Managing the Crisis |

India Country Report

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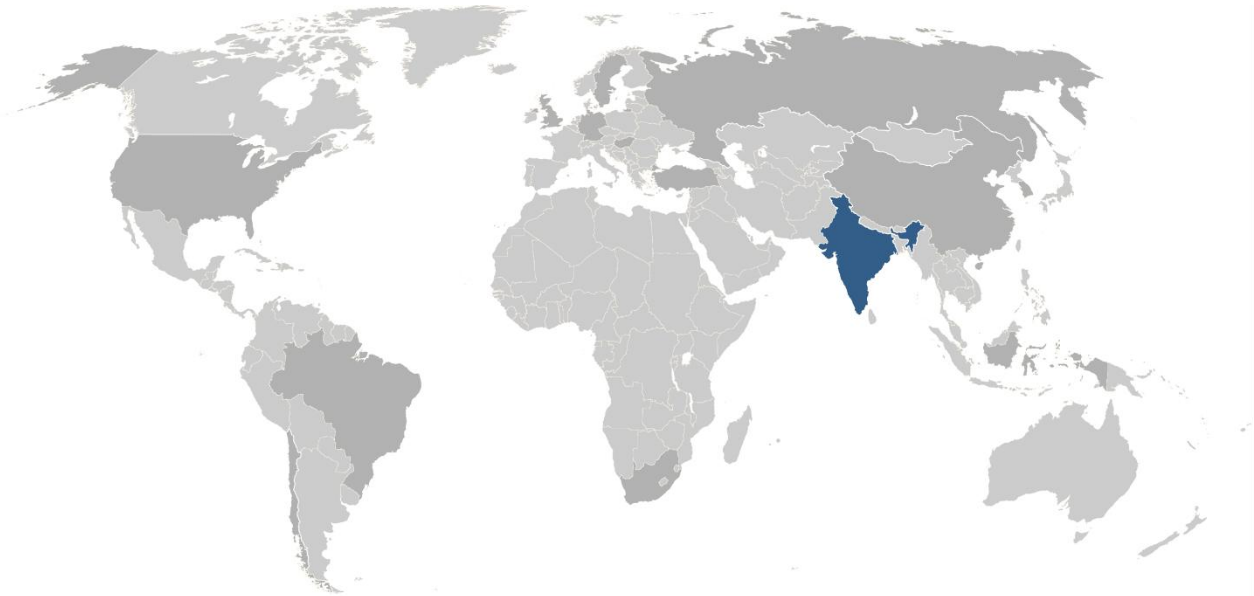

This report is part of the study *Managing the Crisis* which assesses 14 governments' response to the global economic and financial crisis between September 2008 and September 2009 on the basis of a standardized set of criteria.

Please cite as follows: Bibek Debroy, *India Country Report*. In: Bertelsmann Stiftung (ed.), *Managing the Crisis. A Comparative Assessment of Economic Governance in 14 Economies*. Gütersloh: Bertelsmann Stiftung, 2010.

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1. Risk Exposure at the Outset of the Crisis

- What was the structure of demand (e.g., share of private/state consumption, gross capital formation, exports and imports in GDP/GNI)?
- To what extent was the economy exposed to macroeconomic imbalances (e.g., foreign debt, trade or fiscal imbalances)?
- Was/is the financial system primarily bank- or market-based?

Economic structure and macroeconomy

The beginning of India's present period of growth dates to 1991, when the Indian government introduced a cycle of economic reforms. With the exception of industrial de-licensing, most of the initial reforms concerned the external sector. They included the elimination of quantitative restrictions (QRs) on exports and the rationalization and elimination of export subsidies, the latter of which were replaced by a system of export incentives. Further reforms included a reduction in import duties, moving away from an officially fixed rupee and allowing the market to determine the exchange rate, introducing a liberal policy on foreign institutional investments, and opening up the country to foreign direct investments (FDI). Because of the federal nature of the constitution, reforms in the domestic economy (most factor markets) are matters for the individual states. Consequently, beyond the financial sector most domestic reforms have been slow. The major pending reforms have to do with the rural economy, taxation, public expenditure (including subsidy targets) and the legal system.[1]

As of 1991, real GDP growth began to pick up, reaching an annual average of approximately 6 percent for the years 1991 – 1992. More interesting, however, is India's growth as of 2003, which was largely driven by a decline in interest rates. From the fiscal year of 2003-04 to 2007-08, the annual average growth rate was at 8.8 percent. This translated into per capita income growth of 7.3 percent.[2] More specifically, growth for the following years was as follows: 2003-04 (8.5%); 2004-05 (7.5%); 2005-06 (9.5%), 2006-07 (9.7%); and 2007-08 (9.0%).

[1] Infrastructure, public enterprise reform and the labor market are not listed separately because they are implicitly subsumed within the other items.

[2] India follows a fiscal year system, from April 1 to March 31 of the subsequent year. Unless otherwise specified, data are from the Government of India's *Economic Survey, 2008-09*, Department of Economic Affairs, Ministry of Finance; http://indiabudget.nic.in/

In 2007-08, the share of private consumption expenditure in GDP was 57.2 percent, with government consumption at 9.8 percent of GDP and gross capital formation at 36.2 percent.[3] Over time, the share of private consumption has declined, while that of capital formation has increased. The figures on the contribution to growth are slightly different. In 2007-08, private consumption contributed 53.8 percent to growth, government consumption 8 percent, gross capital formation 55.7 percent and net exports -14.0 percent. For private consumption, the most important contributions come from food, beverages and tobacco, followed by transport and communication. For the same year (2007-08), gross domestic savings have steadily increased to 37.7 percent of GDP, with the public sector comprising 4.5 percent and the private sector 33.2 percent. Of the 33.2 percent from the private sector, the household sector represented 24.3 percent and the private corporate sector registered 8.8 percent. Gross capital formation for the same year also steadily increased, reaching 39.1 percent of GDP. Of this, 9.1 percent came from the public sector and 28.5 percent from the private sector.

In line with liberalization, the share of trade in GDP has steadily increased. In 2007-08, exports accounted for 14.1 percent of GDP and imports for 21.9 percent. The high percentage for imports was a function of large crude oil imports. The resulting trade deficit was -7.8 percent of GDP. Because of a surplus in the invisibles account, the current account deficit was at -1.5 percent. Net FDI was equivalent to 1.3 percent of GDP and portfolio investments amounted to 2.5 percent of GDP. Net FDI inflows totaled $15.4 billion in 2007-08; portfolio investments reached $29.6 billion. Because in 2007-08 the Reserve Bank of India (RBI, India's central bank) prevented the rupee from appreciating, India accumulated an additional $9.2 billion for its reserves.

India's primary macroeconomic imbalance was internal. In 2003, the federal government passed a Fiscal Responsibility and Budget Management (FRBM) act. The individual states then passed similar legislation.[4] This law mandated a fiscal deficit-to-GDP ratio of three percent in 2008-09, with a revenue deficit of zero percent. In fact, the fiscal deficit was 2.7 percent of GDP in 2007-08 and widened to 6.2 percent for the following year.[5] The revenue deficit was 1.1 percent of GDP in 2007-08 and 4.5 percent in 2008-09. The targets for fiscal consolidation set by the FRBM act have therefore been postponed.

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[3] Figures for 2007-08 are deliberately used because those for 2008-09 are affected by the global crisis and its aftermath. The percentages do not add up to 100 because of rounding approximations. These are figures in market prices; those in constant prices are marginally different.
[4] Sikkim and West Bengal are the only states that haven't implemented such legislation yet.
[5] The 6.2% figure is not from *Economic Survey*, but from the budget for 2009-10, which was presented on July 6, 2009; http://indiabudget.nic.in/ub2009-10/bs/speecha.htm.
(accessed February 25, 2010). *Economic Survey* had a marginally lower figure of 6.1%.

Three points need to be made about these deficit figures. First, these figures pertain only to the central government and do not include a gross fiscal deficit of 2.3 percent of GDP contributed by states in 2007-08. Second, they do not include off-budget items that have the same effect as deficits.[6] Third, this widening of deficits was caused in large part by fiscal packages introduced after September 2008.

There are notable exceptions to this third point. Much of the government's emphasis on public expenditure through flagship programs predated September 2008. Such programs included the National Rural Employment Guarantee Scheme (NREGS), farmers' debt relief and the 6th Pay Commission for government employees.[7] Furthermore, the economy began to contract before September 2008, which adversely affected tax revenue (as described under "Policy priorities prior to crisis") and adversely affected tax revenue. Unlike developed countries, the tax revenue base in developing countries like India is narrower and disproportionately affected in times of downturn.

The FRBM act did not stipulate any explicit targets for the reduction of government debt.[8] Outstanding central government liabilities (internal debt and external debt valued at historical exchange rates) were 60.1 percent of GDP in 2007-08, with 57.7 percent contributed by internal liabilities. A pending reform aims at separating debt management from the central bank's formulation of monetary policy. At the end of March 2008, the total external debt was $224.8 billion. Of this, short-term debt accounted for $47 billion, or 20.9 percent of the total.[9] Sovereign (government) external debt was $56.9 billion. In 2007-08, external debt to GDP was 19.0 percent; the debt service ratio was 5.4 percent.[10] The ratio of foreign exchange reserves to total external debt was 137.8 percent and the ratio of short-term debt to foreign exchange reserves was 15.2 percent. Unlike the balance of payments crisis in 1990-91, all external debt indicators were sustainable and nowhere near crisis levels.

In March 2008, external commercial borrowings comprised 27.8 percent of external debt. Non-resident deposits were 17.5 percent and export credit was 6.0 percent. 92.1 percent of short-term debt was in the form of trade-related credits, with an absolute figure of $43.8 billion. While the overall balance of

[6] Such as oil and fertilizer bonds.
[7] This directly affects 3.5 million central government employees, but eventually has spillover effects on another 16.5 million employees in the public sector, state governments, local governments and 15 million quasi-government employees.
[8] The rules stipulated a reduction in incremental debt by one percentage point of GDP every year.
[9] Defined as debt of less than one year in duration.
[10] Defined as a ratio of net current account receipts.

payments management was fine, the situation was quite vulnerable. Possible downside risks include a slowdown in exports or remittances and the withdrawal of foreign institutional investments.

India's commercial banking sector includes public sector banks, old private sector banks, new private sector banks and foreign banks. Public sector banks still dominate. In 2007-08, they held a 69.9 percent share of total assets of scheduled commercial banks. Statutorily, the law mandates that scheduled commercial banks invest 24.0 percent of demand and time liabilities in designated government securities. This is known as a SLR (statutory liquidity ratio) requirement. The actual figure of 27.8 percent in March 2008 was, in fact, higher than what is statutorily required. Domestic scheduled commercial banks, both public and private, have to ensure that 40 percent of credit goes to priority sectors; the target is 32 percent for foreign banks. The interest spread was 2.35 percent in 2007-08, showing that the costs of financial intermediation are still high and competition and efficiency are still low. The Indian private corporate sector has increasingly used external capital (including capital from foreign institutional sources) to fund investments.

For example, the share of external finance increased from 44.5 percent in 2004-05 to 64.1 percent in 2006-07. In 2007-08, $34.3 billion of financial flows arrived in the form of FDI, $8.8 billion through American deposit receipts/global deposit receipts (ADRs/GDRs) and $30.4 billion through external commercial borrowings (ECBs). Within domestic sources, in 2006-07, 54.2 percent of flows came through industrial credit, in other words from banks and financial institutions. The remainder was from public and rights issues and private placement.

- What was the government's economic record (e.g., growth, unemployment rate, inflation and fiscal position) prior to the crisis?
- What was on the economic agenda prior to September 2008 (e.g., anti-inflation, efficiency-oriented, redistributive, supply vs. demand-side policies)?

Policy priorities prior to crisis

Forming shortly after the 2004 elections, the United Progressive Alliance (UPA), as a ruling coalition led by the Indian National Congress (INC) party, has pursued policies targeting two different issues: inclusive growth and containing inflation. According several observers, the UPA defeated the previous ruling coalition, the National Democratic Alliance (NDA), which had ruled from 1999 to 2004 under the leadership of the Bharatiya Janata Party (BJP), in large part because India's high rate of growth after 2003 had bypassed certain sections of society.

Whereas the first UPA government (UPA-I) had emphasized inclusive growth since 2004, it was not until 2007, when the 11th Five Year Plan

(2007-2012) was drafted, that the government rigorously targeted "inclusive growth."[11] While preparing for the five year plan, in 2006 the planning commission drafted an approach paper, "Towards Faster and More Inclusive Growth," in which they flagged disparities between the rich and poor, deprivation among scheduled castes, scheduled tribes, other backward classes (SCs, STs and OBCs) and some minorities, and discrimination based on gender and locality.

In its Economic Survey (2008–09), the government therefore addressed these problems with plans like the Bharat Nirman program, the mid-day meal scheme, the National Rural Health Mission**,** the Jawaharlal Nehru National Urban Renewal Mission, and the National Rural Employment Guarantee Scheme (NREGS).[12] Other flagship programs include farmers' debt relief, preferential measures in favor of SCs, STs and OBCs, special grants for backward districts and more recently (2009), a right to free and compulsory elementary education. All of these initiatives resulted in increased public spending. Unfortunately, efforts to improve transparency, accountability and efficiency in public spending were limited to the Right to Information (RTI) legislation and greater vigilance on the part of civil society. Despite having done little to improve in this area, in 2009 the UPA government was re-elected in the general elections. Regarding the electoral outcome as a vindication of its leftist policies, the UPA-II is led once again by the left-of-center INC.

There was a debate about the efficacy and efficiency of public expenditure before UPA-I came to power in 2004. As the focus on inclusive growth gained momentum, however, actors within certain political circles began taking for granted the concept of greater public expenditure. This was particularly evident in 2007-08 and the first half of 2008-09. The fiscal stimulus introduced after September 2008 was therefore regarded as a natural continuation of this trend. Even within academic circles, critics of growing public expenditure as a policy instrument became a minority. Beyond emphasizing efficiency, proponents of public expenditure emphasized front-loading fiscal reform. A group chaired by Vijay Kelkar had earlier issued two reports on reforming direct and indirect taxes. These culminated in a 2004 report on the implementation of the FRBM act, which argued that the right point in which to introduce fiscal reform was when growth was high and tax revenue buoyant.[13] Along this line of reasoning, fiscal reform should have been front-

[11] Planning Commission, *Eleventh Five Year Plan (2007-2012), Inclusive Growth, Vol.1*, (New Delhi and Oxford: Government of India and Oxford University Press, 2008).
[12] Indian Ministry of Finance, *Economic Survey 2008-09;* http://indiabudget.nic.in/ (accessed February 25, 2010). These plans target essentially rural infrastructure.
[13] Indian Finance Ministry, *Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003,* report submitted July 2004, http://finmin.nic.in/reports/index.html (accessed February 25, 2010).

loaded. The UPA-I's public expenditure commitments, however, made this type of front-loading difficult to implement, leaving the government with little fiscal latitude in September 2008.

The Indian government's second policy priority was containing inflation. India has a wholesale price index (WPI) and two separate consumer price indices—CPI(IW) and CPI(AL/RL).[14] RBI's attempt to prevent rupee appreciation led to accumulation of foreign exchange reserves and liquidity in the system. In addition, global oil and commodity prices increased. In August 2008, the annual WPI-based inflation was 12.8 percent. RBI responded by tightening monetary policy, which began to slow down growth even before September 2008. Debates regarding inflation that have appeared particularly in the financial media and academic papers have criticized the Indian government for drawing upon the WPI to make policy decisions. Currently a weekly series published with a time lag of two weeks, the WPI price series need to be revised and revamped. Another issue prevalent in these debates point to inflation as an outcome of food price increases and hikes in global commodity prices. Monetary policy has therefore proved ineffective in addressing inflation. Hikes in interest rates only served to reduce growth. A third issue in the debates centers on the system's excess liquidity as a function of RBI's intervention in foreign exchange markets and the sub-optimal effects of an excessive accumulation of foreign exchange reserves. Critics argue that the rupee should instead be allowed to appreciate. A fourth criticism points to high levels of government borrowing which led to upward pressures on interest rates. It is therefore argued that RBI's task of managing public debt should be decoupled from its task of conducting monetary policy.

- How stable was the executive branch in the years/months prior to September 2008 (e.g., credibility/legitimacy of leaders/parties in government, cabinet stability/reshuffles, parliamentary/electoral support)?
- How much room did fiscal conditions provide for a major stimulus (e.g., budget surpluses/deficits, conditions for issuing additional treasury bonds)?
- How much room was there for monetary policy initiatives (e.g., pre-crisis level of interest rates, required reserve ratios, flexibility of foreign exchange rate regime)?

Executive, fiscal & monetary capacities to respond to downturn

When the global crisis hit, UPA-I was in its last year before the general elections of 2009. At various points between 2004 and 2009, because the INC and its immediate allies did not create a majority, UPA-I garnered the sup-

[14] Earlier, there were four consumer price indices (CPIs). CPI-UNME, the CPI for urban non-manual employees has now been discontinued. CPI-IW, the CPI for industrial workers, is slated to become a CPI for urban India. CPI-AL, the CPI for agricultural labor (meaning agricultural workers) and CPI-RL, the CPI for rural labor, are now being merged to become a CPI for rural India. Meanwhile, the WPI is also being revised.

port of the Left Front, the Samajwadi Party (SP) and the Bahujan Samaj Party (BSP). After the Left Front withdrew support because of the Indo-U.S. nuclear deal, UPA-I comfortably survived a trust vote August 2008.

Given the UPA-I's enhanced credibility as a result of the trust vote, it should have had an easier time formulating and implementing policies targeting structural reform. There were two factors hindering this. First, elections were imminent; second, much of implementation was a matter of state government competence. In addition, the UPA faced opposition to the issues of land acquisition, compensation, resettlement and rehabilitation (particularly with respect to the special economic zones (SEZs)). A closer look at the debates over reform show the underlying issue to be a lack of consensus on the role of government and its core areas of governance. Though many have blamed the parties on the left that were included in UPA-I for this lack of consensus, this is only partially true. Given the differing opinions regarding the government's role in the economy, it was unrealistic to expect structural reforms after September 2008.

In terms of its fiscal capacities, if the Indian government had taken advantage of the good growth years (i.e., high tax revenues) in order to bring about fiscal consolidation, it would have had greater latitude in its fiscal policy at the onset of the crisis. The government has also placed on its agenda a timetable of a unified goods and services tax (GST) to be implemented as of April 2010. The goal here is to standardize, harmonize and eliminate discretionary exemptions and thereby reduce compliance costs. At the time of this writing, this item remains on the agenda and the timeline has not been pushed back. Other fiscal stimuli involving the discretionary and arbitrary reduction of indirect tax rates for specific sectors are also on the agenda, as are the Finance Ministry's proposal for a new Direct Tax Code.[15] While still under discussion, the ministry has invited public comments on this issue. If and when the new code is implemented in 2010, it would bring an end to several exemptions and a phase-out of some discretionary direct tax packages introduced in the wake of the global crisis.

Center-state financial relations should also be mentioned here. Broadly speaking, there are two channels for funds to be transferred from the center to states. The first is through the Planning Commission, in which funds are typically used for what are called planned programs.[16] Within the Planning Commission, there are central sector and centrally sponsored schemes

[15] Indian Finance Ministry, *Direct Taxes Code Bill 2009*; http://finmin.nic.in/dtcode/ (accessed February 25, 2009)

[16] We are glossing over an internal debate on government budgetary norms and procedures, including distinctions between plan and non-plan expenditure, and those between revenue and capital expenditure.

(CSSs) for specific areas that draw upon some resources from the center and the remaining sums from states.[17] With the economic downturn and its adverse impact on tax revenue, states have asked for increases in the center's contributions. This is also true of public expenditure pre-dating September 2008, such as the 6th Pay Commission and its impact. In most public expenditure, resources filter through central government ministries and departments to state governments and then down to districts. Some estimates claim that no more than 10 percent of public expenditure reaches target beneficiaries.[18] While leakage accounts for some of this loss, there are also very high administrative costs to consider. This arduous transmission mechanism also means that there are significant time lags in delivery. In programs like NREGS, direct transfer to districts has now been allowed. This inefficiency raises the issue of decentralization and devolution in states into local bodies. Some state finance commissions have made such recommendations, though most have not been implemented.[19] The second source of transfers from the center to states stems from the Central Finance Commission, which makes recommendations on how the divisible pool of taxes should be apportioned between the center and the states based on certain formulae. The 13th Finance Commission was supposed to submit its report on October 31, 2009, but the timeline was extended to December 31, 2009.[20]

In terms of monetary policy reform, there was some room to loosen monetary policy once the global slowdown put downward pressure on global prices. Beyond the fact that India's monetary policy is not decoupled from public debt management (large government borrowing exerted upward pressures on interest rates), there were other problems with the transmission mechanism. The administered interest rate for small savings set a floor to deposit rates and exerted upward pressure on interest rates. Priority sector lending, such as for agriculture and exports, at concessional interest rates also makes lending rates less flexible.[21] A large amount of borrowing also occurs in the informal and unorganized market.[22] A gap has always existed between household savings being pre-empted by government instruments

[17] Special category states have to bear a lower share; for these, the central government's contribution is often 100%.
[18] The precise figure varies from program to program.
[19] Finance Commission, http://fincomindia.nic.in/ShowContentOne.aspx?id=16&Section=1 (accessed February 25, 2010).
[20] Finance Commission, http://fincomindia.nic.in/ (accessed February 25, 2010). The formulae vary from one Finance Commission to another.
[21] Reserve Bank of India, *Annual Policy Statement for the Year 2009-10*, April 21, 2009; http://rbi.org.in/scripts/NotificationUser.aspx?Id=4936&Mode=0 (accessed February 25, 2010).
[22] Such lending, at roughly twice the rates of interest on bank credit, is especially concentrated in the sectors of trade, hotels and restaurants. If one takes trade as an example, only 30% of credit to this sector derives from the banking sector; 70% derives from the non-banking and informal sectors. The lower down the value chain and the smaller the entity, the higher in general the rate of interest charged.

and credit needs of the unincorporated sector. Despite talk of micro-finance and the integration of non-banking financial sectors with banking service providers, nothing much has happened. One result of the global financial crisis, however, has been some renewed emphasis on financial inclusion. In August 2008, the repo rate was 9 percent, the reverse repo rate was 6 percent, the cash reserve ratio (CRR) was 9 percent and the yield on 91-day treasury bills was 9.06 percent.[23] The prime lending rate ranged between 13.25 percent and 14 percent.

- To what extent has the country been exposed to global financial market risks, particularly contagious/toxic financial instruments (e.g., open capital account, floating or pegged/fixed currency)?
- How important was/is the financial sector for the national economy? What was/is the extent of interdependence between the financial sector and real economy?
- To what extent was the economy integrated into regional/global trade flows? How dependent was the economy on foreign demand for manufactures and commodities?
- Did property, equity or other markets display excessive growth and a bubble-like situation prior to September 2008?
- In what condition was the banking sector (e.g., size/structure of banking sector, non-performing loans, capital adequacy ratios of major banks, if available)?

Exposure to specific market and trade risks

Initially after the outbreak of the crisis, there was some discussion about whether the Indian economy was decoupled, at least in terms of the real sector. This was never a tenable proposition, because the dichotomy between the real and financial sectors is at best an artificial one.

The financial crisis impacted India in several ways. First, many Indian companies had short-term debt in foreign currencies. When foreign currency credit could no longer be rolled over to short-term debt, many Indian companies used rupee debt and converted rupees to foreign currencies, thereby drying up domestic liquidity.[24] Beginning in the second half of September 2008, a severe credit crunch struck India and banks became unwilling to lend, even to other banks. This occurred despite the fact that banks and financial institutions have limited exposure to structured financial instruments. Secondly, net portfolio inflows turned negative as foreign institutional investments pulled out, adversely affecting the capital account and the stock market and making the exchange rate volatile. Thirdly, the current account was adversely impacted through a slowdown in exports and some decline in remittances.

No firm estimates are available for employment generation in the export sector, meaning in this context, the export of goods. Rough estimates from the

[23] No changes in any of the policy rates were made until October 11, 2008.
[24] Though the rupee is not fully convertible on the capital account, it is free for such purposes.

Commerce Ministry calculate a direct employment of 6.5 million in exports, with perhaps 15 million if indirect employment is included. Based on a survey undertaken by the Labour Ministry and Commerce Ministry together, around one million jobs may have been lost after September 2008, especially in sectors like gems and jewelry, garments, leather and handicrafts. Export growth is not evenly spread out throughout the country. It tends to be concentrated in clusters, including Surat (diamonds), Panipat (blankets), Tirupur (hosiery), Agra (leather), Ludhiana (woolen garments), Jaipur (hand-printed textiles), Pune (food processing), Ahmedabad (pharmaceuticals), Ambur (leather) and Bangalore (machine tools). There are reports about these areas (particularly Surat, Tirupur and Ludhiana) having been adversely affected. It should be noted that there are several hurdles to classifying exports according to state. Having said this, the bulk of exports originate in Maharashtra, Gujarat, Tamil Nadu and Karnataka, with Andhra Pradesh, Delhi, West Bengal, Haryana, UP and Rajasthan (in that order) following some distance behind.[25]

India's manufacturing sector accounts for 64.4 percent of the country's total exports. The share of manufactured goods exports is even higher for exports to the United States (89.9%) and the European Union (78.5%). Job losses in exports therefore mean job losses in manufacturing—especially for the informally employed. Informal employment is not limited to the unorganized sector, but also exists in the organized sector where wage workers are recruited through informal networks, such as through contractors, and without formal contracts.[26] These informal jobs are the first to be slashed. This leads to reverse migration from urban to rural areas and raises questions about the rural sector's capacity to absorb the returning migrants. There has also been reverse migration from abroad, particularly from the Middle East back to Kerala.[27] An earlier ILO document, flagged such job loss concerns.[28] A subsequent ILO document, which claimed a job loss figure of 20 million for China, offered no specific figures for India but mentioned external migration (such as in Kerala).[29]

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[25] These are exports of goods and do not include services. Data are from DGCI&S (Directorate General of Commercial Intelligence & Statistics) and are from 2006-07; Ministry of Finance, *Economic Survey 2007-08*.

[26] See the discussion in *Report on Conditions of Work and Promotion of Livelihoods in the Unorganized Sector*, National Commission for Enterprises in the Unorganized Sector, Government of India, August 2007.

[27] The reverse flow of skilled and professional H1-B migrants isn't that significant quantitatively, notwithstanding a stricter visa regime and the Grassley-Sanders amendment.

[28] ILO, *Global Employment Trends*, January 2009, http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_101461.pdf (accessed February 25, 2010).

[29] ILO, *Responding to the Economic Crisis –Coherent Policies for Growth, Employment and Decent Work in Asia and Pacific, The fallout in Asia: Assessing labour market impacts and national policy responses to the global financial crisis*, February 2009;

Gross non-performing assets of scheduled commercial banks (SCBs) totaled 1.3 percent in 2007-08. There were 79 SCBs in March 2008 and the assets of the banking sector totaled 91.8 percent of GDP.[30] In March 2008, 17.2 percent of advances by public sector banks were to sensitive sectors (capital market, real estate, commodities), with figures of 34.1 percent for new private sector banks, 18.9 percent for old private sector banks and 26.4 percent for foreign banks.[31] The capital-to-risk-weighted assets ratio was 13.0 percent in March 2008. The BSE (Bombay Stock Exchange) Sensex comprises only one small segment of the capital market, though it attracts a disproportionate amount of attention. In January 2008, the Sensex touched 20,873—an artificially high level that was driven by a limited number of liquid scrips and high foreign institutional investor (FII) demand. Irrespective of the global crisis, a correction was due. The P/E ratios on the BSE Sensex dropped from 27.7 at the end of 2007 to 12.4 at the end of 2008. While it is difficult to generalize for the country as a whole, some correction was also due in the property market, perhaps by a factor of around 15 percent.

Structural or policy advantages and disadvantages

- Did policymakers/executive agencies have any experience in handling financial crises? Did this experience play a role in the 2008-09 policy response?
- Were there independent regulatory institutions or prevention/response schemes in place to contain financial risks?
- Were there internal veto players (e.g., federalist powers, courts) or international obligations that thwarted swift action on the part of the government?
- Have executive powers been extended in times of crisis? Has this been based on formal or informal mechanisms?

India was relatively untouched by the financial crisis of 1997-98, though it had been affected by a serious balance of payments crisis in 1990-91. The high dependence on crude oil imports and the experience of 1990-91 meant that India erred on the side of caution in accumulating foreign exchange reserves. The present level of reserves is sub-optimal in the sense of being excessive and yields a very low rate, since they are invested in “safe” assets. The composition of these assets is confidential.

The 1997-98 crisis was also interpreted as a lesson pointing to the need to liberalize the capital account more slowly. Generally speaking, since September 2008, the RBI and SEBI (Securities and Exchange Board of India) have provided fairly tight regulation, erring on the side of caution, though there have been instances of bear and bull cartels in the capital market and

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http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/meetingdocument/wcms_101730.pdf (accessed February 25, 2010).

[30] Reserve Bank of India, *Report on Trend and Progress of Banking in India, 2007-2008*; http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20India (accessed February 25, 2010).

[31] ibid.

corporate misgovernment. Parliament, courts or international obligations have not constrained any swift responses, either in monetary or fiscal policy. The executive has worked fairly efficiently, with smooth coordination between the Finance Ministry, Commerce Ministry and RBI taking place.

- How strongly has the national economy been hit during the period under review? Where has it been hit most severely thus far (e.g., growth rate, production, trade, employment)?

Initial impact of economic downturn

GDP growth slowed from 9 percent in 2007-08 to 6.7 percent in 2008-09.[32] Slowdowns registered for the same period in the following sectors are particularly significant: manufacturing (from 8.2% to 2.4%), construction (10.1% to 7.2%), trade, hotels, transport and communication (from 12.4% to 9.0%) and in financing, real estate, insurance and business services (from 11.7% to 7.8%). Had growth in community, social and personal services not increased from 6.8 percent to 13.1 percent because of the 6th Pay Commission, GDP performance would have been worse. Quarterly data underscore the slowdown even more clearly. Owing to interest rate hikes, real GDP growth slowed during the 2008-09 fiscal year, registering 7.8 percent for the first quarter and 7.7 percent for the second quarter. For both the third and fourth quarters of the same year, growth declined to 5.8 percent. The most recent data available show growth for the first quarter of the 2009 fiscal year at 6.1 percent.

In discussing the implications these developments have on employment, one must distinguish between losses in existing jobs and the non-creation of jobs that would otherwise have been created. Most media reports focus on losses in existing jobs. However, little robust empirical evidence substantiates such concerns beyond the external sector. The last firm employment elasticities available were worked out by C. Rangarajan and his colleagues when he was the chairman of the Prime Minister's Economic Advisory Council. Using NSS (National Sample Survey) data for the period 1999 – 2005, they found employment elasticity to be at 0.48 for total employment.[33] In an aggregated and back-of-the-envelope kind of sense, a lowering of growth from 8.5 percent to 6.5 percent means a counterfactual job loss of around five million. These five million jobs have primarily been in manufacturing, construction, trade, hotels and restaurants, and transport, storage and communications. Although manufacturing is more visible, the elasticities are much higher for construction.

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[32] Press Information Bureau of India, "Revised Estimates of Annual Income, 2008-09 and Quarterly Estimates of Gross Domestic Product, 2008-09" http://mospi.nic.in/pressnote_t4_29may09.pdf (accessed February 25, 2010).

[33] C. Rangarjana, Padma Iyer Kaul and Seema, "Revisiting Employment and Growth," in Money and Finance, September 2007, http://eac.gov.in/aboutus/chspe/art_revisit.pdf (accessed February 25, 2010).

Exports were first hit through problems in trade financing and then later through a reduction in global demand. Export growth of goods started to decline in September 2008 and has been negative since October 2008. While the export of services continued to show positive growth, the rates of growth were low. In 2007-08, there were net FII inflows of $20.3 billion. By contrast, in 2008-09 there was a net outflow of $15 billion.

2. Agenda-Setting and Policy Formulation

- When did state organs (e.g., government, central bank) begin setting a crisis response agenda? How long did it take to adopt the first crisis measures?
- Who were the driving forces (e.g., government, central bank, foreign actors, media, trade unions, employers` associations) in getting stabilization/stimulus policies started?
- Were these measures launched as executive orders or parliamentary laws? How closely did constitutional bodies (e.g., executive, legislative, central bank) cooperate?
- What kind of role did sectoral or regional lobbies play in policy formulation?

Agility and credibility

With regard to both monetary policy and fiscal policy, India's responses were reasonably swift. On October 11, 2008, RBI reduced the cash reserve ratio (CRR) from 9 percent to 6.5 percent. On October 20, 2008, the repo rate was reduced from 9 percent to 8.0 percent. On October 25, the CRR was reduced again to 6 percent and on November 3, the repo rate was further reduced to 7.5 percent. On November 8, the CRR was reduced to 5.5 percent. On December 6, the repo rate was reduced to 6.5 percent and the reverse repo rate to 5 percent. On January 5, 2009, the repo rate was reduced to 5.5 percent and the reverse repo rate to 4 percent. On January 17, the CRR was reduced to 5 percent. On March 5, the repo rate was reduced to 5 percent and the reverse repo rate to 3.5 percent. Finally, on April 21, 2009, the repo rate was reduced to 4.75 percent and the reverse repo rate to 3.25 percent. The SLR was reduced from 25 percent to 24 percent on November 8, 2008. While rigidities in the transmission mechanism continued, little could be done about these in the short-term because they were outside the central bank's purview. The reductions came in incremental tranches rather than one-shot, because the severity of the credit crunch unfolded gradually and the RBI continued to be concerned about inflation, which was much higher under the CPI than the WPI. For example, food price inflation remained high.[34] In addition, special refinance facilities were introduced for scheduled

[34] The food products group has a combined weight of 25.43% in WPI, compared to 46.2% in CPI-IW, 47.13% in CPI-UNME, 66.77% in CPI-RL and 69.15% in CPI-AL.

commercial banks, the National Housing Bank, the Exim Bank and the Small Industries Development Bank of India, serving as special credit packages for housing, micro and small enterprises and infrastructure. Finally, dated government securities were bought back and a term repo facility was introduced to handle liquidity problems of mutual funds and non-bank financial companies.

Concerning trade, an interest subvention of 2 percent was introduced on December 1, 2008 for labor-intensive exports like textiles, handicrafts, carpets, leather, gems and jewelry, marine products and for small and medium enterprises. In addition, the time periods for pre-shipment and post-shipment export credit were extended. Ceilings on export credit in foreign currency were also increased. There was some liberalization in external commercial borrowings and FDI. Additional allocations were made for export incentives and the inclusion of more sectors.[35] Duty drawback rates were increased for some items on September 1, 2008.[36] Export duties were eliminated or reduced. The time period for fulfilling export obligations was extended. Customs duties and countervailing duties were adjusted.

The government introduced three fiscal stimulus packages between December 2008 and February 2009. It took longer to formulate and implement its fiscal response than the monetary response for two reasons beyond the constraints posed by the FRBM act. First, the idea of decoupling initially gained some acceptance as it was believed that the real sector might be spared a serious hit. Secondly, some decision makers thought that instruments such as farmers' debt relief, NREGS, the 6th Pay Commission and higher procurement prices paid for rice and wheat had already served as forms of public expenditure. The fiscal packages eventually involved cuts in indirect taxes and sector-specific measures for textiles and the other sectors mentioned earlier.[37] The India Infrastructure Investment and Finance Company was also allowed to raise tax-free bonds to fund infrastructure projects. According to IMF estimates, the additional fiscal stimuli amounted to 0.6 percent of GDP in each of the calendar years 2008 and 2009.[38] These packages were financed by three supplementary demands for grants presented to parliament in October 2008, December 2008 and February 2009, all of which amounted to a combined 2.7 percent of GDP. This is higher than the IMF estimate because some earlier public expenditure programs were not covered in the budget for

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[35] We are glossing over the distinction between export incentives and export subsidies because it is not pertinent to present purposes.
[36] The duty entitlement passbook scheme (DEPB) functions in a way similar to duty drawback. DEPB was supposed to end, but was extended and DEPB rates were also increased.
[37] An additional allocation under the Textile Upgradation Fund.
[38] IMF, "Global Economic Policies and Prospects," Note prepared for the G-20 meeting in London, March 2009, http://www.imf.org/external/np/g20/pdf/031909a.pdf
(accessed February 25, 2010).

2008-09, whereas the IMF estimate concerns only those items after September 2008.

The prime movers behind these packages were the Finance Ministry and RBI on the one hand and Commerce Ministry on the other. The latter was principally concerned with the performance of exports. Given the composition of India's parliament, little resistance materialized to the idea of increasing public expenditure and relaxing FRBM. Industry chambers complained about the cost and availability of credit. Exporter organizations highlighted job losses in the export sector, which were also extensively reported in the media.

Consultation with external experts and openness to international collaboration

- Did policymakers actively consult domestic and/or foreign experts outside of government?
- Did the government actively seek collaboration with other governments or international organizations?
- Did the government participate in multilaterally coordinated rescue efforts?
- Was the government curtailed in its response through IMF support programs?

Although the government has not explicitly consulted external policy experts and there have been no IMF support programs, India has been an active player in G-20 meetings. Within this setting, India has emphasized the following:

- coordinated counter-cyclical policies without early and premature exit;
- restoring banking in developed countries;
- reducing protectionism;
- ensuring flows of trade finance and credit;
- reforms in global financial architecture;
- increased resources of international financial institutions;
- early review of IMF quotas;
- developing early warning systems;
- and sharing information on tax havens with closer scrutiny on non-cooperating jurisdictions.

In addition, the UPA-II government has sought to revive the Doha negotiations on development. Indian agriculture has faced several problems ascribable to the lack of small-holder agriculture reform. According to rural/urban census definitions for the 2001 census, 72.2 percent of India's population lives in rural areas. Though this is most often equated with subsistence living, this is not quite true. In other words, there is an agricultural reform agenda, and there is a rural reform agenda that goes beyond agriculture. Agriculture reforms should address the following, all of which are linked to the need to encourage commercialization and diversification:

- allowing corporate sector involvement in agriculture;
- removal of government-imposed restrictions on production, marketing and distribution (i.e., Agricultural Produce Marketing and Control Acts and orders under the Essential Commodities Act);
- a refocus of public expenditure away from input subsidies toward infrastructure and extension services;[39]
- - decentralizing the management of rural infrastructure and -extension services,-
- the disintermediation of distribution chains;
- forward markets;
- contract farming;
- revamping credit and insurance;
- freeing up of land markets.[40]

Also within the domain of agricultural reform is the issue of encouraging off-farm employment, which is where the corresponding rural sector reforms take effect. These reforms aim at increasing the provision of physical and social infrastructure in rural areas. Out of India's 600,000 villages, roughly 100,000 lack one or the other type of infrastructure; some lack both.[41] Only 40 percent of the cultivable land area is irrigated; most of India's agricultural problems are in dryland areas, which is where farmer suicide is frequent.

A double kind of tension persists in the agricultural reform agenda. First, agricultural and rural reforms require reliance on the market, but there is much faith in controls and government intervention, a mindset that has been reinforced by the specter of food price inflation. Secondly, half of the labor force consists of agricultural labor, while the remainder consists of farmers. Ninety percent of landholdings are very small (i.e., less than 2 hectares). While agricultural wage rates have increased—in part because of NREGS—farmers' input costs have at the same time gone up, which has put a squeeze on farm profitability. Fragmentary evidence suggests that the NREGS has also contributed to food price inflation by stimulating demand.

Given this, any opening up of agriculture through the WTO raises political issues in India, even if bound duties are high. While arguing for agricultural

[39] There is also a research and development agenda, but it is not necessarily clear as to why this has to be public-sector driven. Extension services will have to be largely public-sector driven.
[40] There are two distinct issues of ownership and tenancy laws here. The former is contentious, the latter less so.
[41] Partly because villages (and habitations) where population sizes are less than 1000 are simply not viable. If the transport infrastructure improves, some of these villages will disappear and become mainstreamed.

liberalization in developed countries, India has insisted that there should be enough flexibility in the special safeguards agreement (SSA) in agriculture. This position has led to an impasse over the SSA between India and the United States. Though no specifics are yet available, observers believe that this impasse has now been overcome.

In addition to pursuing multilateral talks, India has also been a party to several regional agreements, but this trend predates the September 2008 crisis. One should also note that there was resistance to the free trade agreement with ASEAN, specifically because of the elimination of duties on palm oil.

3. Policy Content

- How large is the stimulus package as expressed as a percentage of GDP (including compensations to those hit particularly hard by the crisis through social/labor policies)?
- The stimulus is spread over a period of how many years?

Scope of stabilization and stimulus policies

It is impossible to provide clear figures on the size of the Indian stimulus package. As mentioned above, the IMF estimates that the Indian government introduced fiscal stimuli on the order of 0.6 percent of GDP for each of the calendar years 2008 and 2009. However, a separate IMF document, after outlining the reasons why IMF estimates are lower than “headline” fiscal numbers, cites a fiscal stimulus of 0.5 percent of GDP for India in 2009.[42]

At a dinner on the occasion of the G-20 meeting in London in April 2009, the Indian prime minister stated, “We in India have been fortunate in having weathered the global downturn better than many others. Our growth rate, which was close to 9 percent in the previous five years, will fall below 7 percent in 2008-09. Like other countries, we have made aggressive use of both monetary and fiscal policy, with a total fiscal stimulus or expansion of the fiscal deficit above the planned level of almost 4 percentage points of GDP in 2008-09.”[43] In his 2009-10 budget speech, the finance minister put the fiscal stimulus at 3.5 percent, “This fiscal accommodation led to an increase in fiscal deficit from 2.7 per cent in 2007-08 to 6.2 per cent of GDP in 2008-09. The difference between the actuals of 2007-08 and 2008-09 constituted the total fiscal stimulus. This fiscal stimulus at 3.5 percent of GDP at

[42] IMF, “The Size of the Fiscal Expansion: An Analysis for the Largest Countries,” February 2009, http://www.imf.org/external/np/pp/eng/2009/020109.pdf (accessed February 25, 2010).
[43]Prime Minister of India Office, Recent Speeches; http://pmindia.nic.in/speeches.htm (accessed February 25, 2010).

current market prices for 2008-09 amounts to Rs.1,86[0],000 core."[44] Whether it is 3.5 percent or 4 percent, apples and oranges are being compared here. The 3.5 or 4 percent represents additional public expenditure by the government and includes expenditure that has nothing to do with immediate fiscal packages related to the crisis.

Describing the Indian fiscal package as temporary, the February 2009 IMF document mentions explicit categories such as infrastructure investment, support to strategic industries and indirect tax reductions.[45] It is, however, difficult to agree with this diagnosis. It is also unclear what the report means by differentiating between support to strategic industries and indirect tax reductions, because the former has been fiscal. Some of the fiscal measures have now been extended to various dates in 2010. The adjustment assistance scheme to ECGC (Export Credit and Guarantee Corporation) has been extended to March 2010 and the 2 percent interest subvention to seven sectors (textiles, handicrafts, carpets, leather, gems and jewelry, marine products, small and medium exporters) has also been extended to March 2010.

There are no firm figures on the size of the fiscal multiplier in India. Figures emanating from the IMF are suspect. However, a quote from the aforementioned IMF report on the FRBM act may be in order. "Since the savings rate in India is high, when compared with most OECD countries, we expect that the multipliers in India would be correspondingly smaller. We see that the expenditure multiplier is larger; that the contractionary effect of cutting expenditure is larger than the contractionary effect of raising taxes…. It is important to emphasize that the above relationships are for a closed economy. In an open economy, characterized by a combination of trade flows, capital flows, and a flexible exchange rate, these multipliers are considerably weakened. When there is a domestic fiscal contraction in an open economy, the weakness in domestic demand is counteracted by a depreciation of the currency, which improves net exports and aggregate demand. Given the increasing openness of the Indian economy, the fiscal multipliers may be smaller, and fiscal consolidation may have a lesser impact on aggregate demand."[46]

[44] Minister of Finance, Budget Speech 2009-10 from July 6, 2009; http://indiabudget.nic.in/ub2009-10/bs/speecha.htm (accessed February 25, 2010).
[45] IMF, "The Size of the Fiscal Expansion"
[46] Indian Ministry of Finance, "Macro Perspective on Fiscal Consolidation," http://finmin.nic.in/downloads/reports/frbm/4.pdf (accessed February 25, 2010).

- How is stimulus spending distributed across sectors? How and to what extent is the financial sector supported (e.g., through loans, guarantees, capital injections)?
- Which industrial and structural policies (e.g. corporate tax cuts, subsidies, company bail-outs) can be observed?
- What kinds of measures target the expansion of public spending on infrastructure? Which ones are designed to sustain business and consumer spending?
- Are policies in support of businesses adequately targeted and delineated (e.g., at creating employment, supporting competitive firms)?

Targeting and coverage of policy tools

India's policy response is best understood within the context of what are identified in the budget as the country's medium-term objectives.[47] These are:

- sustained annual growth of 7 percent;
- creating 12 million new jobs a year;
- reducing head count poverty ratios by half by 2014;
- ensuring agricultural growth at 4 percent;
- increasing infrastructure expenditure as share of GDP to 9 percent by 2014;
- ensuring the growth momentum in exports;
- strengthening regulation;
- expanding the reach of social safety nets;
- strengthening primary health care delivery;
- creating a competitive and well-regulated education system;
- and moving towards energy security.

The budget then goes on to describe three challenges:

- restoring growth to 9 percent;
- making growth inclusive;
- and improving governance and public delivery.

As this list illustrates, beyond the export angle, the UPA-II government's policy response has not really been driven by the crisis. It considers its response instead to be a continuation of the "inclusive" agenda pursued under UPA-I.

In his 2009-10 budget speech, the finance minister stated, "These measures were effective in arresting the fall in growth rate of GDP in 2008-09 and we achieved a growth of 6.7 per cent. There are signs of revival in the domestic industry and the foreign investors have also returned to the Indian market in the last couple of months. It is possible that the two worst quarters since the global financial meltdown in September 2008 are behind us. While the glob-

[47] Minister of Finance, Budget Speech 2009-10.

al financial conditions have shown improvement over the recent months, uncertainties relating to the revival of the global economy remain. We cannot, therefore, afford to drop our guard. We have to continue our efforts to provide further stimulus to the economy."[48] The government provided this stimulus in the forms of public and PPP investment in the following: infrastructure, agricultural development, financial inclusion, the Bharat Nirman program, NREGS, a National Food Security act and the empowerment of the economically disadvantaged sections of the economy.

The government's Economic Survey of 2008-09 divided the policy options into immediate, short-term and medium-term categories. Options for the immediate term needed to address financial panic and uncertainty included guaranteeing bank deposits and inter-bank loans, providing liquidity to banks, and approaching regulation slowly. The Indian government took up none of these policy options. The Economic Survey states that these measures were "not required due to the limited direct exposure of Indian financial institutions to the U.S. financial markets," and that "top policy-makers and the RBI reassured the market in right earnest." In addition, in the short-term, it would have been possible to deliberately engineer rupee depreciation, though this would have incurred costs. As mentioned earlier, the RBI generally prevents rupee appreciation but has allowed the rupee to depreciate. This one-sided intervention has also sought to cushion volatility. Accordingly, the Economic Survey states, "Government did not intervene in the foreign exchange market, allowing the market to determine the rupee exchange rate."

In the short-term, within the realm of monetary policy, the costs of borrowing could have been reduced and market liquidity and credit flows improved. Expansionary fiscal policy in the short-term would include public expenditure on public works, social safety nets and employment as part of the UPA agenda. In the institutional measures listed in the short-term, the Economic Survey refers to the capitalization of banks, "The Central Government contributed to recapitalization of regional rural banks (RRBs); 196 RRBs merged into 85 RRBs. Government recapitalizing public sector banks over two years to maintain CRAR of 12 per cent." This recapitalization is also part of the overall UPA agenda and pre-dated September 2008.

According to the Economic Survey, "The approach of the government has therefore been to use a mix of fiscal measures, including reductions in indirect taxes (excise and service tax) which could be reversed subsequently." This should be read in conjunction with the budget speech, which indicated that the worst of the crisis was behind India and had to do with India's tax reform agenda, pursued since 1991. Gross tax revenues were 12.6 percent of

[48] ibid.

GDP in 2007-08, having increased from 9.3 percent in 1995-96. The 12.6 percent is comprised of direct taxes contributing 6.3 percent and indirect taxes contributing 5.9 percent. The share of direct taxes has steadily increased, while that of indirect taxes has steadily declined. These figures are for central government taxes alone. In 2007-08, state-level taxes accounted for an additional 9.3 percent of GDP. On both direct and indirect taxes, tax reform has involved a lowering of rates and a broadening of the base through the removal of exemptions and discretionary concessions. This kind of tax reform is in conflict with any discretionary fiscal measures. In terms of indirect taxes, a unified goods and services tax (GST) is scheduled to go into effect in April 2010. A new Direct Tax Code has also been prepared in draft form. This too involves eliminating surcharges and levies and the removal of exemptions. In sum, there are fiscal compulsions to exit from the fiscal packages in 2010.

The exception to this principle is found in the area of exports. The latest available export figures (for goods, not services) from the Commerce Ministry are from August 2009 and show that from April to August 2009, exports declined by 31 percent in U.S. dollar terms, compared to a similar period in 2008. In August 2009 alone, they declined by 19.4 percent.[49] While the rate of decline is slowing, there is not much good news on exports yet. Indeed, in the aforementioned list in Economic Survey, the interest subvention on pre-shipment and post-shipment export credit is described as a medium-term measure. There is also the issue of export incentives in the form of duty drawback, or its conceptual equivalent, the DEPB. Until a GST is introduced and state and local body taxes entirely eliminated, the duty drawback or the DEPB cannot be completely transparent, and an export subsidy element creeps into what is actually an export incentive. Transition to a WTO-compatible system of export incentives is unlikely in 2010, both because the GST will take time to be implemented and because the global recovery will take longer.

[49] Indian Department of Commerce, "India's Foreign Trade: January 2010" http://commerce.nic.in/tradestats/indiatrade_press.asp (accessed February 25, 2010).

- Are stimulus measures influenced/limited by pre-crisis development strategies (e.g., industrial policies) or have novel/additional (e.g., environmental) policy objectives been inserted?
- Is the response to the crisis grounded in a broader developmental perspective (i.e., crisis as development opportunity) or predominantly short-term political constituency logic?
- Do stimulus policies address prevailing structural deficits and future growth potential?

Development as an objective of stimulus policies

Apart from the specific reductions in indirect taxes, the other elements of the stimulus package fit into the spectrum of UPA government policies. India's relatively good performance was read as attributable to endogenous and rural sources of growth through hikes in procurement prices, NREGS and farmers' debt relief. NREGS was also perceived to have offered a safety net to migrants who returned from urban export-oriented locations to rural India, such as from parts of Gujarat to parts of Bihar. For manufacturing, the National Manufacturing Competitiveness Council (NMCC) had earlier formulated a national strategy for manufacturing and a national manufacturing competitiveness program.[50] NMCC has highlighted many of the structural rigidities that inhibit manufacturing growth, including infrastructure (particularly roads and power), skills and taxation inefficiencies. At best, the global crisis further underlined the need for these reforms.

In a perverse kind of way, India's relative insulation from the global shock can be attributed to the fact that large chunks of the economy were not integrated, globally and even nationally.

- Has the stimulus included "buy national" clauses? Have import-restricting mechanisms been newly established or re-established?
- Has the country's executive/central bank manipulated the exchange rate or intervened in the foreign exchange market (if so, in which direction)?
- Have there been measures to prop up export industries (e.g., tax rebates, direct export subsidies)?

National bias and protectionism

India's response to the crisis did not include any "buy Indian" clauses. However, customs and countervailing duties were raised, a move made possible by the gap between applied and bound rates. Export restrictions were relaxed, but quantitative restrictions on exports and imports of several agricultural items are determined by what is happening to food price inflation—they do not constitute responses to the crisis specifically. There were several anti-dumping investigations, particularly against China, but these also pre-dated the global financial crisis.

[50] National Manufacturing Competitiveness Council, "National Strategy for Manufacturing" http://nmcc.nic.in/national_menu.aspx (accessed February 25, 2010).

- Which labor market policies have been enacted (e.g., unemployment benefits, rise in public-sector employment)?
- Which social policies have been included (e.g., expansion of support, additional investment in health and education system)?
- Which measures have been taken to support purchasing power (e.g., consumer checks, tax cuts, cash transfers)?

Social protection

NREGS was initially started in 2006 in 200 districts. In 2008, it was extended to all 593 districts, but this decision had nothing to do with the global financial crisis. The only tangible effect of the global crisis on NREGS is that additional attention is now being devoted to the creation of productive assets through NREGS, including irrigation. The government has passed legislation on social security for the unorganized sector. Like the 6th Pay Commission, this decision predates the global crisis. Although there is no available data on the subject, it is likely that public sector employment increased as a result of the crisis.

4. Implementation

- Does the government actively communicate and justify the rationale/goals of its stimulus policies to the public?
- Over time, how has the public responded to the government's management of the crisis (e.g., consumption/investment trends, public opinion polls)?

Political communication

Initially, much of the government's reaction to the crisis was based on the notion that it was a financial sector problem and that India's real sector was insulated and decoupled. The prime minister's address to industry on November 3, 2008 was symptomatic of this view. In his address, the prime minister stated: "Our first priority was to protect the Indian financial system from possible loss of confidence or contagion effects. I am happy to say that the direct exposure of our banks to problem assets is minimal. Our banks are well regulated and also well capitalized. I think we have successfully conveyed to our people that our banking system, both in the public and the private sector, is safe, and the Government stands behind it and that no one should fear for the safety of bank deposits. We have also taken several measures to infuse liquidity into the system to ensure adequate flow of credit."[51] When rumors surfaced in September 2008 about the ICICI Bank going bankrupt, the Finance Ministry and RBI were quick to dispel them. In October 2008, the Associated Chambers of Commerce and Industry (ASSO-

[51] Prime Minister of India, Recent Speeches; http://pmindia.nic.in/speeches.htm (accessed February 25, 2010)

CHAM) published a report suggesting that Indian manufacturing would shed 25 percent of its jobs, a claim castigated by various government spokespersons as unrealistic and sensational. Under government pressure, ASSOCHAM withdrew the report. Just as the global financial crisis was unfolding, the terrorist attacks in Mumbai in November 2008 shifted the public's and the government's attention away from economic matters.

Perceptions of the crisis began to change when FII exits and profit-booking began to affect the capital market (especially the Sensex) towards the end of 2008. When the Sensex lost heavily in December 2008 and January 2009, government responses were based on the belief that this was a temporary blip in an otherwise strong macroeconomic picture. Because of time lags, the bad news on exports didn't begin to filter through until January 2009. In February 2009, the government changed procedures within FDI policy in order to attract FDI and reverse the capital outflow. By then, news was beginning to filter through about returning migrants and job losses in exports. Independently, the Labor Ministry and Commerce Ministry initiated studies on job losses in the export sector, since a Federation of Indian Export Organizations (FIEO) survey claimed inordinately high job loss figures of 10 million.

Overall, the public responded favorably to the government's management of the crisis. The UPA was voted back into power in the general elections of 2009 with a slightly higher share of the vote than it had received in the previous election. However, this gain was more a vindication of UPA's overall management of economic matters rather than a specific endorsement of the way in which it handled the economic crisis specifically. The public continues to express reservations primarily about inflation, in particular food inflation, which was accentuated by the drought of 2009.

Modes and time frame of implementation

- How large has the time lag been between adoption and implementation of selected major stimulus components?
- What are the reasons for delay in implementation (e.g., legal barriers, insufficient capacities, corruption)?
- Have sectoral or regional interest groups influenced the workings of policy implementation in any way?

In terms of the way in which the stimulus package has been implemented, there have been concerns about whether the indirect tax cuts were being passed on to consumers. Allegations of cartels in the cement and steel industries had been floating around prior to the crisis and industry, pointing to the fact that its input costs had gone up, argued that the indirect tax cuts could not be passed on to the consumer.

There have always been complaints of delays and corruption in government delivery and public expenditure programs, and similar complaints have been made regarding NREGS. Indeed, administrative reforms are needed in order to ensure that public programs and infrastructural provisions are properly implemented. It should be noted that the broader agenda of administrative law reform involves two kinds of relationships: dealings between the citizen and the government on the one hand, and dealings between an enterprise and the government on the other. Since 1991, both citizens and entrepreneurs have exercised countervailing pressure to contain corruption and improve the inadequate delivery of services. However, such countervailing pressure has generally been limited to certain geographical, primarily urban, parts of the country. People have questioned the executive's failure to act through public interest litigation, particularly in cases of environmental protection.[52] They have also raised concerns about funds being siphoned from government spending and an inefficient distribution process. Administrative reforms—whether introduced before or since the crisis—do not appear to have acquired sufficient momentum. However, the Administrative Reforms Commission (ARC) set up by the UPA government has submitted 15 reports addressing areas in need of reform. The most relevant thus far include the report on local governance (6th), e-governance (11th) and citizen-centric administration (12th).[53] Finally, one should also mention the Unique Identification Authority of India (UIDAI), which was set up under UPA-II in order to issue each resident a 16-digit identity numbers. UIDAI plans to start issuing UIDs in 12 to 18 months and establish numbers for 600 million people within four years. This initiative may eventually limit the leakage of funds and target subsidies, but it cannot be ascribed to the global crisis either.

As a result of the crisis, some service sectors previously beyond the purview of trade unions—such as civil aviation—have begun to undergo unionization.

- Beyond emergency stand-by programs with the IMF, has the government collaborated with other governments or international organizations in implementing its response to the crisis?

International or regional cooperation

Beyond the G-20 meetings mentioned earlier, India has not been a part of any regional or international policy packages. However, in a trend that predates the global crisis, India has increasingly been resorting to regional trade agreements.

[52] The issue of the judiciary stepping into the executive's arena naturally arises.
[53] Dept. of Administrative Reforms and Public Grievances, *Second Administrative Reforms Commissions Reports*; http://arc.gov.in/ (accessed February 25, 2010).

5. Funding, Tax and Monetary Policies

- Has the government initiated tax reductions/incentive schemes?
- Have these been aimed at the private and/or the corporate, domestic or the foreign sectors?

Tax policies in support of stimulus/ stabilization

India's government directed tax reduction and incentives at the business sector.[54] In many sectors where public expenditure is now sought, no evidence exists of demonstrated market failures. The India of today is not the same as the India of the 1950s. Even if there are goods that need to be subsidized, there are means of subsidization that conform to principles of choice, competition and efficiency. For example, public financing need not necessarily be equated with public provisioning. Secondly, since September 2008, there has been a shift away from private investment towards public investment.

- What kind of policies did the central bank contribute to the national crisis response? Which unconventional measures were used to fight the crisis?
- If an independent national monetary policy is not feasible, were there substituting measures in the country's exchange rate policy?

Monetary and currency policies in support of stimulus/ stabilization

Monetary policy was loosened in the aftermath of the crisis. However, inflation has been an issue of concern, and as food price inflation has reached critical levels, monetary policy is being tightened, with further tightening expected in April 2010. Whereas the exchange rate is determined by the market, it is nonetheless managed by the RBI in order to cushion volatility. As both foreign direct investment and portfolio investments have recovered, there is upward pressure being put on the rupee.

[54] One deliberately avoids the use of the expression "the corporate sector" since not all business in India is corporatized.

- Relative to conditions at the outset of the crisis, does stimulus funding have a solid foundation in monetary policy or in bond/credit markets?
- Is the program part of the normal budget/integrated into the budgetary cycle, or is it financed primarily from sources outside of the formal budget?
- Is there cross-level burden-sharing between center and regions (e.g., debt issuance, fund transfers)?
- Is financial aid given to banks/companies/households in a discretionary way or based on well-defined formulas (e.g., conditionalities)?
- Did the government make credible commitments to terminate its expansionary fiscal and monetary policies under (what kind of) post-crisis conditions?

Credibility of funding mechanisms

India's corporate bond market is inadequately developed. Large chunks of the credit market are informal, which in addition to administered exchange rates, constrains the transmission of monetary policy instruments. However, NREGS requires funds to be transferred to beneficiaries through bank accounts or post office savings accounts, which has expanded financial inclusion.

The government's fiscal response to the crisis was integrated into the budgetary cycle, as the system for supplementary grants is also part of the budgetary process.

Given India's federal system of government, much of funding and delivery is a matter of state authority, and it is difficult for the center to compel states to introduce or facilitate reforms targeting efficiency. Similar issues arise with the devolution of funds, where center-to-state fiscal transfers are not transparent because of the diverse channels through which they take place. There is a dearth of accountability mechanisms in administrative structures, and no apparent linkages can be established between expenditure and tangible improvements in outcomes.

It should be noted that the dilution in powers of the Finance Commission began in the late-1960s, a period in which centrally sponsored schemes began to proliferate. To ensure devolution to local bodies, the government should ideally replace all three channels (the Finance Commission, the Planning Commission and centrally sponsored schemes) with a single one (the Finance Commission) and make individual state finance commissions' recommendations mandatory. However, it is unlikely that the center is going to let go. Indeed, it was the desire to increase the center's powers that originally led to the institution of centrally sponsored schemes and the dilution of the Finance Commission (with an increase in such transfers from the Planning Commission).

By the time the 6th Pay Commission recommendations percolate through to individual states, they will be in poor fiscal shape. With the exception of so-called special category states (in which the center provides 100% of funding), states are required to produce a matching grant to the transfers they receive, though ratios vary from program to program. Given the increases in public expenditure associated with the crisis, states have already begun to clamor for greater central assistance.

In its last submitted report in January 2009, the Prime Minister's Economic Advisory Council stated, "The incremental transfer payment of 5 per cent of GDP to the household and corporate sector through subsidies and tax reduction is large by any definition. It may be argued that much of it antedated the financial crisis, but the fact is that its disbursement overlapped the crisis and would have the same effect had the transfers been conceived at a later date. In addition to this, there has been a move to re-prioritize expenditures and to try and increase the roll-out of public-private infrastructure projects, especially in the road sector."[55]

The issue of targeting subsidies has always plagued India. While it is accepted that subsidies are needed for the poor, or "below the poverty line" households, disagreement reigns on how to define the poor and problems of exclusion and inclusion. The Planning Commission generates poverty estimates with National Sample Survey (NSS) data; the last large NSS sample was taken in 2004-05 and showed an all-India poverty ratio of 27.5 percent, with significant concentrations in places like rural Bihar and rural Orissa. The Rural Development Ministry has commissioned an independent survey for poor households in rural areas.[56] This lack of data makes it impossible to distribute aid, financial or otherwise, to households on the basis of objective criteria.

Beyond the specific instances where time lines are mentioned (and these are extendable), the government has made no identifiable commitments to roll back expansionary fiscal and monetary measures. With inflation increasingly becoming an issue, expansionary monetary policy might be rolled back in April 2010. The government is likely to discontinue the special tax exemptions in the course of 2010. It is unlikely that the government will introduce rollbacks in public expenditure and return to fiscal consolidation and the FRBM act. However, PSU privatization (sales of majority stake) and disinvestment (sales of minority stake) were on hold under UPA-I. Under UPA-II, the prospects of disinvestment, such as through initial public offerings (IPOs) and including those to retail investors, are brighter. The budget

[55] Economic Advisory Council to the Prime Minister, *Review of the Economy 2008-09*; http://eac.gov.in/reports/eac_rv0809.pdf (accessed February 25, 2010). The 5% figure is higher than the earlier figures because it includes the 6th Pay Commission.
[56] Ministry of Rural Development, *BPL Census-2002 Complete Household Survey*; http://bpl.nic.in/index.php?bpl= (accessed February 25, 2010).

speech for 2009-10 stated, “The Public Sector Undertakings are the wealth of the nation, and part of this wealth should rest in the hands of the people. While retaining at least 51 per cent Government equity in our enterprises, I propose to encourage people’s participation in our disinvestment programme. Here, I must state clearly that public sector enterprises such as banks and insurance companies will remain in the public sector and will be given all support, including capital infusion, to grow and remain competitive.”[57]

6. Feedback and Lesson-Drawing

- Have there been revisions or additions to the original policy packages or a sequence of distinct stimulus policies in response to unexpected new developments?

Policy feedback and adaptation

While the policy packages were incremental, it would be difficult to argue that these represented learning by doing. Changes in the cash reserve ratio, repo rates and reverse repo rates by RBI are always small and incremental. The three distinct fiscal packages owe their origin to the fact that the government increasingly understood the severity of the crisis.

- Has major institutional reorganization/capacity-building been undertaken in financial supervision?
- Do we find new institutions that were not in place prior to the crisis (e.g., bad banks)?

Institutional restructuring

There has been no institutional restructuring undertaken that can be ascribed to the crisis. The crisis has not contributed to any remarkable changes in financial regulation and supervision. The government did not create new institutions such as so-called bad banks.

[57] Minister of Finance, Budget 2009-10 Speech.

7. Tentative Economic Impact

- What do major economic performance indicators tell us about the short-term effectiveness of the crisis response (e.g., growth rate, unemployment rate, industrial output, private consumption, consumer/producer confidence, inflation, exports, bank balance sheets, credit squeezes)?
- How has the political logic of crisis management (i.e., crisis as an opportunity to broaden political support) worked out for the major decision-makers so far? How has the reputation of major government leaders at the center of the crisis response evolved (e.g., based on polls, election results, backing within their political party)?

Economic and political effectiveness of the crisis response

As already noted, during the 2008-09 fiscal year, real GDP growth declined from 7.8 percent in the first quarter to 5.8 percent in the third and fourth quarters. During the first quarter of 2009, however, growth increased to 6.1 percent. Given the earlier hikes in interest rates, the baseline growth trajectory dropped from around 8.5 percent in 2003-04 to around 7.7 percent in 2007-08. A model created by the Indian Council for Research on International Economic Relations (ICRIER) projected that the global crisis would result in lower growth rates for India of 6.3 percent in 2008-09 and 4.8 percent in 2009-10.[58] Though the assumptions used in this model may be debatable, it is nonetheless expected that the global crisis will reduce baseline growth by three percentage points, from 7.7 percent in 2008 to 4.8 percent in 2010. Given the fact that exported goods accounts for 14 percent of GDP, an even greater drop in growth rate percentages is possible. The dollar rate of growth in exports (excluding service sector exports) is expected to have dropped from roughly 20 percent in 2008 to below zero percent by 2010, which should shave off roughly 2.8 percentage points from incremental GDP growth.

Apart from creating some volatility in exchange rates, the global crisis affected India through the financial and banking sector, exports, and the capital market. Of these, exports are clearly a real sector phenomenon. As opposed to the counter-factual base-line of 4.8 percent, India was on a growth path of around 6 percent (5.8% in Q3 and Q4 and 6.1% in the following quarter). Although these are somewhat arbitrary and roughly calculated figures, the policy response arguably contributed an incremental 1.2 percent to GDP growth. In this context, the policy response doesn't include investments, which have time lags and will only manifest themselves in the medium term.

[58] Rajiv Kumar, Matthew Joseph, Dony Alex, Pankaj Vashisth and Debosree Banerjee, *Indian Economic Outlook, 2008-09 and 2009-10*, ICRIER Working Paper No. 234, March 2009, http://www.icrier.org/publication/WorkingPaper234.pdf (accessed February 25, 2010).

It also does not mean an export revival is underway. The stimulation of private and public consumption accounts for the 1.2 percent incremental growth. In rough terms, 1.2 percent incremental GDP growth spelled for 1.8 million jobs, either old jobs retained or new jobs that were created. Greater accuracy on employment figures is not possible at this time, since unemployment data are unreliable and only available with time lags. India suffers most generally from under-employment rather than unemployment. Studies on NREGS show that its implementation has increased agricultural wage rates, reversed migration and led to food price inflation by increasing rural demand.

The index of industrial production (IIP) covers most of Indian industry, certainly the organized segment. The latest month for which these figures are available is July 2009. Beyond monthly fluctuations, the Indian IIP does not show declines in production, though the rate of growth has slowed. For example, growth in July 2009 was at 6.8 percent as compared to 4.6 percent for the months April through July 2009.[59] In July, consumer goods grew by 8.8 percent, intermediate goods by 9.0 percent, capital goods by 2.0 percent and basic goods by 4.8 percent. There are thus signs of a consumption revival, but not of an investment revival.

According to the National Council for Applied Economic Research (NCAER), which compiles a business confidence index together with the Economic Times, this peaked in January 2008 and has been on the decline ever since. Despite the fiscal and monetary stimulus packages, the index continued to decline. This is largely because interest rates continued to be high and external demand had not revived.[60] This is partly understandable because it pertains to industry, in particular manufacturing, whereas growth has been driven largely by the rural sector. This survey also predates the revival of the stock market and a fresh round of IPOs. For example, the Sensex has climbed back to around 17,000.

UPA-II and the Congress Party's reputation have not take a hit, partly also because the BJP and the left parties are in a bit of a disarray.

[59] Economic Times, "Business Confidence Down, But Not Out," May 30, 2009; http://www.mospi.gov.in/mospi_iip.htm (accessed February 10, 2010).
[60] ibid.

- Is there early evidence that the structure of the economy will change (e.g., greater role of the state, changes in sectoral shares in GDP)?
- Could old structural imbalances be aggravated? Can we already identify new structural imbalances? Have previously existing imbalances been tackled?

Structural distortions

The fiscal stimulus policies have distorted the overall goal of tax reform, but are likely to be withdrawn eventually. The major distortion to be found is in attitudes regarding state intervention, echoed by similar feelings across the globe. The global crisis has been interpreted not as a case for greater regulation or improved focus on the content of regulation, but simply as a sign that market-oriented reforms are bad. Hence, the share of the government in the economy is likely to increase, though there is no empirical or statistical evidence of this yet.

8. Concluding Remarks

Prior to the global financial crisis, the Indian media suggested that there were debates within and between the Finance Ministry and RBI about the extent to which the financial sector should be opened up, including the introduction of new foreign banks and branches. As was the case in the wake of the East Asian financial crisis of 1997-98, such banking sector reforms are now unlikely, and steps towards capital account convertibility will also be gradual. On a positive note, India's long-pending agricultural and rural sector reforms might now be implemented and reforms in the pension and insurance systems are also possible.

In terms of policymaking and its response to the crisis, the government erred in two ways. First, during the years of high growth, it was assumed that growth would continue indefinitely and that there would be no cyclical downturn. Standard indicators on financial crises do not factor in the inevitable ups and downs of the business cycle. At an individual level, in extremely visible sectors, high wages and high consumption expenditure, often debt-driven, were not backed up against the potential for a downturn. Government policy-formulation also had not factored in the possibility of a downturn. Second, government policy-formulation had not recognized the extent to which financial operations of Indian companies were globalized. Consequently, the shock of the initial foreign exchange liquidity crunch caught the government off-guard. Hopefully, these lessons have been learned.

The worst of the crisis is over and growth prospects in 2009-10 and 2010-11 should be around 6.5 percent. Growth to 9 percent levels requires an export revival, which is unlikely before the fiscal year of 2011-12. There have also been concerns raised about the impact that the drought in 2009 will have. Fortunately, the drought has turned out to be less severe than was initially thought. Problems with infrastructure (especially roads and electricity) remain a constraint and many of the solutions offered, such as captive generating sets, are inefficient at best.[61] While infrastructure reform and skills shortage remain pressing issues, they are likely to become binding constraints when growth reaches 9 percent.

However, the government has signaled moves toward fiscal consolidation and some kind of exit from tax reductions. Excise cuts have been partially reversed in the 2010-11 budget, which was announced on February 26, 2010. A goods and services (GST) tax is also scheduled to be implemented in 2011-12, which suggests that excise rates will increase further. The 13th Finance Commission's recommendations—now public—also recommend fiscal consolidation with a central GST rate of 5 percent and a state level GST of 7 percent.

[61] Telecom constitutes an outstanding example of success in infrastructure reform, whereas power represents a resounding failure in infrastructure reform. Also, India's road program stagnated under UPA-I but is flourishing under UPA-II. In fact, a revolution triggered by the National Highway Development Programme (NHDP) is underway in roads, though it has yet to be sufficiently appreciated. The program has transcended the original NHDP plans and now covers feeder roads.

Study Context

The Bertelsmann Stiftung has a long tradition of assessing the quality of governance and devising evidence-based policy strategies for decision makers.

The **Transformation Index (BTI)** monitors political management, democratic quality and economic development around the world. The BTI encompasses all 128 developing nations and countries in transition that have a population of more than two million inhabitants, and have not yet attained fully consolidated democracy and a developed market economy.

The **Sustainable Governance Indicators (SGI)** offer a complementary focus on the OECD member states. The SGI evaluate the sustainability of political action in 15 different policy fields (from economy, labor, and education to environment, research and development), the quality of democracy and questions of strategic management capability in each of the 31 OECD countries.

The study *Managing the Crisis* is a joint initiative of the two projects.

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