THE ROLE OF STATE IN MANAGING DOMESTIC BUSINESS AGAINST GLOBAL CRISIS

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Abstract

The global financial crisis originated in the U.S. which surfaced in 2007 with the failure of a few leading institutions and most notably Lehman Brothers, which led to freezing up of several markets including the overnight inter-bank market with a sharp jump in defaults and foreclosures. The effect is being witnessed in all major economies of the world, financial institutions in Europe and to a much lesser extent in East Asia. The global slowdown has also affected the business climate in India and the growth rate of all the industries within. In India, the adverse effects have so far been mainly in the equity market because of reversal of portfolio equity flows, and the consequent effects on the domestic forex market and liquidity conditions.

The macro effects have so far been muted due to the overall strength of domestic demand, the healthy balance sheets of the Indian corporate sector and the predominant domestic financing of investment. Economists feel, the large Indian domestic market can keep fuelling growth of the Indian economy, though at a lower pace, despite financial crisis leaving the US and Europe reeling under recession. The Indian domestic market is so big that if there is some pause in the global market, it will not affect too much the Indian corporates. India must adopt a strategy of self-reliance to protect the domestic industry for economic and social growth besides engaging in global trade. In my paper my objectives are to justify the argument that globalisation or global trade is beneficial for India but at the same time we should equally concentrate in strengthening the domestic market; and we should encourage those industries for free trade in global market which are potentially strong and protect those industries which are infants and should wait until they are not self-sufficient to compete openly in the global market and with some suggestions regarding the policies the govt. should adopt.

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1. Introduction:-

The global financial crisis originated in the sub-prime mortgage crisis which surfaced nearly six years ago in the U.S. With interest rates rising and home prices falling, there was a sharp jump in defaults and foreclosures. With the failure of a few leading institutions and most notably Lehman Brothers, the entire financial system was enveloped into an acute crisis. Major Banks and other financial institutions around the world have reported losses of approximately US $ 435 billion as on 17th July, 2008 (Onaran, 2008). A host of factors, such as the low interest rates, complex mortgage securitization process, leveraged debt of banks and financial institutions, rise of perverse incentives and complexity for credit rating agencies, expanded linkages between national financial centres that stimulated expansion in credit and spurred economic growth.

Still the effect is being witnessed in all major economies of the world. Several countries are experiencing rapid contraction in their Global Domestic Product, rising unemployment levels and an overall slowdown in the pace of investment activity. The global slowdown has also affected the business climate in India and the growth rate of all the industries. India's present economic woes are marked by a rapid fall in the value of the rupee caused by persistent inflation of the past few years and the high current account deficit (CAD) of about $85 billion (4.5 per cent of GDP) which needs to be funded through uncertain capital inflows year after year. In India, the adverse effects have so far been mainly in the equity markets because of reversal of portfolio equity flows, and the consequent effects on the domestic forex market and liquidity conditions.

The macro effects have so far been muted due to the overall strength of domestic demand, the healthy balance sheets of the Indian corporate sector, and the predominant domestic financing of investment.

2. Objectives of the Study:-

My objectives are to justify the argument that globalisation or global trade is beneficial for India when we should equally concentrate in strengthening the domestic market; and encourage those domestic industries for free trade in global market which are potentially strong and protect those industries which are infants and should wait until they are not self-sufficient to compete openly in the global market and to give some suggestions regarding the policies the govt. should adopt.

3. Background:-

3.1. Impact of Global Crisis on Indian Economy :-

India, South Asia's largest economy, has been facing major challenges owing to the global financial crisis. The immediate effects were plummeting stock prices, a net outflow of foreign capital, a large reduction in foreign reserves and a sharp tightening of domestic liquidity. These caused a rapid depreciation of the exchange rate and a surge in short-term interest rates. The second round effects emerged from a slowdown in domestic demand and exports. Demand effects have been particularly severe in housing, construction, consumer durables and the IT sector. As a result, manufacturing production has taken a hit and activities in the organized services sector (housing, construction, IT) are down sharply.

The Impact of Global Economic Crisis in India can be prominently found in the following areas:-

- **Information Technology:-** where approximately 61 per cent of the Indian IT Sector revenues were from U.S financial corporations like Goldman Sachs, Washington Mutual, Citigroup, Bank of America, Morgan Stanley and Lehman Brothers);
- **Indian Banking System**:- where Indian banks, both in the public sector and in the private sector, are financially sound, well capitalized and well regulated, no direct impact on account of direct exposure to the sub-prime market was in evidence;
- **Stock and Forex Market** :- where foreign institutional investors' (FIIs') withdrew its equity and these withdrawals drove the Sensex down from over 20,000 to less than 9,000 in a year. Dollar purchases by FIIs and Indian corporations to meet their obligations abroad have also driven the rupee down to its lowest value in current time;
- **Industrial Sector and Export Prospect**:- where it has slowed down the growth of industrial sector, with from 8.1 per cent in 2007 to 4.82 per cent in 2013. The service sector, which contributes more than 50 per cent share in the GDP and is the prime growth engine, is slowing down, besides the transport, communication, trade and hotels & restaurants subsectors.) and

- **Employment**: where a survey conducted by the Ministry of Labour and Employment states that in the last quarter of 2008, five lakh workers lost jobs from the sectors as Textiles, Automobiles, Gems & Jewellers, Metals, Mining, Construction, Transport and BPO/ IT sectors. There was also a significant drop in new hiring.

3.2 Domestic Market to Protect Indian Economy from Global Crises(Experts' Views):-

Large domestic market keeps fuelling growth of the Indian economy, though at a lower pace, despite financial crisis leaving the US and Europe reeling under recession. While the Reserve Bank and stock regulator SEBI have announced measures to improve liquidity in the system, the equity market has suffered painful bruises in India in sync with the global bourses. But economists feel, the domestic market, which is much bigger than the exports, would save the day for the economy.

The Indian domestic market is so big that if there is some pause in the global market, it will not affect the Indian corporates. Unlike other countries, India has a vast market and a significant proportion of their (Indian industry) output is targeted for the domestic market (according to Secretary General of the FICCI Amit Mitra). The global turmoil would impact the Indian financial sector and the problems in the US and Europe would hurt the Indian economy but the impact has not been direct. He agreed that a wide Indian market will help sustain the growth to some extent (According to ICRIER Director Rajeev Kumar).

4. Methodology :-

The data for this study have been collected from secondary sources of information are mainly from the web sites and News dailies (news papers) besides from the research publications which are mentioned in the reference section.

5. Analysis and Discussion:-

The Indian economy looked to be relatively insulated from the global financial crisis that started in August 2007 as the Reserve Bank of India (RBI) raised interest rates until August 2008 with the objective of cooling the economy and bringing down the gross domestic product (GDP) growth rate, which visibly was contributing to the build up of inflationary pressures in the economy.

India's foreign debts are mostly private, and the Indian government's fiscal position, is not so strong but is also not as weak as seen in Latin America in the 1980s or some European countries more recently. There is a large annual budget deficit around 9 percent of gross domestic product (GDP) – but recent growth and a significant degree of inflation mean that debt relative to GDP was around 66 percent by the end of 2013. This is not to play down the pressures. The effect of exchange rate depreciation is to push up domestic inflation in part because much of India's oil is imported and world oil prices are in dollars, so depreciation immediately pushes up the domestic price in rupees. Indian companies have a massive exposure of close to $200 billion of loans from abroad and the sharp fall in the rupee is making their repayment even more difficult.

In a sense, the depreciation of 15 to 20 per cent in 2013 of the currencies in Brazil, South Africa, Turkey, Indonesia and India can be seen partially as a knee-jerk reaction to the smart recovery of the housing market in the U.S. and the consequent prospect of the Federal Reserve gradually unwinding its ongoing $40 billion a month support to mortgage bonds over the next year or so. The U.S. Federal Reserve balance sheet was roughly $890 billion in 2007. It has ballooned to a little over $3 trillion today simply by printing more dollars. Such massive liquidity injection by printing dollars in such a short period is probably unprecedented in American history. This is also unsustainable because sooner rather than later, such excess liquidity could send both inflation and interest rates shooting up in the U.S. which again may not be good for the rest of the financially connected world.

5.1Present Global Economic Situation and Prospects :-As per The United Nation's World Economic Situation and Prospects (WESP), 2013 report, six years after the eruption of the global financial crisis, the global economy is still struggling to recover. During 2012, growth of the world economy has weakened further. The global economy has grown at 2.2 per cent in 2012, at 2.4 per cent in 2013 and is expected at 3.2 per cent in 2014.

Weaknesses in the major developed economies are at the root of the global economic slowdown. The report stresses that most of them, but particularly those in Europe, are trapped in a vicious cycle of high unemployment, financial sector fragility, heightened sovereign risks, fiscal austerity and low growth. Several European economies and the euro zone as a whole are already in recession. Deflationary conditions continue to prevail in Japan. The economic woes in Europe, Japan and the United States are spilling over to developing countries through weaker demand for their exports and heightened volatility in capital flows and commodity prices.

Economies in developing Asia have weakened considerably during 2012, as the region's growth engines, China and India, have shifted into lower gear. While a significant deceleration in exports has been a key factor behind the slowdown. Given persistent inflationary pressures and large fiscal deficits, the scope for policy stimulus in India and other South Asian countries is limited. China and many East Asian economies, in contrast, possess much greater space for countercyclical policy.

5.2Present Indian Economic Scenario:-Real GDP growth sharply rebounded to 5.6% in Q3-2013 driven by exports which benefited from the significant INR depreciation where private consumption is likely to be the main driver. The economy growth rose only slightly to 4.3% in 2013, and is expected to gradually improve to 5% in 2014 and to 6% in 2015. The decline in political uncertainties after the general elections in May 2014 would boost domestic demand. The INR depreciation also added to inflationary pressures. The RBI hiked its policy rate by a cumulative 50bps to 7.75% in September and October 2013. The INR has stabilized at 62 per USD, well off its weak point at 68 in August 2013. Inflation is expected to remain persistently high, averaging 6-6.5% over the next two years, reflecting structural bottlenecks on the supply side.

5.3 Government Set to Protect Domestic Industry:- India is ready to protect its domestic manufacturers from Chinese products swamping the market, despite the danger of WTO rules looming large. The move, however, courts the danger of other countries dragging India to WTO terming the favours granted as unfair trade practices under the international agreement.

Three central ministries - Telecom, Heavy Industries and Renewable Energy - would soon have policies to protect domestic producers from the increasing penetration of foreign manufacturers especially in the form of cheaper equipment from China.

These three sectors contribute to around 1/3 of annual manufacturing output in terms of money but their growth has slowed down in the recent years, with many players opting for cheaper and less reliable Chinese goods, thereby making the market unprofitable for domestic manufacturers.

The move, however, is laced with the danger of other countries dragging India to WTO terming the favours granted to domestic industry as unfair trade practice under the international agreement.

India will look into the provisions of all the Free Trade Agreements (FTAs) with other countries so as to protect the interest of the domestic industry(According to Union Minister of State for Commerce and Industry, E M S Natchiappan , Economic Times).

6. Recommendations:-

In the present era, where Multi National Companies are trying to capture the Indian market, Indian domestic industry plays a motivational role to establish their own enterprise and make opportunities for Indians to solve the problem of unemployment and contribute in the economic growth of India. Domestic entrepreneurs serve as the catalysts for the process of rapid industrialization and economic growth. There is no doubt that globalisation helps a country in getting better quality products, cheaper rates, most advanced technologies; but we should also make our domestic industry self-dependent at the same time.

On the basis of the present situation of Indian economy, the following recommendations can be made:-

(a) **Promotion of Domestic Industry**: - The most important is to promote the domestic industry side by side with the encouragement of foreign companies. It aims to protect the domestic manufacturing sector.

(b) **Employment Generation**: - The basic objective of the economic reform should be to create employment in the setting up of industries. Unemployment is the today's biggest problem. An entrepreneur is a person who helps to solve this problem.

(c) **Promotion of Industrialization**:- To achieve the above two objectives Indian Govt. should focus to industrialize the country. This promotes industrial development. Domestic producers can take part equally in the competition with the MNCs.

(d) **Production of Consumer's Goods**: - In the present era it is very important that a manufacturer must produce consumers goods which where technology is often rather simple and the demand for the product is easily identifiable.

(e) **Improvement in Balance of Payment**:- Decrease in import of goods and increase in export means inward flow of foreign capital to India and less outward flow of foreign capital from India. This condition helps to reduce deficit in Balance of Payment which can improve economic condition of India.

(f) **Promotion of Technical Education**: - There can be large economic and social benefits from promotion of technical education. The argument that MNCs exploit the human resource of developing countries like India becomes valid as they find cheap, unskilled or semi-skilled labours here and they outsource it mainly. Promotion of technical education improves technological knowledge and worker skills, more conductive to growth, national pride, self-sufficiency and new attitude for global competition.

(g) **Convenient Market Information**: - Domestic entrepreneurs should get information very conveniently about current update about global economy. A developing country may lack the expertise to judge just which of the thousands of heterogeneous industrial goods it could best market abroad.

(h) **Promotion of SSI Sector** :- As regards the small scale industry (SSI) sector plays the vital role in Indian economic development the Indian Govt. should take steps to increase the export potential of SSI sector. Individual assistance for participation in overseas fairs, study tours and also production of publicity materials for overseas publicity should be provided to the SSI entrepreneurs.

(i) **Better Infrastructure** :- For better industrialisation govt. should consider this on the top most priority. And to achieve this Govt. should invest a large part from its budget in better road, air connectivity, sanitation, drainage system, easy and convenient ware housing system, availability of input materials, etc.

Some other necessary reforms include: creating a better environment for infrastructure development with an appropriate institutional framework such as a dispute-resolution mechanism, independent regulatory authority, and special investment law; establishing a uniform labour code after an independent review and proper consultation with stakeholders; ensuring proper design and planning of special economic zones (SEZ), including local-level solutions for land acquisition and sector-specific policies with incentives to attract FDI into SEZs; revisiting outdated laws, controls, regulatory systems, and government monopolies affecting the investment environment; and finally, encouraging non-governmental facilitation services for foreign investors.

Overall, India needs to address its lack of adequate infrastructure, rigid labour laws, and bureaucratic delays and make state-level reforms to realize its FDI potential.

(j) **Special Attention to Agri-Industry** :- A primary step that the Indian government must take to reduce inequality and poverty is to improve productivity growth in agriculture. More than 56% of the total labour force depends on agriculture, although this sector contributes only 16% to India's total GDP in 2013. The government should institute policies that provide education and vocational training in order to move people out of agriculture and make use of opportunities in the market economy.

(k) **Improve Socio-Economic Infrastructure**: - Growth is necessary for the government to meet the socio-economic infrastructure requirements for a majority of the population. Lagging investor confidence and an economic slowdown in manufacturing and industry would disappoint the aspirations of millions of young people searching for jobs. With a median age of 25 years, India has a young population compared to other Asian countries like Japan and China, which need to deal with an aging population. Now India must sustain its growth and create jobs to reap the rewards of its population dividend.

(l)**Protection to Infant Industry**: - Infant industries must be protected in order to allow them to grow to a point where they can fairly compete with the larger mature MNCs. Without this protection, infant industries will die before they reach a size and age where economies of scale, industrial infrastructure, and skill in manufacturing have progressed sufficiently to allow the industry to compete in the global market. They should get extra facilities like tax rebate, cheaper loan, training, financial support from govt., etc. Industries need to improve their products, overall marketing efficiency and energy management and cut their costs to survive i.e. radical corporate restructuring across the board.

(m) **Direct subsidies**: Government subsidies (in the form of lump-sum payments or cheap loans) are sometimes given to local firms that cannot compete well against imports. These subsidies are purported to "protect" local jobs, and to help local firms adjust to the world markets.

(n) **Using natural resources**:- The government can easily generate $20 billion or one per cent of GDP by allowing higher coal and iron ore production from its large reserves. Our annual coal imports have gone up from roughly $7 billion five years ago to about $18 billion now in 2013. The increased dollar outflow was largely avoidable because India has among the largest coal reserves in Asia. India could have saved $10 billion simply by producing more domestic coal.

(o) **Food security mechanism**: Further, a more rounded food security mechanism can help insulate the poor from rising food inflation. This can free up the Reserve Bank of India to look at the manufacturing inflation as a dominant basis for making monetary policy and help ease interest rates for industry.

(p) **Anti-dumping legislation:** Supporters of anti-dumping laws argue that they prevent "dumping" of cheaper foreign goods that would cause local firms to close down.

7. Conclusion:-

For globalisation to have a positive effect, all it requires is that countries respond to opportunities and adjust to constraints with proper safety nets. In India, we do not have any specific strategy because ours is a reactive liberalisation and not a proactive and planned liberalisation. Thus, what is required is ---the need to revisit our approach to globalisation and reforms on our terms, keeping in mind our requirements and interests; and to make it an agricultural and people-led liberalisation rather than just a corporate and business-led liberalisation.

One cannot overstate the importance of sound economic management, strong fiscal positions, credible proactive monetary policy and rigorous financial-sector oversight. Emerging markets like India must convince foreign investors they are on.

The aim of globalisation is to build up a constituency for economic reforms and unlock vital resources for generating better employment opportunities and getting people out of poverty. Instead of developing a pessimistic outlook and finding faults in the process of globalisation, it is better that India pulls up its socks and moves ahead. It is true that any restructuring will have losers and gainers, but there are no perfect answers to all the problems. We, the People of India, will have to eventually choose one path; the choice must be in the direction that points to the growth of our nation which will only happen by making globalisation work for the poor and that is only possible if we make our domestic industry so much strong, obviously witnessing the globalisation together that any sudden turbulence like global financial crisis India will stand as it is and will keep a lesson for others.

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