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GLOBAL ECONOMIC RECESSION AND ITS IMPACT ON INDUSTRY AND EMPLOYMENT IN INDIA

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ABSTRACT

The world economy faces the worst crisis since 1930s. It has affected almost all countries in the world. The emerging economies like India suffered through spillover effects. Industry and employment sector experienced a regressive jolt due to drying up of credit, squeezing of market and slowdown in demand. The social cost of the crisis is unemployment. This paper argues that in devising a proper policy for combating recession, not only bailout packages but also a mix of monetary and fiscal policy is required.

Introduction

Since the onset of economic depression caused due to fallout of financial sector in the United States in September 2008 and it's consequent effect on world economy several questions comes out about the future prospects of the global economy especially for the developing countries who were erstwhile depended on the developed nations to a great extent through export, trade, investment and industrial channels. The introduction of structural adjustment programmes for stabilizing the economies of these countries and uplifting the growth trajectory has opened up. With the introduction of globalization and liberalization encompassing almos every country and industry of the world, these countries and their industries are now opening up on the world stage from the narrow confines of its national boundaries. In order to achieve higher growth trajectory they became more dependent on their developed counterparts in terms of exports, trade and technological agreement. The sudden collapse put a regressive jolt on their growth story, which decelerates global growth to 4.5% in the first quarter of 2008 comparing 2007, has slowed down economic activity in both the advanced and emerging economies. Slowdowns of economic activities all over the world across the countries were observed. The United States, Europe and Asian economies all have experienced a collapse of wealth due to sudden fall of stock prices and bursting of housing bubble. Started as a 'sub-prime' crisis originated in purely financial sector of the world's capitalist citadel it affected the real sector. Reckoning the apocalyptic impact of the crisis and sustaining collapse of the world's richest financial institutions, a corner of the world's intelligentsia termed it as "once a

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century' event and more pragmatically ' the end of capitalism'. Considering its deflationary nature some of the economists started to compare it with the "Great Depression" of 1930s.

A rough estimation of the total capital loss across the world hitherto available suggests almost US $25 trillion, which is roughly 60% of the one year's global income. So, it became a never denying fact that rocked the world economy after great depression of 1930s. Again its impact became broader based due to its contagion effect across the world's leading economies. Though the crisis in its early stage largely affected the developed world but its ripple effect aggravated the downward spirals of the economic activity in emerging economies. The immediate impact on most of the Asian economies was slowdown in economic activity. Earlier these economies were heavily dependent on their manufacturing exports to the United States and other developed countries. When the crisis occurs this inflicted through different trade and financial channels to these economies. The countries like China and India have impacted much less due to their lower shares in export sector and higher domestic demand and comparatively more government involvement in the financial sector. But the financial sectors suffered severely due to plummeting stock and commodity prices and a rise in unemployment rate. The credit became costly and consumer demand plunged to lower level. In this situation the present paper seeks to analyze the future prospect of industrialization program initiated in these countries. The rest of the paper is organized as follows. Following an introduction in section I, section II highlights the genesis of the crisis, Section III discusses about the impact of crisis on India and the possible policy response from the policymakers of the country and section VI gives concluding remarks.

Genesis of the crisis

The crisis, which started with a contraction of financial sector in most of the developed economics and ultimately spilled over across the countries, has its epicenter in the United States. In analyzing the genesis of the present crisis it is customary to put forward some definitional aspects of the crisis. A crisis may be characterized as fall of expectation from a high level to a low level. Financial crisis is a very broad term that covers a whole range of events including crashes in the housing market, stock market, foreign exchange market, current account of nations and of course the banking sector substantially lowering the growth of output and employment. The severity of the crisis depends upon how much it can affect the banking sector. In general, it may be defined as a variety of situations in which some financial institutions or assets suddenly lose a large part of their value. In the 19th and early 20th centuries, many financial crises were associated with banking sector performances, panics created in the financial sectors, stock market crash, currency crisis, balance of payment crisis

and sovereign defaults. In the theory of business cycle, recession has been characterized as periodic toughs of business cycle, which has been arrived in regular economic process. The phase between every trough and peak in a business cycle has been classified as expansionary phase. When this time phase expands for a longer period, a lack of confidence in economic activities has been observed. We call it a depression. Some economists believe that financial crisis are caused by recessions and even if a financial crisis is the initial shock that sets off a recession, there are certain other factors behind prolonging the recession.

Many economists have offered theories about how financial crisis develops and how they could be prevented. Financial crisis are still a regular occurrence around the world as a general phenomenon of financial system. According to Alvin Hansen, who described recession of US economy before World War II, "American experience indicates that with a high degree of regularity every other major business boom coincides roughly with a boom in building construction, while the succeeding major cycle recovery is force to buck up against a building slump". However, the present crisis is more severe than the previous crisis. There is plethora of explanation of the present crisis from many a section of the world's intelligentsia. These comprises with policy makers, industry professionals, management experts, financial engineers and economists. Some of them opined it as the crisis of management, crisis of network and valuation, accounting etc. The economists in the world tried to describe this crisis in their own fads and fashion. In analyzing the causes of the crisis, economists across the world provided different types of explanation. These can be divided in two broad categories. One school advocated the Schumpeterian approach of creative destruction which is inherent in the capitalist system and finally converted in a crisis. While other group accused the delinquent role of neo-liberal philosophy which freed the financial capital from its regulatory shackles, which was considered as an infallible panacea of market based approach on the one hand, and keeping labour force away from production process on the other which started in the mid' 60s just after the end of golden age of capitalism. The former approach envisages these types of shocks are necessary to keep the capitalist engine in motion, which comes from new technology, final demand and new form of industrial production and purely new type of managerial skills that the capitalist system nourishes. The later approach blamed the unscrupulous role of financial capital, which was given high importance in the liberalized era and neglected the role of labour-force by freeing them in the name of retrenchment; voluntary retirement scheme etc. over years has ultimately come to the roost.

The unfolding of the nature and the impact of the present crisis in its full extent provides some serious understandings. The head of U.S. Federal Reserve, Ben Bernake has publicly stated that the current global economic slowdown is by far the worst crisis afflicting the center of

global capitalism since 1930s. It triggered by a dramatic rise in mortgage delinquencies and foreclosure in the United States with major adverse consequences for banks, insurance sectors and financial markets around the world. The crisis has exposed pervasive weaknesses during 2008 in financial industry regulation and the global financial system. The sub-prime crisis that started in the latter half of 2007, soon transformed into a global financial crisis in September 2008 after the Government of United States has allowed the collapse of Lehman brothers. It has affected the economy to a great extent by freezing credit flows, stopped commodity market and plunged the equity market. The sub-prime mortgage crisis and the bursting of other real estate bubbles around the world are widely expected to lead to recession in the United States and a number of other countries in 2008. Many companies in the United States issued mortgages in recent years and were made to sub-prime borrowers with lesser ability to repay the loan. When mortgage prices began to decline in 2006-07, mortgage delinquencies generated and securities backed with sub-prime mortgages lost most of their value. The result has been a large decline in the capital stock of many banks and USA government-sponsored institutions.

Global recession and corporate layoffs are occurring everywhere that really dampened the investors and they are still not in a position to take any positive step of investment because the recession is still continuing. The entire world seems to be sinking into recession. The industrial houses are feeling the heat of financial crisis and the aftereffects are reduction of credit, slow down of growth, abandon of production, reduction of sale price of commodity, increase of cost of capital, reduction of employees and time and cost over-run. With this the economies of other developed countries in Europe and Asia experienced the virtual collapse of global trade, which led to a sharp downturn in their trade, manufacturing and employment. At the same time commodity prices including oil prices have plummeted to record lows with further falls expected in coming months. In order to combat the crisis, the developed economies reacted sharply with a concerted effort by announcing huge bailout packages for their financial arms. But their efforts were not beyond criticism. The impact of the crisis in the other Asian countries was graver. The negative feedback report from export oriented economies like China, East Asia and Central and Southern Europe further aggravating the downturn in core Organization for Economic Cooperation and Development (OECD) economies and developing into a vicious downward spiral cannot at this stage be ruled out. This has exerted a serious implication for other emerging economies like India.

Impact of the crisis in India

India, like other developing emerging economies has experienced the crisis to a great extent.

It has been reflected by the overall performance of the structural variables. The crisis become more severe than it was expected earlier. But some section of economists, policy makers decried at the time of crisis in the western economies that India is insulated from the western economies and the robust growth it has experienced earlier were mostly driven by domestic factors. They hoped that the economy will remain resilient amidst the global crisis and the growth story will almost remain in the future like the past. By this, they tried to promote the famous decoupling theory and with the passage of time their proposition becomes elusive. The Economic Survey rightly envisaged that "The global financial meltdown and consequent economic recession in developed economies have clearly been major factor in India's economic slowdown. Given the origin and dimension of the crisis in the advanced countries, which some have called the worst since the Great Depression; every developing country has suffered to a varying degree. No country, including India, remained immune to the global economic shock."

The shock, according to the Governor of Reserve Bank of India, D.Subba Rao, comes from three channels; the trade channel, the financial channel and the confidence channel. But affected almost all section of economic activities trough forward and backward channels. Here we shall discuss the effect of the shock on the industry and employment sector of the economy. What started out as a sub-prime crisis triggered by a housing-bubble in August 2007 transformed into a financial crisis by September 2008 and finally spilled over to the real economy late last year. The massive de-leveraging in financial markets has culminated in one of the worst economic contractions in history. With investors pulling out from overseas markets, a tightening credit market and declining consumption, industry has been forced to scale back production and defer capital expenditure plans. This, in turn, led to weakening labor markets and consumers reining in spending thereby reinforcing the vicious cycle that governments around the world are currently engaged in breaking. The International Monetary Fund (IMF) estimates Global Gross Domestic Product (GDP) to have grown by 3.2% in 2008 compared to 5.2% in 2007, propped up by developing economies that registered a 6.1% growth. Increasing integration in the global economy, however, has led to hitherto de-linked economies to be hit by the crisis as hard as the developed ones.

Developed economies have been hit by a combination of collapse in demand for high tech exports as well as declining domestic demand. Similarly, developing economies have been hit not only by decline in trade but also by dropping domestic consumption, fuelled by reversal of capital flows, collapse of stock markets and deterioration in financing conditions. As a result of the foregoing developments, there has been a significant change in fundamentals of the economy, foremost being decline in availability of cheap credit. These changes have led to a major shift in assumptions on the basis of which industry operates and plans for the future.

Commodity prices that peaked in July 2008 have more than halved now (crude oil is hovering in the $50-60 range, down by ~60% from 2008 peaks). Factors that drove prices higher including a weak dollar, low pre-boom investment in extractive industries, supply restrictions, diversion of farmland for bio-fuels and export restrictions by governments have all moved in the opposite direction since. In sharp contrast to high levels of inflation seen last year, deflation is now a potential threat to economies already suffering from low investment and consumption. Low demand has affected agriculture too. Food prices fell 34% (IMF estimates) in the second half of 2008 driven by slowing demand, higher yields and higher acreage under cultivation in response to high prices in the preceding period. Fiscal balances of developing countries are also under pressure as a result of falling tax revenues. These challenges are further reinforced by political compulsions that push for growing protectionism.

The IMF forecasts global GDP to decline by 1.3% in 2009; the deepest recession post World War II, with high income countries declining by 3.8% and growth in developing countries slowing down to 1.6%. The Indian economy is expected to grow between 4.5% and 5.5% in the Financial Year 2009-2010. The recently announced stimulus package of US$1.1 trillion by the G20 is expected to help towards reaching a recovery by early 2010. The outlook, however, continues to be uncertain regarding timing of any possible recovery, the concern being whether policies will be enough to arrest the negative feedback between deteriorating financial conditions and weakening economies. Commodity prices have stabilized within a broad range since December 2008 and are expected to remain so for the remainder of 2009. Declining prices and consumer demand are expected to affect agriculture with indications of lower acreage planned for 2009. World trade too is expected to fall 9% in volume terms in 2009. Overall, while 2008 was a challenging year for business given the extreme volatility and supply side restrictions, 2009 is likely to present challenges due to weakening demand with margins sustained only due to steep fall in input prices.

Advanced economies in Asia have been affected due to their high export dependence and large exposure to the drop in global demand for automobiles, electronics, and other consumer durable goods. However, emerging Asia is expected to continue to grow, led by China and India. With trade comprising a smaller share of the economy, India is less exposed to the decline in global demand with domestic consumption expected to remain relatively robust. Though growth of the industrial sector started to slow down in the first half of 2007-08, the overall growth during that year remained as high as 8.5 per cent. The index of industrial production for the year 2008-09 points towards a sharp slowdown with growth being placed at 2.4 per cent. Manufacturing growth was placed at 2.3 per cent in 2008-09 as compared to 9.0 per cent in 2007-08. Mining grew at 2.3 per cent in 2008-09 as against 5.1 per cent in

2007-08 while electricity showed a deceleration in growth from 6.4 per cent in 2007-08 to 2.8 per cent during 2008-09. Slower growth in all use-based categories, except consumer durables, contributed to the deceleration in the industrial sector. The performance of six core industries comprising crude oil, petroleum refinery products, coal, electricity, cement and finished steel (carbon) grew at 2.7 per cent as compared to 5.9 per cent in 2007-08. The growth in index for crude oil turned negative 1.8 per cent as compared to positive 0.4 per cent in 2007-08. There was a deceleration in the growth of cement and finished steel reflecting the negative sentiments in the construction and manufacturing sectors.

The worst effect of the recession was on the employment sector. The social cost of the recession is growing up of unemployment in most of the economics. India is no exception (Table 1). There has been a job cut in almost all the sectors (except in government sector) has been observed throughout the world. The International Labour Organization (ILO) has presented the picture of reduction in employment across the world. In India, according to labour bureau, mining, metal and metal products, textile and garments, gems and jewellery, construction, transport and some segment of service sector (mostly, information technology and Business Process Outsourcing (BPO) services including private banks) has suffered much (Table 2). This was due to slow down in investment and industrial growth. At the same time a reduction in foreign direct investment was also observed. Due to slow production in Indian industrial sector (Index of Industrial Production lowest in November, 2008) job cut, lay off and retrenchment has been observed in the Indian manufacturing. On the other hand, high degree of protectionism was observed from the overseas front. The bailout packages offered by their government with strict employment conditionality, has gone against the workers of other countries. This also freed the workforce from its regular employment in abroad. At the same time closure of BPO houses due to shortage in their work has also freed some of the workers from this sector. The resultant effect was a decrease in employment. At the same time slowdown in agriculture across the world and subsequent decline in investment in this sector has also lowered the employment in these sectors. The construction sector, which absorbs a large section of workforce, has reduced its employment generating capacity due to lack of investment in that sector with the unfolding of the crisis. Small producers and traders suffered much with the fall in prices and drying up of credit. This all contributed near to a stagflation situation of the economy (Table 3).

Conclusion

India, unlike other countries in developed world and Asia, though affected less in the ongoing crisis but cannot escape unscathed in the present crisis because its economy has become

more integrated with the rest of the world over last eighteen years. It is largely dependent on overseas investment for industrial and infrastructural development. Again, Foreign Institutional Investors played an important role in keeping the Indian Stock Market attractive by supplying adequate liquidity. Monetary policy is a string and can be pulled in time of inflation but cannot be pulled in time of depression. So the authority shall be cautious in taking further monetary stimuli to combat this recession. In constructing the monetary and fiscal framework for combating recession one must keep on its long run effectiveness (Friedman, 1948). The government of India has taken several monetary and fiscal measures to combat the recessionary effects on the economy. The intention of this section is not to find out the blemishes of these measures, as they are need of the hour of that time. The major challenges before the government at that moment were to maintain the growth story of the economy almost intact. The plummeting stock market, the decreasing demand, fall in index of industrial production, growing unemployment, and decreasing prices were the major challenges appeared before the government with the advent of the crises. This is not yet over. For countries such as India, keeping international markets open is very much important. The Foreign Direct Investments played an instrumental role in uplifting the growth trajectory. Analogous to that, maintaining fiscal and monetary stability is also a major task. At the same time arrangement for credit to industrial sector especially for Small and Medium Enterprises and Small and Micro Enterprises are also necessary as it accounts for a major section of people in terms of employment and livelihood. Providing special privileges such as subsidies should encourage the entry of the SMEs; low interest loan, tax concession and these can contribute to employment creation and entry of new industries.

A recession proof industrial policy is of paramount important that really can pay rich dividend in the near future. Access to infrastructure services (financial, physical, labour) is crucial for economic growth and poverty reduction. Energy to drive industry and create jobs, water to support agricultural production, and roads and ports to transport products to the market are critical to any country in this moment of economic downturn. The right infrastructure financing can open doorways to the 'post-recession' period that many nations are expecting with interest and hope. There is a need to take a proactive policy of wooing investors to invest in new projects in these sectors like electricity, roads, airports, ports, education, and health through different arrangements. There may be variety of arrangements e.g. joint ventures, public-private enterprises, private etc. There may be some incentives for the private operators because of their superior efficiency. Fiscal concession, low market price of land may be offered to them in order to assure attractive return. Infrastructure projects often take years to prepare but it is the right time to investment in education and health that will lay the foundation for the

future. Domestic mobilization from non-bank sources through fresh capital issue in the primary market, external borrowing, foreign direct investment and private placements has to be increased.

Earlier in India its reliance on agriculture was unique in the world. After liberalization, the investment on agriculture has declined remarkably which causes actualization of rural workforce and at the same time skyrocketing of food prices. In order to reverse this massive investment in agriculture is required. There is an absolute need for effective use of public resources for reviving growth and to safeguard the interest of the masses through wide appreciation among the public and political class. Medias also can play an important role by disseminating information and promote serious debate over strategically important areas. Considering the present state of industrialization it is not important to emphasize on location-specific sentiment but to consider numerous other factors affecting internally or externally. Growth of output, employment and well-being of the masses will be the ultimate aim. This can be achieved by pumping finance into the development projects and effective use of all the available resources. With rising unemployment, job losses and salary cuts, there is a great deal of fear and frustration. Safety nets for pure and vulnerable section are also essential. Again, insulation of financial sector from external shock is very essential. The crisis, which India is facing, is purely an imported one. In a nutshell, India needs a policy for reviving the real economy through fiscal and monetary stimuli.

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Table-1

Performance Compared To Pre-Lehman Levels (figures in US $)

Source : FactSet. Bloomberg Sharma, Ruchir, "Macro is all that matters", The Economic Times, August 10, 2009

Table 2

Rate of growth at factor cost at 1999-2000 prices (per cent)

Source : Central Statistical Organization as quoted in Economic review, Government of India, 2009

Table 3

Quarterly estimates of GDP 2007-08 and 2008-2009 (percentage change)

Source : Central Statistical Organization as quoted in Economic review, Government of India, 2009