GLOBAL RECESSION AND ITS IMPACT ON DEVELOPING ECONOMIES

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Introduction:

In economics, a **recession** is a business cycle contraction, a general slowdown in economic activity. During recessions, many macroeconomic indicators vary in a similar way. Production, as measured by gross domestic product (GDP), employment, investment spending, capacity utilization, household incomes, business profits, and inflation all fall, while bankruptcies and the unemployment rate rise. Recessions generally occur when there is a widespread drop in spending, often following an adverse supply shock or the bursting of an economic bubble. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply, increasing government spending and decreasing taxation.

Definition:

In a 1975 *New York Times* article, economic statistician Julius Shiskin suggested several rules of thumb for defining a recession, one of which was "two down consecutive quarters of GDP". In time, the other rules of thumb were forgotten. Some economists prefer a definition of a 1.5% rise in unemployment within 12 months. In the United States,the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) is generally seen as the authority for dating US recessions. The NBER defines an economic recession as: "a significant

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decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." Almost universally, academics, economists, policy makers, and businesses defer to the determination by the NBER for the precise dating of a recession's onset and end. In the UK recessions are generally defined as 2 successive quarters of negative growth.

Attributes:

A recession has many attributes that can occur simultaneously and includes declines in component measures of economic activity (GDP) such as consumption, investment, government spending, and net export activity. These summary measures reflect underlying drivers such as employment levels and skills, household savings rates, corporate investment decisions, interest rates, demographics, and government policies. Economist Richard C. Koo wrote that under ideal conditions, a country's economy should have the household sector as net savers and the corporate sector as net borrowers, with the government budget nearly balanced and net exports near zero. When these relationships become imbalanced, recession can develop within the country or create pressure for recession in another country. Policy responses are often designed to drive the economy back towards this ideal state of balance. A severe (GDP down by 10%) or prolonged (three or four years) recession is referred to as an economic depression, although some argue that their causes and cures can be different. As an informal shorthand, economists sometimes refer to different recession shapes, such as V-shaped, U-shaped, L-shaped and W-shaped recessions.

History:

There is no commonly accepted definition of a global recession, although the International Monetary Fund (IMF) regards periods when global growth is less than 3% to be global recessions. The IMF estimates that global recessions seem to occur over a cycle lasting between 8 and 10 years. During what the IMF terms the past three global recessions of the last three decades, global per capita output growth was zero or negative. Economists at the IMF state that a global recession would take a slowdown in global growth to three percent or less. By this measure, four periods since 1985 qualify: 1990–1993, 1998, 2001–2002 and 2008–2009.

According to economists, since 1854, the U.S. has encountered 32 cycles of expansions and contractions, with an average of 17 months of contraction and 38 months of expansion.[5] However, since 1980 there have been only eight periods of negative economic growth over one fiscal quarter or more, and four periods considered recessions:

- July 1981 – November 1982: 14 months
- July 1990 – March 1991: 8 months
- March 2001 – November 2001: 8 months
- December 2007 – June 2009: 18 months

For the past three recessions, the NBER decision has approximately conformed with the definition involving two consecutive quarters of decline. While the 2001 recession did not involve two consecutive quarters of decline, it was preceded by two quarters of alternating

Government responses:

Most mainstream economists believe that recessions are caused by inadequate aggregate demand in the economy, and favor the use of expansionary macroeconomic policy during recessions. Strategies favored for moving an economy out of a recession vary depending on which economic school the policymakers follow. Monetarists would favor the use of expansionary monetary policy, while Keynesian economists may advocate increased government spending to spark economic growth. Supply-side economists may suggest tax cuts to promote business capital investment. When interest rates reach the boundary of an interest rate of zero percent conventional monetary policy can no longer be used and government must use other measures to stimulate recovery. Keynesians argue that fiscal policy, tax cuts or increased government spending, will work when monetary policy fails. Spending is more effective because of its larger multiplier but tax cuts take effect faster.

Stock market:

Some recessions have been anticipated by stock market declines. In *Stocks for the Long Run*, Siegel mentions that since 1948, ten recessions were preceded by a stock market decline, by a lead time of 0 to 13 months (average 5.7 months), while ten stock market declines of greater than 10% in the DJIA were not followed by a recession. The real-estate market also usually weakens before a recession. However real-estate declines can last much longer than recessions. Since the business cycle is very hard to predict, Siegel argues that it is not possible to take advantage of economic cycles for timing investments. Even the National Bureau of Economic Research (NBER) takes a few months to determine if a peak or trough has occurred in the US.

During an economic decline, high yield stocks such as fast moving consumer goods, pharmaceuticals, and tobacco tend to hold up better. However when the economy starts to recover and the bottom of the market has passed (sometimes identified on charts as a MACD, growth stocks tend to recover faster. There is significant disagreement about how health care and utilities tend to recover. Diversifying one's portfolio into international stocks may provide some safety; however, economies that are closely correlated with that of the U.S. may also be affected by a recession in the U.S. There is a view termed the *halfway rule* according to which investors start discounting an economic recovery about halfway through a recession. In the 16 U.S. recessions since 1919, the average length has been 13 months, although the recent recessions have been shorter. Thus if the 2008 recession followed the average, the downturn in the stock market would have bottomed around November 2008. The actual US stock market bottom of the 2008 recession was in March 2009.

Impact on Developing Economies:

Rise in the prices of commodities and raw materials

- A reversal of the trend suggested by the Prebisch-Singer hypothesis that the terms of trade between primary products and manufactured goods tend to deteriorate over time; the developing countries faced limited prospects for economic growth through trade

- contrary to expectations, the prices of oil, agricultural products, metal and minerals increased significantly leading to a perceptible rise in the income and purchasing power of people in the rural areas
- strengthened the consumer base and resilience of the economy and added to an ever expanding pool of middle class

Rise in employment, wages and incomes

- Came through the pursuit of export led industrialization strategies linked to the development of buyer driven value chains
- Marked a significant departure from the import substituting industrialization strategies of the preceding era, which along with centralized planning and employment relations
- They conformed to a post-war construct of full-time and life-time jobs in the organized sector, all sought to be spread through the producer driven value chains
- Much of the growth in employment, productivity and wages took place outside in the unorganized sector led by the new value chains
- Serious implications for income distribution; most notably its conformity with the predictions in Kuznets hypothesis

Features of an increasingly integrated world

- Price signals got transmitted faster; inflation, interests and currency exchange rates became fairly autonomous variables
- Correspondingly a rapid rise of asset prices – equities, houses and real estate – in a market characterized by "irrational exuberance"
- Parallel expansion of credit lines to support the packaging and distribution of a huge volume of toxic assets with dubious credentials or prospects for solvency
- Disconnect between productivity growth and assets prices became evident as regulatory institutions failed to control the latter

The crisis was an accident waiting to happen

- As it engulfed the developed world, the financial majors got burnt; their acolytes in the developing world too were affected

- Untold human suffering followed when the asset prices collapsed after which credit lines got dried up; production declined; inventories piled up; jobs disappeared and a fully fledged recession surfaced
- Adverse effects of the recession were felt all over the world, as export markets for commodities and intermediate goods collapsed; the impact on countries varied in scale and intensity

In general a lesser impact on the developing countries

- firstly, with the fall in commodity prices, notably of petroleum products inflationary spiraling came under control
- Reduction in asset prices was lower and its impact less devastating in comparison to the situation in the developed world
- Depreciation of developing country currencies helped to minimize any major reduction in the volume of export
- A larger volume of cheaper goods and services became accessible consumer in the rich countries

Interesting developments on the migration front

- No significant reduction in the intake of migrant workers in the receiving countries, except in some Emirates in the Gulf region
- A huge increase in the volume of remittances mainly from the dollar denominated currency regions; in Kerala alone remittances are estimated to have increased by Rs.10,000 cr equal to 2 Billion USD
- The pace of internal migration increased spending on infrastructure development
- The economically backward regions of India became net exporters of labour, leading to sizeable increases in remittances

Global economy got organized responding to the crisis

- A resurrection of Keynesian economics came with a pronounced emphasis on expansionary fiscal policies; the USA started debating policies for the reform of health care and housing market
- Bail-outs and special stimulus packages targeted on the lower end of the income distribution pyramid were put into operation
- Deficit financing gained wide currency even in the rich world
- India had already made impressive strides with massive public spending packages, notably under the NREGA
- With a sizeable and growing middle class, India and China have emerged as major economics insulated to withstand any global crisis

The combined efforts have had discernible effects

- The figures in Table 1 suggest that recovery is in the horizon for major countries of the global economy
- Predicated growth rates for the year 2010 are in the positive territory among the industrialized countries while in China and India they would rise to higher and more credible levels.
- Budget deficits have soared in all the countries, rich and poor, where the post-recession growth recovered

Some notable lessons from the recession and responses

- reinstated a notion, eclipsed in recent decades, that the state has primacy with three major roles in the functioning of markets:
- a facilitating role promoting citizens rights and immunities
- a regulatory role preventing any mode of iniquitous growth
- a redistributive role to protect the weak and vulnerable
- The need to institute a global financial regulatory regime to prevent the onset of future excesses and abuses
- Brought out the vast under-utilized potential for stimulating growth through expansionary economic policies at the national level

- Highlighted the significance of employment planning and equitable income distribution in developing countries.

The strategic importance of employment planning

- The crux of the employment problem lies in turning latent unemployment into open employment
- Scope for creating revolving employment leading to more sedimented employment through asset creation and infrastructure
- A vast reservoir of untapped labour resources, especially female labour, comes in handy for strengthening assets
- The NREGA led to perceptible improvement in employment and wages; it paid rich political dividends in many Indian states

Labour market policies for equitable growth

- need to draw a distinction between protectionist and promotional policies for employment; we cannot protect what does not exist, especially in societies far remote from the threshold of near total urbanization and full employment
- In India employment in the organized sector-registered establishments under the surveillance of the state-with the state as the principal employer, has been perceived as the most effective means of ensuring equitable distribution; the main thrust of legislative enactments was to project jobs in the organized sector
- Regulations that restricted firing could have restricted new hiring; though employment stagnated in the organized sector, from the 1990s onwards, employment, productivity and wages rose in unorganized sectors

Table 1

Some performance indicators of major economies

Countries	Rates of Groeth of GDP (%)		Budget balance (% of GDP)
	2009	2010	2009
USA	-2.7	+2.0	-13.7

Japan	-6.1	+1.0	-6.8
China	+7.2	+7.6	-4.3
India	+5.5	+6.4	-7.8
Britain	-3.7	+1.1	-13.9
Germany	-6.0	+0.6	-4.7
France	-2.9	+0.7	-6.6
Italy	-5.0	+0.4	-5.2
Euro area	-4.4	+0.6	-5.9

Source : Economic intelligence unit of the Economist, July 25 ,2009

Conclusion:

The International Monetary Fund has warned that a global recession cannot be ruled out, as the effects of the eurozone debt crisis are spreading to more countries, banks and investors. Antonio Borges, the head of the IMF's Europe program, on Wednesday said that a recession in 2012 "cannot be ruled out," citing a possibility that the "activity will turn downwards," AFP reported. The IMF forecasts the growth rate in Europe to slow down to 2.3% in 2011 from 2.4% in 2010, and to 1.8% in 2012. Inflation is expected to decline from 4.2% in 2011 to 3.1% in 2012. On Wednesday, the IMF issued a 100-page report describing the eurozone economic prospects and policy changes that would be required if a downturn is confirmed. "Finding a durable solution to the euro area sovereign crisis has become more than overdue," the IMF said in its report. Borges said the international lender would recommend "changing economic policy" away from austerity and back towards the US and British-style stimulus. If ever there was a more significant recession in Europe, and I hope that is not the case but we cannot exclude it, then... all those countries with fiscal leeway might want to consider that," he added. Since last year, the European Union and the International Monetary Fund have provided Greece with two rescue packages worth over USD 380 billion in return for tough austerity measures. On Sunday, Athens declared that it could not meet its 2011-2012 deficit targets, which prompted EU finance ministers to hold a decision on providing the crisis-hit Greece with its next package of bailout fund worth eight-billion-euros. In September, the IMF warned that the financial crisis in developed economies had entered a "dangerous new phase", saying a fall back into recession for Western economies would have serious knock-on effects for the rest of the world.

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