causes of the global financial crisis and the policy responses to the crisis. Taking

1. Strengthen financial market transparency.
2. Strengthen regulatory regimes, prudential oversight and risk management and ensure that all financial markets, products and participants are regulated.
3. Protect integrity of the world's financial markets.
4. National and regional regulators to form regulations and enhance cooperation and coordination across all segments of financial markets.

5. Reform international financial institutions and expand the membership of the Financial Stability Forum (FSF).

The Summit in Washington also explicitly acknowledged that the above mentioned measures cannot be brought into practice until the countries are committed to an open global economy. Therefore, the summit recognised the need to reject protectionism and mentioned that in the next 12 months refraining new barriers to investment and trade in goods and services, imposing new restrictions and implementing WTO inconsistent measures to stimulate exports – will all be steps in this direction.

Very recently, the G-20 met in London on 2 April, 2009 and formulated the Global Plan for Recovery and Reform in response to the crisis. The broad agreement reached at the London Summit was a \$1.1 trillion programme of support to restore credit, growth and jobs in the world economy.

#### NEXT STEPS IDENTIFIED AT THE LONDON SUMMIT

- Undertake expansionary fiscal policy in order to create jobs. This includes lower interest rates by central banks and restoring lending and repairing the financial sector.
- Build a stronger, more globally consistent, supervisory and regulatory framework for the future financial sector so as to prevent such crisis in the near future.
- In order to ensure continuous flow of capital to emerging markets and developing countries, increased resources to the tune of \$250 billion to be made available to the IMF, increased resources by upto \$500 billion for flexible new arrangements to borrow and increase in lending in the order of \$100 billion by the Multilateral Banks.
- Reform international financial institutions and to further this, the summit proposes implementation of the IMF quotas and voice reforms, implementation of the World Bank reforms, appointment process of heads and senior leadership in such institutions be made more open and transparent and selection be based on merit.
- Finally, recognizing the fall in world trade growth, the Summit reiterated its stand on rejecting protectionist measures till 2010. It committed to ensure availability of \$ 250 billion over the next two years to support trade finance.

Besides the steps mentioned, the Summit also emphasized the need to reach a balanced conclusion to the Doha Development Round which as claimed, will boost the global economy by atleast \$150 billion per annum. In addition, taking cognizance of the effect of the recession on the vulnerable in the poorest countries, the Summit reaffirmed its commitment towards meeting the MDGs and official development assistance to countries, provision of \$50 billion to support social protection, \$6 billion additional concessional and flexible finance for poorest countries over the next 2-3 years through sales of IMF gold and proposed that the UN should take the lead in assessing the impact of the crisis on the poorest and most vulnerable.

#### INDIA AT THE G-20

India is a major developing economy increasingly getting integrated into the world economy through the process of economic liberalisation and globalisation. It now has an important stake in the stability of global economic and financial system. Infact, India's presence at the emergency summit in Washington is reflective of the vital role that India has come to play in the world economy. India, therefore, is in the important position to voice the concerns of the developing world and ensure inclusivity in the measures taken to resolve the financial crisis.

India raised several issues and concerns in the G-20 meet held in London. These issues and concerns are deeply implicated in the issue of global credit crisis, the corrective measures that the developed world needs to undertake in order to resolve it and the inclusiveness (or otherwise) of these measures vis-à-vis the developing world. Thus, while India hopes that G-20 would indeed provide a solution to the crisis, it also intends to ensure that the concerns of the developing world are taken into account in the process.

The most important issue raised by India at the G-20 summit as far as the developing nations are concerned was regarding the policy of protectionism that a large number of developed nations are resorting to, in reaction to the financial crisis. Recession has led to the tightening of markets and restrictions on services in various developed nations leading to job losses in developing countries. India has asserted that a protectionist policy would not just be opposed by it but instead, would be met by reciprocal reactions. Since, Indian firms are now investing in various countries and creating jobs there, this has given the Indian government ample room to negotiate against any such policy move.

G-20 and the Global Recession: Where does India stand?

“The broad agreement reached at the London Summit was a \$1.1 trillion programme of support to restore credit, growth and jobs in the world economy”

“The most important issue raised by India at the G-20 summit as far as the developing nations are concerned was regarding the policy of protectionism”

## G-20 and the Global Recession: Where does India stand?

“India has also asserted the need for a coordinated and comprehensive global response to the global financial crisis”

“Most of the G-20 leaders, want the IMF to play the leading role in the financial architecture within which coordinated fiscal stimulus driven expansion should occur”

### WHAT IS PROTECTIONISM?

Protectionism is the economic policy of limiting trade between nations through a variety of restrictive trade regulations aimed at discouraging imports. Protectionism refers to policies that aim at ‘protecting’ indigenous businesses and workers within a country from foreign competition by regulating trade with foreign nations. The experience of Great Depression suggests that in event of global slowdown, countries usually resort to ‘beggar thy neighbour’ protectionism. This makes nations, particularly the developing ones, apprehensive of the possibility of policy reenactment by a number of developed nations faced with the problem of unemployment. In this economic crisis, the leaders of the developed nations have been careful to assert that they would not adopt the protectionist policies. Contrary to their declarations, however, large numbers of monetary and fiscal regulatory mechanisms are being put in place by the big trading nations. The recent stimulus package that has been announced by Obama too has protectionist elements. One, is a clause that makes it mandatory for all the federally funded projects to buy local products. The second that limits the use of immigrant skilled labour on H1-B visa in projects receiving the bailout money. The tendency to barricade national economies is quite pervasive and despite declarations to the contrary, a large number of countries, especially the developed ones, are increasingly resorting to these policies.

An important point that needs to be acknowledged in this regard is that resolution of the financial crisis is not possible without the economic recovery of the fast developing nations like India and China. It would be a difficult task to persuade the developed nations against putting restrictions on finances and services. Though these countries have overtly denounced application of any such measure, they are being covertly put in place in several countries. India has decided to negotiate the issue at both bilateral and multilateral forums. It has already raised its voice against the protectionist measures surreptitiously creeping in through the stimulus package put in place by President Obama. It is especially keen to see that the services sector remains open, for instance, that the US rolls back the moves to curb the number of H1B visas that are granted to skilled workers.

In the Washington summit the G-20 finance ministers supported India’s stand against protectionism. They have promised to maintain open trade and investment and have agreed that protectionism through raising trade barriers or creating barriers for the free movement of workers would not resolve the crisis. They have also agreed to substantially increase IMF fund by around 250 million dollar which is also something that India has been demanding for sometime.

India has also asserted the need for a coordinated and comprehensive global response to the global financial crisis. It emphasized on the need for coordinated fiscal stimulus by the richer countries in the London G-20 summit. The most obvious issue in the context of the credit crisis is that of a fiscal stimulus. Prime Minister Manmohan Singh asserted that given the enormity of the situation, a coordinated fiscal stimulus by the countries that are in a position to do so would help counter the severity of the recession. He also asserted that the various nations must take appropriate policy actions to facilitate the coordinated fiscal stimulus at the global level.

India asserted that the developed nations must distinguish between the immediate goal of addressing the financial crisis and the long term goal of preventing any such crisis from occurring again. While the first objective necessarily needs a coordinated global response from the developed nations who must keep in mind the welfare of the developing nations while deciding on the measures that need to be taken, the latter can only be addressed by building a new global financial architecture which must include a credible multilateral system of surveillance.

The new global financial architecture must necessarily entail a strengthened and reformed IMF which has lately come to play an extremely marginal role so that the implications of the global financial crisis for the developing nations are as minimal as possible. India along with other members of the BRIC countries –Brazil, Russia and China – has asserted that they are willing to help restore the international capital flows through IMF but want a concomitant expansion of their IMF quotas which determine their financial contribution as also their voting powers in the organization.

Most of the G-20 leaders, want the IMF to play the leading role in the financial architecture within which coordinated fiscal stimulus driven expansion should occur. As Prof. Prabhat Patnaik, contends, ‘The IMF has always believed in imposing “conditionalities” upon deficit countries, so that they adopt adjustment measures, including through fiscal policy, to close the current deficits for which IMF finance is made available. True,

the IMF has always followed different policies for the advanced and the underdeveloped economies, its “conditionalities” for curtailing the deficits being reserved only for the latter group. Nonetheless the IMF’s entire approach and philosophy are diametrically opposed to what is required for the co-ordinated fiscal stimulus proposal to succeed. The fact that it sticks to the same approach and philosophy even in the present context is made clear by the “conditionalities” it either has imposed on, or is discussing with, Iceland, Pakistan and Hungary. Given its approach, the IMF, and the World Bank for that matter, are the last institutions that should figure in any financial architecture that is sought to be built around the programme of a coordinated fiscal stimulus. And yet the G-20 leaders while expressing themselves in favour of such a stimulus continue to swear by these institutions.’ Prof. Patnaik’s view must serve to make us skeptical of the role of IMF if we seek to build an equitable international financial architecture.

The new global financial architecture, as demanded by India and other developing nations, must be multilateral, reflecting the changed economic realities and with adequate representation from

various countries. The reform of the global financial architecture also needs to fill the various regulatory gaps in the financial system and hence proposed a global prudential and regulatory standard for the financial institutions. It emphasised the needs for a new system of global investment which would entail greater inclusivity in the international financial system. It also seeks place in the Financial Stability Forum (FSF), an international body constituted to encourage the stability of the financial system. It includes the members of the government and bank officials from 12 countries and is likely to be expanded. India and China are extremely strong contenders in this regard.

India has urged the world community to expand its investment in infrastructure by the public sector and the private sector, wherever possible, as one of the mechanisms to counter recession. Also industrialised countries can help revive the trade flows in developing countries by expanding the trade credit available to these countries. This would facilitate the resolution of the crisis and help the developing countries tackle unemployment and poverty.

G-20 and the Global Recession: Where does India stand?

“India has urged the world community to expand its investment in infrastructure by the public sector and the private sector, wherever possible, as one of the mechanisms to counter recession”

#### CIVIL SOCIETY AND THE G-20 LONDON SUMMIT

Civil society actors in India, ahead of the G-20 summit in London, have urged India to play a lead role in democratizing G-20, to make it more inclusive and participatory, ensuring a broader representation of interests especially those of the more marginal and vulnerable sections of society. The civil society groups have demanded a comprehensive and thorough reform of the international financial system. The principles of equity and social justice must underline any such attempt at reformation of the system. Economic democracy, ecological sustainability, fulfillment and protection of the livelihood rights and equality are the principles that must inform the process of financial reform. They have urged the rich developed nations to refrain from any move towards protectionism. The G-20 must ensure that the fiscal stimulus packages encourage and promote ecologically sustainable growth aimed at addressing the issues of poverty and unemployment. The reformed financial system must, henceforth, be under greater public control, more transparent and accountable.

**N**ow that the economic slowdown is truly upon us, and the government is no longer in complete denial about the vulnerability of the economy, the discussion is dominated by the possible effectiveness of the policy measures that have been announced to deal with it. But this depends upon two different features: first, what has caused the recession in the first place; and second, how it will affect different economic agents.

By both counts, the measures announced so far appear to be lacking. On the first count, there is an official presumption that this is simply an imported crisis. And there is an associated blindness to important lessons about the regulation of finance that are coming from the developed world. Unlike possibly any other government in the world today, the Indian

Most of the government's measures are designed to ease the credit crunch and revive the stock market and investor confidence: by lowering interest rates, by propping up the banking system through promises of fresh capitalisation, by injecting new liquidity through relaxed credit norms. Clearly all this will not be enough in the current liquidity trap conditions, but at least it will directly benefit some large banks, corporate houses, builders and export units. The idea is that this will in turn benefit those who are employed by such agents, and therefore prevent job losses that would otherwise occur.

Yet in all this the government is ignoring two major groups of workers who are already directly hit, and who together account for the majority of the workers in the country: farmers and migrant labourers. Cultivators in India have already been

# The Economic Geography of Recession

-Jayati Ghosh

government is going in for more financial liberalisation, even when the results of such deregulation in terms of creating unsustainable bubbles and spawning major crises are there for all to see. While this may provide some immediate relief by propping up the rupee and stopping the bleeding of foreign exchange reserves, it will create the conditions for a much worse country-specific financial crisis in the near future.

On the second count, the policy response thus far is deficient because it seems to have ignored most of the people who are likely to be badly affected, in favour of a few who happen to be more well-connected. This particular economic crisis, because it has both financial and real economic aspects, is going to affect different people very differently. The financial sector is clearly hit. Stock market investors have lost (at least nominally) huge amounts, and the credit crunch is adversely affecting both large corporates and smaller businesses.

This inevitably has knock-on effects on the real sector, adding reduced domestic demand to the problem of depressed export markets. And so real economic activity, in both tradeables and non-tradeables, is affected and this directly translates into employment losses.

through more than a decade of agrarian crisis, which persisted even through the period of rising international crop prices.

They have then been on a complete roller coaster in price terms in the past year, as world trade prices of most crops doubled and then collapsed within a few months, and by the end of the year came to settle at levels below those of two years ago.

Many cash crop cultivators, who had begun their sowing operations on the basis of crop prices determined by the relative prices of just a few months ago, now find that their cultivation will simply be financially unviable at prevailing input and output prices. With particular regions of the country, including some of the fragile dry land areas, increasingly dominated by such cash crop cultivation (such as cotton, groundnuts, soya beans) it is not difficult to imagine what will happen to livelihoods in such cases.

This is a major economic catastrophe that is not just waiting to happen - it is already unfolding. So a series of monetary and fiscal packages that does not even mention, let alone address, the inevitable problems of cash crop cultivation, is bizarre to say the least. The other major group that is already negatively affected is of those

workers who are employed on casual contracts, who now find that even their fragile jobs no longer exist. Many of these are migrant workers, often short-term migrants whose very existence tends to be ignored by our official statistics. The economic boom of the past decade relied heavily on such workers. This was very obviously true in the construction industry. But it was also the case in some labour-intensive services, such as cleaning, maintenance, private security, driving and related services, that catered to the requirements of the expanding corporate sector, and in effect subsidised it by providing a cheap and flexible external labour force. A lot of manufacturing, especially in those sectors such as garments, leather goods, gems and jewellery and metal products where exports have been seriously hit by the world recession, have also increasingly relied on informal contract workers, who could be hired and fired at will.

Many of these workers have already been laid off and many more will now indeed be fired, or at any rate lose their jobs at least temporarily. And so they will be forced either to stay in precarious conditions in the urban areas, or go back to their places of origin - villages or smaller towns. They will change from becoming providers of remittance incomes to their households, to becoming dependents of these households, even as these households face more fragile material circumstances than before. And so the negative multiplier effects will permeate geographically.

The potential for social and political upheaval caused by such economic changes should not be underestimated. The heat will be felt by state governments, who (despite the paltry provision of more borrowing facility announced most

recently) will also be reeling under the pressure of coping with reduced tax revenues and increase salary expenditure because of the recent Pay Commission award. So state governments will not be in a position to deal with the consequences, unless explicit provision is made by the Centre for them to cope with these new and adverse circumstances.

This has significant implications, because many of these migrant workers, for obvious reasons, come from the most depressed and backward regions of the country, where there is currently little potential for productive income generation. These are often also the regions of dry land agriculture, where remittance incomes play a vital role in sheer survival. They are also - no surprise! - the regions where extremist Maoist activity is widely prevalent, because of the anger bred by persistent backwardness and rising inequalities.

So the economic geography of this unfolding crisis is likely to have huge political fallout. Because we live in an electoral democracy, it might be expected that the government - or at least the political parties involved who know they have to face the people in a general election in just a few months - would take note of these negative effects on the majority of voters. It is both extraordinary and alarming to realise that thus far nothing in the policy pronouncements suggests that the welfare of such people - cultivators and migrant workers - is at all a consideration for the central government. Their future is being sacrificed because our rulers seem unable to stop paying homage to a different type of mobility at the altars of international finance capital, however discredited this might be in the present global scenario.

*This declaration emerged out of the Second Women's Consultation convened by the WWG on FfD in New York from April 24-26, 2009. The following networks endorse this statement: African Women's Development and Communication Network (FEMNET), Agribusiness Action Initiatives (AAI), Arab NGO Network for Development (ANND), Association for Women's Rights in Development (AWID), Center for Budget and Governance Accountability (CBGA), Development Alternatives with Women for a New Era (DAWN), Feminist Task Force-Global Call to Action against Poverty (FTF-GCAP), Global Policy Forum (GPF), International Gender and Trade Network (IGTN), International Trade Union Confederation (ITUC), Medical Mission Sisters, Network for Women's Rights in Ghana (NETRIGHT), Third World Network-Africa (TWN-A), Women's Environment and Development Organization (WEDO) and Women in Development-Europe (WIDE). The WWG on FfD is coordinated by DAWN.*

**W**e, the Women's Working Group on Financing for Development (WWG on FfD), recognize that the financial and economic crisis represents a critical political opportunity to make significant structural changes in the global development, macroeconomic and financial architecture that reflect rights-based and equitable principles.

only platform for genuine global dialogue and governance on global public 'goods'; where women's rights and human rights are enshrined; and where each country large or small has a voice at the table.

We call on all heads of state and government to commit to constructively engage in the High Level Conference on the UN Conference on the World

# The Economic Crisis from a Feminist Perspective

A call for structural, sustainable, gender equitable and rights based responses to the global financial and economic crisis  
April 27, 2009

The recent G-20 decision to replenish International Monetary Fund (IMF) resources is deeply flawed as it perpetuates failed neoliberal economic policies, reinforces structural inequalities, and will increase developing country indebtedness. Moreover it is based on an overproduction and overconsumption model that ignores social reproduction, sustainability of the resources of the planet; and is based on a few acting to the exclusion of the many.

We need an alternative more inclusive process not one lodged in the International Financial Institutions (IFIs) that have created the crisis but in the United Nations (UN), which today is the

Financial and Economic Crisis and Its Impact on Development (HLC) and ensure an effective follow up mechanism.

It is only through a more inclusive approach that the search for solutions can move beyond double standards, the perpetuation of moral hazard, the inequitable distribution of resources, and disproportionate burdens on the most vulnerable.

We therefore propose the following actions to respond to the current crisis with alternative policy approaches that harmonize with international standards and commitments to gender equality, women's rights and human rights and empowerment.

## I. Re-position the UN's leadership role in a new global development, economic and financial architecture that fully integrates gender equality and women's rights

1. Strengthen the authority of the UN to lead the necessary rights-based pro-development economic and financial reforms, in particular responding to issues of global macroeconomic policy including its social and ecological dimensions.
2. Support the HLC with Summit level participation and ensure concrete recommendations on new foundational and structural agreements on global development, economic and financial governance that fully integrates gender equality and women's human rights based on internationally agreed goals, including the Beijing Platform for Action, the Convention on the Elimination of All forms of Discrimination Against Women (CEDAW), and International Labour Organization Conventions.
3. Establish a global representative UN body that would guarantee accountability of all international economic organizations, set the agenda for macroeconomic, financial and development cooperation reforms and management in ways that respect policy space and country ownership while enhancing mutual accountability for internationally agreed goals and standards including those related to gender equality.
4. Ensure that in the ongoing UN reform process, the new gender equality entity will have the capacity and resources to participate meaningfully in the coordination necessary for development, macroeconomic and financial governance.

## II. Immediate reform of the global financial architecture to effectively manage liquidity shortages and payments imbalances and ensure that policy responses do not shift the burden of adjustment to the care economy.

1. Immediately create a range of alternative regional and international funding arrangements for governments to meet their liquidity requirements, especially of developing countries.
2. Establish a UN Global Economic Coordination Council that is transparent, accountable, and with the full and equal representation of developing countries and the involvement of women's rights and other civil society organizations.
3. Hasten the adoption of national capital gains taxes, environment taxes, and taxes on financial transactions in order to change incentive structures for profit generation and generate

funds for programs/projects (such as increased access to health insurance and finance) that support impoverished women and men.

4. Cancel the illegitimate and odious debt of developing countries and immediately create an international legally binding framework for an orderly and transparent debt audit process and workout mechanism with the participation of debtor governments, women's rights and other civil society organizations.
5. Ensure that the UN plays a pivotal role so that developed countries fulfill their commitments to increase the quantity and quality of Official Development Assistance (ODA), including to address the negative effects of the crisis in developing countries. Traditional ODA and new financing must not impose any policy conditionalities including on the basis of gender, environment and human rights.

## III. Reduce financial sector instability and arrest capital flight through transparent and accountable regulation

1. Replace the IMF with a new multilateral institution that will monitor the financial sector to prevent volatility, take into account the social, gendered and environmental costs of financial products, and be based on a one-member-one-vote system not weighted by monetary contribution.
2. Strengthen the independence, credibility and transparency of national, regional and international regulatory mechanisms by moving away from free market and moral hazard practices.
3. Improve credit rating classification methods, governance and transparency of credit rating agencies, as well as institute an oversight mechanism.
4. Establish or strengthen national regulatory measures in the banking and financial markets complemented by appropriate competition policy and consumer protection policies.

## IV. Abandon neo-liberal policies governing trade and finance toward addressing global imbalances and social and gender inequalities

1. Set in place national, regional, and international measures and processes that respect national policy space, ensure the principle of Special and Differential Treatment and are consistent with internationally agreed standards and commitments, including to women's rights and gender equality. The crisis opens an opportunity to move countries away from the imbalances and gaps of the World Trade Organization (WTO) regime and the failed Doha Round.

## The Economic Crisis from a Feminist Perspective

## The Economic Crisis from a Feminist Perspective

2. Regain lost national policy space resulting from bilateral and multilateral trade agreements by undertaking global and regional reviews of related commitments. Mandatory clauses in the General Agreement on Trade in Services (GATS) and Free Trade Agreements (FTAs) on the liberalization of trade in financial services have been one of the main causes of the contagion and have contributed to the exclusion of women from credit services; these must be stopped and rolled back immediately.
3. Remove agricultural goods from the Commodities Futures Market and reform trade in agriculture toward protecting people's livelihoods and right to food. Protect all small-scale commodity producers from financial speculation by improving monitoring and reporting of market-based price risk management techniques and products.
4. Strengthen the ability of developing countries to use a mix of trade and investment policy tools necessary for them to mitigate the impact of the global financial crisis on their real economies. Industrialized countries must not use their stimulus packages for subsidies and procurement that exacerbate asymmetries in the global trading system.
5. Central monetary authorities must balance the relationship between price stability and development goals, using counter-cyclical policies and other tools. To bridge the gap between micro-finance and the financial sector they should rationalize their credit allocation programs in accordance with development goals with a view to upscale financial resources accessible to asset-poor women, small farmers, and the impoverished thereby ensuring decent livelihoods and the right to food.
6. Regulate Foreign Direct Investment (FDI) and multinational corporations ensuring that their practices are consistent with environmental sustainability, social protection, gender equality, human and labour rights and people's livelihoods. Establish reporting standards to address tax evasion in the context of intra-firm trade and adopt a stronger global agreement on the closure of tax havens.

### V. Recognize and value social reproduction in responding to the crisis and in re-designing development strategies and macro economic policies

1. Create or strengthen automatic macroeconomic stabilizers and social insurance systems to help developing economies weather the crisis. In the

absence of such systems, women's unpaid labour acts as a stabilizer and increases their burden.

2. Prioritise social infrastructure investments and not just physical infrastructure investments and move beyond one-time subsidies to gender equitable job creation, social services provisioning and social protection within a rights based framework.
3. Ensure that stimulus packages feature micro finance for women who have lost their jobs due to the crisis and who must be provided additional support to sustain their micro enterprises. Moreover governments lending programs must be accessible to poor women who do not have assets, particularly women farmers.
4. Carry out gender budgeting on fiscal stimulus packages and ensure that there is participation and consultation with national women's machineries and women's groups on all measures related to responding to the crisis.

### In the long run:

1. Create coherence between macroeconomic policy and gender equality goals by, among other actions, changing the incentive structures in society so that the responsibilities for provisioning and care are shared among states, markets, households, and between women and men.
2. Eliminate the gender-wage gap, promote living wage and decent work policies to recognize the contributions of formal and informal workers to productivity and the range of services required for a fully functioning society, including the care of all generations and their gendered implications.
3. Develop and utilize indicators of both paid and unpaid work in national income accounts and labour force statistics, including time use, in order to institutionalise the value of social reproduction and establish its relationship with production in macroeconomic policy making.
4. Increase public investment in social services and sectors and halt their privatization since this increases the burden on women and undermines their enjoyment of economic and social rights.
5. Create efficient, effective, transparent and accountable public finance management systems and practices through participatory mechanisms, including but not limited to gender-responsive budgeting.