

Impact of the Financial Crisis on the Poor in India: Some Initial Perspectives

As part of contribution by the United Nations Development Programme (UNDP) to the ongoing dialogue on the impact of the global financial crisis, we present in this collection some 'Initial Perspectives' on its impact on the poor in India, written by some of the country's leading economists and analysts.

Rajiv Kumar presents a succinct analysis of the channels through which the financial crisis has impacted the Indian economy while Bibek Debroy examines the impact of the slowdown in economic growth at a disaggregated level -- both by sectors and by regions. Jayati Ghosh analyses the impact of the crisis on agriculture, migrants and home-based workers. Vijay Mahajan unfolds the differential impact of the financial crisis on goods and services consumed by the masses and the elite. Seeta Prabhu from UNDP India, highlights the likely impact of the financial crisis on the achievement of the Millennium Development Goals and human development.

In keeping with UNDP's perspective, these papers focus on 'people', particularly the poor: in agriculture, in the informal sector, in non-farm activities and on the goods and services they consume. They delineate the conundrums emerging from the development pattern followed thus far and point to the need for policy actions to transform the situation to one of enlarging the range of choices and opportunities for the vulnerable sections of the population.

We hope this compilation of viewpoints from independent analysts will facilitate debate and the emergence of viable solutions that strengthen the linkages between economic growth and human development.

Global Financial and Economic Crisis: Impact on India and Policy Response

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The impact of the global crisis has been transmitted to the Indian economy through three distinct channels viz. the financial sector, exports and exchange rates. The Indian banking sector was not overly exposed to the sub-prime crisis. While exports of both goods and services, still account for only about 22 percent of the Indian GDP, their multiplier effect for economic activity is quite large as the import content is not as high as for example in the case of Chinese exports. Therefore, an export slump will bring down GDP growth rate in this year. The third transmission channel is the exchange rate as the Indian Rupee has come under pressure.

In terms of policy response, there is not much room for further fiscal policy action as the consolidated fiscal deficit of the central and state governments in 2008-09 is already about 11 percent of the GDP. Any further increase in fiscal deficit to GDP ratio could invite a sharp downgrading of India's credit rating and a loss of business confidence. It is more important to focus policy attention on removing some of the many remaining structural bottlenecks on raising the potential GDP growth rate. Essentially this will imply efforts at improving the investment climate both for domestic and foreign investors; removing the entry barriers for the entry of corporate investment in education and vocational training; improving the delivery of public goods and services and expanding physical infrastructure capacities including a major effort at improving connectivity in the rural regions.

Introduction

The Indian economy looked to be relatively insulated from the global financial crisis that started in August 2007 when the 'sub-prime mortgage' crisis first surfaced in the US. In fact the RBI was raising interest rates until July 2008 with the view to cooling the growth rate and contain inflationary pressures. But as the financial meltdown, morphed in to a global economic downturn with the collapse of Lehman Brothers on 23 September 2008, the impact on the Indian economy was almost immediate. Credit flows suddenly dried up and the overnight money market interest rate spiked to above 20 percent and remained high for the next month. It is perhaps judicious to assume that the impacts of the global economic downturn, the first in the center of global capitalism since the Great Depression, on the Indian economy are still unfolding.

The severity and suddenness of the crisis can be judged from the IMF's forecast for the global economy. For the first time in sixty years, the IMF is now forecasting a global recession with negative growth for world GDP in 2009-10. The IMF has revised its forecasts downwards thrice since July 2008, and it is not yet certain that this will be the last revision. The WTO has predicted that world trade, which has virtually collapsed in the second half of 2008 is likely to decline by as much as nine percent in 2009-10. We have already seen exports from world's major exporters, like Germany, Japan and China, plummeting by more than 35 percent in the last quarter of 2008. The sharp decline in economic activity is despite the large stimulus, estimated at more than USD3 trillion that OECD economies have put in place. Yet the bad news does not stop. The worst downside scenario could be for the US economy being trapped in a Japan like "L" shaped recovery for the next few years. This will imply a further decline in world exports and softening of global commodity prices. In turn it will result in sharp slowdown in world exports and result in widespread unemployment and social stress in major exporting economies. This could well generate irresistible protectionist sentiments and if governments do succumb to these, it will unleash the dreaded downward cycle which could see the global economy plunging over the precipice into a prolonged recession. It is therefore prudent not to underestimate the severity of the present crisis.

Impact of the Global Crisis on Indian Economy

The impact of the global crisis has been transmitted to the Indian economy through three distinct channels viz. the financial sector, exports and exchange rates. The financial sector including the banking sector, equity markets, external commercial borrowings and remittances has not remained unscathed though fortunately, the Indian banking sector was not overly exposed to the sub-prime crisis. Only one of the larger banks, ICICI was partly affected but managed to thwart a crisis because of its strong balance sheet and timely action by the government, which virtually guaranteed its deposits. The equity markets have seen a near 60 percent decline in the index and a wiping off of about USD1.3 trillion in market capitalization since January 2008 when the Sensex had peaked at about 21,000. This is primarily due to the withdrawal of about USD12 billion from the market by foreign portfolio investors between September and December 2008. The foreign investors withdrew these funds in order to strengthen the balance sheet of their parent companies. Commercial credit, both for trade finance and medium-term advances from foreign banks has virtually dried up. This has had to be replaced with credit lines from domestic banks but at higher interest costs and has caused the Rupee to depreciate raising the cost of existing foreign loans. Finally, while the latest numbers are not yet available, remittances from overseas Indians have reportedly fallen as oil producing economies in the Gulf and West Asia begin to suffer from decline in oil prices. The second transmission of the global downturn to the Indian economy has been through the steep decline in demand for India's exports in its major markets. The first sector to be hit was the gems and jewelry which felt the impact in November itself and where more than 300,000 workers have lost their jobs. The negative impact has since covered other export oriented sectors garments and textiles, leather, handicrafts and auto components. The 21 percent decline in exports in February 2009 is the steepest fall in exports for the last two decades. It is unlikely that exports will recover within this year. While exports of both goods and services, still account for only about 22 percent of the Indian GDP, their multiplier effect for economic activity is quite large as the import content is not as high as for example in the case of Chinese exports. Therefore, an export slump will bring down GDP growth rate in this year.

The third transmission channel is the exchange rate as the Rupee has come under pressure with the outflow of portfolio investments, higher foreign exchange demand by Indian entrepreneurs seeking to replace external commercial borrowing by domestic financing and the consequent decline in foreign exchange reserves. This is likely to continue because current account will remain in deficit and the capital account, which has been in deficit in the second and third quarters of 2008-09, will not generate the needed surplus to cover the current account deficit. This will imply further drawing down of foreign exchange reserves and continued downward pressure on the exchange rate. However, with foreign exchange reserves remaining at 110 percent of total external debt at the end of December 2008, investment sentiments should not be unduly affected in the near term. The nearly 25 percent depreciation in the Rupee's exchange rate has partially nullified the benefits from the decline in global oil and gas prices and increased the cost of commercial borrowings. The weaker Rupee should encourage our exporters and it is possible that with imports declining as sharply as exports, the country's trade deficit may actually improve in the short run and the external sector balance may remain stable and not pose any major policy issue.

Overall, it would be fair to say that the timing of the external shock from the global economic downturn has been rather unfortunate. Coming right on the heels of a policy induced contraction in economic activity, its initial impact, as reflected in the third quarter GDP growth falling to 5.3 percent and the steep decline in exports, has been perhaps exaggerated. This negative impact has been, to an extent, ameliorated by the quick policy response both by the RBI and the Central Government. The RBI has infused about USD80 billion, as additional liquidity by cutting the CRR, lowering the SLR and unwinding the MSS. The RBI has also signaled its expansionary preference by cutting its repo rate, at which it lends funds to commercial banks from nine to five percent in less than six months. The reverse-repo rate has also been brought down to 3.5 percent to

discourage banks from parking overnight funds with the RBI. Three fiscal stimuli have been announced between November 2008 to February 2009. These amount to about 1.3 percent of the GDP. However, to these stimulus packages we should also add the fiscal outlay of measures announced in the 2008-09 Budget in February 2008. These included some measures that implied a hefty transfer of purchasing power to the farmers and to the rural sector in general. These included, farm loan waivers, funds allocated to the National Rural Employment Guarantee Scheme (NREGS), Bharat Nirman (targeted for improving rural infrastructure), Prime Minister's Rural Road Programme and a large increase in subsidies on account of fertilizers and electricity supplied to the farmers. All these measures, taken more out of political considerations and not in response to the global crisis, have nevertheless helped to shore up rural demand for both consumer durables and non-durables.

Some of us at ICRIER have used a model of Leading Economic Indicators to forecast GDP growth for India¹. We have modified the model to not only incorporate the impact of the external shock provided by the global economic downturn but also to take in to account the mitigating impact of the monetary and fiscal measures taken by the government. According to this model, Indian economy will grow by about 6.3 percent in 2008-09. The Economic Advisory Council to the Prime Minister has now also brought down its estimate of 2008-09 GDP growth to 6.5 to seven percent and not 7.1 percent as given by CSO in its advanced estimates and used for budget formation by the finance ministry. The GDP growth is likely to further decline to between 4.8 to 5.5 percent in 2009-10. Other agencies like the IMF, the World Bank and the ADB have also estimated Indian GDP growth in 2009-10 at similar levels in their latest forecasts released in March 2009. Thus, Indian economy will come down from the nine percent trend that it had achieved in the last four years. The growth targets for the 11th Five-Year Plan will also have to be surely lowered.

Policy Response

There is not much room for further fiscal policy action as the consolidated fiscal deficit of the central and state governments in 2008-09 is already about 11 percent of the GDP. This is likely to rise further as further necessary public expenditures are announced in the next budget and economic activity slows down. Any further increase in fiscal deficit to GDP ratio could invite a sharp downgrading of India's credit rating and a loss of business confidence. With inflation down at less than one percent and likely to remain below five percent in the coming months, there is room for bringing down the repo rate further. However, the more important issue is to try and induce commercial banks to bring down their lending rates as these currently remain at around 10 percent even for their prime borrowers. This is largely a result of the 'crowding out effect' of the large government borrowing programme. To address it, the government may have to consider monetizing its borrowing requirement so that liquidity is not squeezed out of the system. This poses the danger of stoking inflation in the medium-term but perhaps more importantly the breakdown of macro-prudential discipline that has been achieved after considerable effort. It would seem, therefore, that government's options for taking counter cyclical and reflationary measures in the short term are rather limited.

In our view, it is more important to focus policy attention on removing some of the many remaining structural bottlenecks on raising the potential GDP growth rate. Essentially this will imply efforts at improving the investment climate both for domestic and foreign investors; removing the entry barriers for the entry of corporate investment in education and vocational training; improving the delivery of public goods and services and expanding physical infrastructure capacities including a major effort at improving connectivity in the rural regions. These measures will constitute the package of second generation of structural reforms and will enable the Indian economy to climb out of the downward cyclical phase and then to extend the upward phase for a longer period than was achieved in the last cycle.

¹ Rajiv Kumar et al The Outlook of Indian Economy, ICRIER Working Paper No. 235

Growth Downturn and Its Effects

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It is widely accepted now that the slowdown in the global economy has impacted the Indian economy though not as badly as those in countries which are more globally integrated. Impacts in India are spatially as well as sectorally differentiated. Despite a variety of media reports about job losses, there is little empirical evidence of this having occurred outside of the export sector, meaning the export of goods sector. It should also be noted that export growth is not evenly spread throughout the country, but is rather concentrated in clusters where the impact of job loss is felt more acutely. At this stage, it is still unclear as to how temporary are these job losses. The media reports about job losses in IT, ITES and financial services are quantitatively not that significant.

On the positive side, the rural sector, particularly in rice and wheat-growing irrigated areas, seems to have offered some kind of a cushion to India in the growth slowdown. Globalization and integration also means greater exposure to uncertainty and external shocks. Hopefully, the present episode will lead to policy changes that provide necessary insurance cushions, collectively or individually.

Introduction

There is no longer any support for the view, initially put forward in September 2008, that the Indian economy is decoupled from global shocks, or the related view that a financial sector crisis does not impact the real economy. While in a longer-term sense, growth rates in emerging market economies may have become delinked somewhat from growth rates in developed economies (especially after the east Asian financial crisis in 1997-98 and subsequent recovery), this does not necessarily hold for cyclical effects.

India's growth picked up in 1992-93 and then moved to a higher trajectory of around 8.5 percent from 2003-04. Consumption, investment and exports have driven this growth. And this growth also occurred when the external environment was benign. If the external environment now turns malign and export growth becomes zero or negative, this cannot but have an effect on GDP growth.

The most recent official data (2006-07) shows exports of goods as 14 percent of GDP and exports of goods and services as 21 percent of GDP. Since 2002-03, exports of goods have grown by more than 20 percent in dollar terms, crossing 30 percent in 2004-05. The most recent export figures (goods alone)² show that for the period April 2008 to January 2009, exports have grown by 13.2 percent in US dollar terms. What is more pertinent, however, is what has happened since September 2008. In January 2009, exports declined by 15.9 percent, compared to January 2008.

There continue to be differing points of view on three issues, which are related. First, how bad has the growth slowdown been in 2008-09? Second, flowing from the first, what will be the growth record in 2009-10? Third, when will the recovery begin?

Growth Projections

Government projections still talk about 7.1 percent real growth in 2008-09 and expect seven percent growth in 2009-10. The interim budget presented on 16 February 2009 spoke of a nominal GDP growth of 11 percent in 2009-10. However, the CSO Q3 2008-09 GDP figures show growth of 5.3 percent. What is also pertinent for

² January 2009

these Q3 figures is a growth of 17.3 percent in the category “community, social and personal services”, reflecting the impact of the Sixth Pay Commission. Were this effect to be netted out, growth would probably be of the order of 4.5 percent. Therefore, contrary to government projections, most outside estimates are based on a growth rate of between 4.5 and five percent in the second half of 2008-09, a rate of growth that continues through the first half of 2009-10 too. There is also some consensus that there will be recovery in the second half of 2009-10. That does not, however, mean recovery to the dizzying 8.5 percent heights. While individual projections differ, most independent forecasts would be something like five percent for the first half of 2009-10 and six percent for the second half, with 5.5 percent for the entire year. The government’s expectations of seven percent are primarily based on the three fiscal stimuli packages and monetary policy loosening working their way through.

From the point of view of the poor, the impact of the financial crisis should not be looked at in isolation. We also need to factor in the food and fuel crises that preceded it. India’s inflation rate, based on the wholesale price index (WPI), is declining and the point-to-point WPI-based inflation rate may soon turn negative in early April 2009. However, different CPI (consumer price index) based inflation indicators are available for January and February 2009 and these still show point-to-point inflation rates in excess of 10 percent. While CPI-based inflation is also on its way down, the major reason for a difference between WPI and CPI trends is the relatively higher weight in the latter to food products and high food inflation.

Effects of the Slowdown

In general, we know the kind of effects which a slowdown in growth brings about. Firstly, exports, foreign investments (direct and portfolio) and ODA flows suffer, reflected in slower growth. Secondly, this means poverty-reduction effects of growth also suffer. Thirdly, government revenue is adversely affected, limiting the fiscal space available to governments. Unlike developed countries, the base for taxes, especially indirect taxes, is narrower in developing countries and tax revenue drops relatively more when there is a slowdown. The Centre’s fiscal deficit is likely to be 6.5 percent of GDP in 2009-10, with the States contributing another 3.5 percent. Even without including off-budget items (such as oil and fertilizer bonds), this illustrates the limited fiscal space the government possesses.

Fourthly, there are differential spatial effects, since those who are more integrated and connected with global and national markets suffer more.³ The rural sector, particularly in rice and wheat-growing irrigated areas, seems to have offered some kind of a cushion to India in the growth slowdown. The Rural Marketing Association of India conducted a study, between July and December 2008, on India’s rural markets and found no evidence (at least during this period) of a slowdown, particularly among those who earn a living from agriculture. There was a marginal impact among those who earn a living from trade and manufacturing.

Jobs Lost, Jobs Gone

The last firm employment elasticities we have are those that were worked out by C. Rangarajan when he was the Chairman of the Prime Minister’s Economic Advisory Council. Using NSS data for the period 1999-2000 to 2004-05, the derived employment elasticities were 1.52 for agriculture, forestry and fishing, 0.34 for manufacturing, 0.88 for construction, 0.59 for trade, hotels and restaurants, 0.27 for transport, storage and communications, 0.94 for finance, insurance, real estate and business services and 0.48 for total employment

As a very rough indicator of employment effects of the slowdown, one can make some rough calculations, contrasting Q2 of 2008-09 (before the external shock hit) with Q3 of 2008-09.

³ Such differential geographical impacts have been documented in east Asia, after the financial crisis of 1997-98.

Even before the external shock, GDP growth had slowed because of the monetary tightening. Q2 of 2008-09 registered growth of 7.6 percent and at the aggregate level, this would have meant a creation of 18.2 million jobs. A decline in growth to 5.3 percent means a creation of 12.7 million jobs. As a counter-factual, 5.5 million jobs that would otherwise have been created, will now no longer be created.

By the same token, the decline in agriculture in Q3 is marginal. But in Q2, agriculture grew by 2.7 percent and this would have led to the creation of 10.3 million jobs. Manufacturing declined by 2.2 percent in Q3, contrasted with an increase of five percent in Q2. That increase in Q2 would have meant creation of 0.8 million jobs, contrasted with a possible job loss of 0.4 million in Q3. Construction growth declined from 9.7 percent in Q2 to 6.7 percent in Q3, suggesting 0.5 million fewer job creation. Similar figures are 1.3 million for trade, hotels, transport and communication. (Given the back-of-the-envelope kind of way these numbers have been derived, one should not read too much into the precise numbers.)

There is a difference between existing jobs being lost and employment growth that would otherwise have occurred, not happening. Consequent to the slowdown, most attention has focused on the former. However, the latter is no less important and quantitatively, is more significant. The 11th Five-Year Plan (2007-12) document mentions that from 2000 to 2005, the incremental employment growth has been 46.72 million, a not insignificant figure over a period of five years. It has to be noted that most of this growth has occurred in the unorganized sector. Of that 46.72 million, 8.84 million jobs were created in agriculture, 8.64 million in manufacturing, 6.44 million in construction, 10.70 million in trade, hotels and restaurants, 4.04 million in transport, storage and communications, 3.12 million in financial, insurance, real estate and business services and 4.59 million in community, social and personal services⁴.

Other than agriculture, the bulk of employment creation since the reforms of the early 1990s has occurred in manufacturing, construction, trade, hotels and restaurants and transport, storage and communications. It is, therefore, in these sectors that the growth slowdown hurts the most. Financial services may be extremely visible, but particularly if real estate is excluded, this sector does not account for a significant share of employment creation⁵.

States with Accelerated Growth Suffering?

In terms of the impact disaggregated by state, the following proposition can plausibly be advanced. The growth pick up in the 10th Five-Year Plan (2002-2007) over the Ninth Five-Year Plan (1997-2002) varied from state to state. Among non-special category Indian states, this pick up in growth was especially marked in Andhra Pradesh, Bihar, Goa, Gujarat, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, UP and West Bengal. There was no significant increase in the growth rates of the other states.

Therefore, if there is a growth slowdown, states with accelerated growth should suffer more. This needs to be qualified with the composition of that growth, since if growth is primarily based on agriculture, the State will tend to be relatively more insulated from externally-triggered slowdowns. By this token, the adverse employment effect should be concentrated more in States like Andhra Pradesh, Goa, Gujarat, Haryana, Karnataka, Maharashtra, Punjab, Tamil Nadu and UP. This is an adverse employment effect interpreted in terms of a slowdown in fresh employment creation, as opposed to a loss of existing jobs.

⁴ Agriculture is somewhat different and the problems concerning agriculture have nothing to do with the global slowdown, although global prices and trade policy do have indirect impacts. Essentially, these problems with agriculture underline a failure to introduce assorted reforms in the rural sector.

⁵ Much the same can be said about the preoccupation with IT and ITES, or H1-B visas and slowdown in out-sourcing.

There are rough estimates of direct employment of 6.5 million in exports, with perhaps 15 million if indirect employment is included⁶. Based on a survey undertaken by the labour and the commerce ministry, there have been government figures that around one million jobs may have been lost, especially in sectors like gems and jewellery, garments, engineering goods (cycles, hand tools), chemicals, leather and handicrafts. This figure can be compared with the ILO estimate of 20 million job losses in China, due to China's greater export orientation. An independent Federation of Indian Export Organizations (FIEO) survey suggests job losses of 10 million. Given what is known about employment in exports, this may be rather wide of the mark, as was an earlier ASSOCHAM, an industry chamber, report (eventually withdrawn) to the effect that Indian manufacturing would shed 25 percent jobs across the board as a result of the slowdown. One million seems like a more realistic figure, at best touching two million. It should also be noted that export growth is not evenly spread out throughout the country, but is rather concentrated in clusters, e.g.: Surat (diamonds), Panipat (blankets), Tirupur (hosiery), Agra (leather), Ludhiana (woolen garments), Jaipur (hand-printed textiles), Pune (food processing), Ahmedabad (pharmaceuticals), Ambur (leather), Bangalore (machine tools) and Chennai (leather).

Of these, the only instances where there seem to be firm job losses are in Surat and Ludhiana. Without downgrading the importance of job losses, one must remember that industry body estimates of recession may tend to be over-stated, in an attempt to obtain fiscal concessions from the government. In addition, a second problem concerns the nature of the downturn. In the period immediately following September 2008, there was also a credit problem, spilling over into the export sector. This has eased off somewhat and needs to be distinguished from a demand contraction.

Job losses: Temporary or Permanent?

Conceptually, India's exports depend on the supply-side, the demand-side and the exchange rate. It has also been argued that since India's exports are in low value segments, income reduction in developed countries might actually increase the demand for exports from India. This is an argument that might, for instance, be advanced for garments. A global demand contraction may also be less important than price uncompetitiveness caused by an appreciation in the value of the rupee⁷.

Given the fragmentary nature of the information, the best that one can do is to depend on figures like 20,000 construction workers who have lost their jobs in the Gulf and job losses of 40,000 for engineering, 100,000 for gems and jewellery and 500,000 for garments. Of these, the engineering job losses are spread throughout India; the gems and jewellery ones are especially located in Gujarat (Surat, Ahmedabad), and; the garments losses are located mostly in Ludhiana and Tirupur, in that order of importance. At this stage, it is still unclear as to how temporary these job losses, as opposed to more permanent.

Jobs and the Unorganized Sector

Overall, these job losses have characterized the unorganized sector. This should not be taken to mean that the enterprise impacted is itself in the unorganized sector. Without getting into these niceties of distinctions between "unorganized" and "informal", it can be noted that somewhere between 40 and 45 percent of India's exports originates in the small-scale sector, which effectively means the unorganized or informal sector. And even when an enterprise is in the organized sector, it may well have informal sector workers, i.e., workers who possess no formal contracts, since employment is often done through contractors. Initially, downsizing adversely affects those who are employed in unorganized enterprises and those who are employed in

⁶ There are no firm estimates on exports segregated by states. Nor are there any firm estimates of employment generation in the export sector i.e. exports of goods.

⁷ Post crisis, the rupee has depreciated vis-à-vis the US dollar.

organized enterprises, but whose employment contracts are informal. This is true as a conceptual principle and is also validated by anecdotal accounts of what has been happening.

Social Security/Safety Nets and Migration

A key characteristic of informal sector employment is lack of protective labour legislation, including that on social security. Social security of course may mean different things e.g., unemployment insurance, old-age pensions, medical cover, etc. Of the present work-force of around 500 million, not more than 40 million are covered by social security, whatever definition one uses. As of now, beyond social security provided by the community or the family, workers who have lost jobs because of the growth downturn have no access to any social security.

Indeed, the only form of social security that exists so far is through the National Rural Employment Guarantee Scheme (NREGS), as the more comprehensive social security scheme for unorganized sector workers has not yet got off the ground. In this context, what needs to be highlighted is that most workers who have lost their jobs are migrants from other states. Inter-state migration has occurred for many years⁸, as states have differed in economic performance and geographical areas where there has been greater demand for labour have not necessarily been areas where there has been the supply of labour. Inter-State migration occurs notably from Bihar, UP, West Bengal and Orissa to states such as Karnataka, Andhra Pradesh, Tamil Nadu, Maharashtra and Gujarat, and encompasses semi-skilled and unskilled labour in the export sector.

Other than the obvious negative effect on remittances and consumption expenditure, the loss of export-related jobs means a return flow of migrants to their home states. There are anecdotal accounts of this already having occurred for Bihar and eastern parts of UP, related to a downturn in the diamonds sector. If the growth slowdown continues for a couple of years, this reverse migration might also extend to construction, trade, hotels and transport (though to date there is no evidence of this occurring). Anecdotal accounts so far point only to a loss of employment in the export good sector; a sector where NREGS does not provide an immediate safety net. Returning migrants are not always classified as rural workers -- a prerequisite for NREGS -- and in addition there can be administrative delays in issuing the required NREGS job cards.

Opportunities from Crisis

In conclusion, there does seem to be a consensus that India has not suffered as much as other countries and that the growth downturn is indeed no more than that -- falling far short of a recession. The recovery in India is also certain to be faster. In the years of high growth, there was room to ensure that "fallback cushions" for a possible period of downturn were put in place. That did not quite happen, since there was an implicit complacency that the growth story would continue. However, globalization and integration also means greater exposure to uncertainty and external shocks. Hopefully, the present episode will lead to policy changes that provide necessary insurance cushions, collectively or individually. And it is far better that this lesson is learnt when growth declines from 8.5 to 5.5 percent rather than from 8.5 to zero percent.

⁸ The Green Revolution in Punjab and Haryana was driven by migration from UP and Bihar.

Global Crisis and the Indian Economy

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Recent high economic growth in India was fundamentally dependent upon greater global integration, related to the deregulation of finance combined with fiscal concessions that spurred a consumption boom among the top two deciles of the population especially in urban areas, even as deflationary fiscal policies, poor employment generation and agrarian crisis kept mass consumption demand low. The impact of the crisis on agriculture is much more severe than has been recognized. Exposure to global price volatility was associated with a growing reliance on private debt, because of the lack of extension of institutional credit, coupled with growing inability to meet debt service payments because of the combined volatility of crops and prices. Official sources suggest that there has already been a sharp fall in employment in the export-oriented sectors. Many newly unemployed are migrant workers, often short-term migrants with casual contracts whose very existence tends to be ignored by official statistics. As opportunities for paid employment have dwindled, even during the boom, home-based subcontracting activities to women workers, or work in very small units that do not even constitute manufactories, often on piece rate basis and usually very poorly paid and without any known non-wage benefits, substituted to some extent.

Food grain prices have gone up the most, by more than 10 percent in the year until March 2009. This obviously affects household budgets, especially among the poor for whom food still accounts for more than half of total household expenditure. Clearly, much more creative and imaginative policy responses are required, in terms of changing directions of investment and consumption in the home market to emphasize wage-led growth, diversifying exports and generally making moves designed to turn economic adversity to advantage.

Introduction

It took some time for policymakers and analysts in India to recognize both the speed and the intensity of the effects of the global crisis on India. Indeed, there were arguments that India, along with China, is “decoupled” from the global system and capable of becoming an autonomous growth pole, based on its recent high growth from a low per capita income base and young population leading to falling dependency ratios. In addition, the “strong” domestic financial sector was also seen to be immune to shocks from the international financial system.

However, it turns out that this presumption was wrong, and even involved a faulty assessment of the previous boom. Recent high economic growth in India was fundamentally dependent upon greater global integration, related to the deregulation of finance combined with fiscal concessions that spurred a consumption boom among the top two deciles of the population especially in urban areas, even as deflationary fiscal policies, poor employment generation and agrarian crisis kept mass consumption demand low. The substantial rise in profit shares in the economy and the proliferation of financial activities combined with rising asset values to enable a credit-financed consumption splurge among the rich and the middle classes, which in turn generated higher rates of investment and output over the upswing. This was, therefore, quite similar to speculative bubble-led expansion in several other countries in the same period. This also made the growth process more vulnerable to internally and externally generated crises.

By the middle of 2008, even before the global crisis really hit India, this process too was reaching its limits. The crisis made matters much worse by causing sharp declines in exports of manufactures and reversal of capital flows such that both current and capital accounts of the balance of payments have worsened. The macro

issues have been much commented upon, but the specific impact upon certain groups has much less widely noted. The crisis has been accompanied by changes in employment and relative prices that have adversely impacted especially upon three sections of the population that were already very vulnerable: cultivators, migrant workers and home-based women workers. In addition, it has sharply affected food insecurity which was already a problem in the country.

Cultivators

The impact of the crisis on agriculture is much more severe than has been recognized. Cultivators in India have already been through more than a decade of agrarian crisis, which persisted even through the period of rising international crop prices. The problems of farming in India are both deep and varied. They include weather problems such as less reliable monsoons, more frequent droughts or floods, soil degeneration, lack of institutional credit and insurance leading to excessive reliance on private moneylenders, problems in accessing reliable and reasonably priced input, difficulties in marketing and high volatility of crop prices.

Except for the first set, these are all related to public policies from the early 1990s onwards, that systematically reduced the protection afforded to farmers and exposed them to import competition and market volatility; allowed private profiteering in agricultural input supply and crop purchases without adequate regulation; reduced critical forms of public expenditure; tried to cut subsidies by increasing the prices of important inputs like fertilizer and water and electricity rates, ran down or destroyed important public institutions that have direct relevance for farming, including public extension services and marketing arrangements; and did not adequately generate other non-agricultural economic activities.

At the same time that various forms of public protection for cultivation were being reduced, trade liberalization meant that Indian farmers had to operate in a highly uncertain and volatile international environment. They were effectively competing against highly subsidized large producers in the developed countries, whose average level of subsidy amounted to many times the total domestic cost of production for many crops. In addition to increasing the risks of farming, volatile crop prices also generated misleading price signals. Indian farmers tend to respond quickly and extensively to price signals by shifting to more high-priced crops. This caused large and often undesirable shifts in cropping pattern which ultimately rebounded on the farmers themselves.

In dry land areas, traditional staple crops such as millets and sorghum were abandoned in favour of oilseeds such as groundnut which require more irrigation and purchased inputs, and which have also faced major volatility in crop prices. As a result of the shift away from traditional staple grains to cash crops, there was much greater use of a range of purchased inputs, including new varieties of seed and related inputs marketed by major multinational companies. Small cultivators, who took on debt (often from informal credit sources at very high rates of interest) in order to pay for these cash inputs, then found themselves in real difficulty if crops failed or output prices remained low.

So the inevitable uncertainties associated with weather fluctuations were compounded by further problems of extremely volatile crop prices, which were no longer inversely related to harvest levels but followed an international pattern. Further, this dramatic volatility of output prices was associated with continuously rising prices of inputs. This was especially marked because of government attempts to reduce fertilizer subsidies, and progressive deregulation of supplies of inputs such as seeds and pesticides.

Such exposure to global price volatility was associated with a growing reliance on private debt, because of the lack of extension of institutional credit, coupled with growing inability to meet debt service payments because of the combined volatility of crops and prices. Farmers already had inadequate access to institutional credit, but things got much worse after 1993. Financial liberalization measures caused a significant slowdown

in the growth of bank credit, particularly from commercial banks to rural areas, and a relative fall in proportion of bank credit flowing to the priority sectors, especially agriculture. The impact of the slowdown in rural banking fell disproportionately on poor and small borrowers.

Volatility of output prices remains a huge problem for farmers. And the central question of the huge burden of farm debt has really not been solved, despite the “loan waiver” for farmers announced in the 2008-09 Budget. This is because most farmers operate in the informal credit market, to private sources who are typically either rural moneylenders or input dealers. Marginal farmers, tenants and women farmers still remain outside the ambit of institutional credit, and most farm debt is informal. The real problems of rural debt cannot be addressed without dealing with cases of both public and private debt and recapitalizing the moneylenders to alleviate the problems of borrowers and keep private rural credit channels flowing.

Meanwhile, crop price volatility has become much worse in the past year, dramatically increasing the difficulties of cash crop producers. Globally, primary commodity prices zoomed upwards in 2007 and the first half of 2008, and then collapsed very rapidly thereafter. So all the price gains of the period January 2007 to mid-2008 were wiped out by the later fall in prices. Farmers did not benefit from such a short-lived price boom, especially if they produced cash crops. Instead, they now face lower prices of their output even as food prices have continued to increase. This is particularly true for cultivators of cotton and oilseeds, prices of which have crashed compared to a year ago. Cultivators who opted to sow these crops when their prices were at their peak now face a completely different environment with very different configurations of costs and prices that could easily make the cultivation process completely unviable financially.

Migrant Workers

Official sources suggest that there has already been a sharp fall in employment in the export-oriented sectors like textiles and garments and gems and jewellery, and even in industries catering more to the domestic market like metal products, automobiles and construction. Many newly unemployed are migrant workers, often short-term migrants with casual contracts whose very existence tends to be ignored by our official statistics. The economic boom of the past decade relied heavily on such workers: not just in the sectors mentioned above but in labour-intensive services, such as cleaning, maintenance, private security, driving and related services. These were not simply informal activities: many of them catered to the requirements of the expanding corporate sector, and in effect subsidized it by providing a cheap and flexible external labour force.

Such workers are now forced either to stay in precarious conditions in the urban areas, or go back to their places of origin – villages or smaller towns. They consequently change from becoming providers of remittance incomes to their households, to becoming dependents of these households, even as these households face more fragile material circumstances than before. Many of these migrant workers, for obvious reasons, come from the most depressed and backward regions of the country, where there is currently little potential for productive income generation. These are often also the regions of dry land agriculture, where remittance incomes play a vital role in sheer survival. Unsurprisingly they are also the regions in which extremist Maoist activity is widely prevalent, because of the anger bred by persistent backwardness and rising inequalities.

Home-based Workers

As opportunities for paid employment have dwindled, even during the boom, home-based subcontracting activities, or work in very small units that do not even constitute manufactories, often on piece rate basis and usually very poorly paid and without any known non-wage benefits, substituted to some extent. There are estimated to be more than 15 million women workers in the unorganised sector, and more than half of them are women involved in home-based work for different types of industry, dominantly on a piece-rate basis. This

includes *zari*, *charkha*, or other handloom work, *bindi* sticking, stitching labels, food processing, and also potentially hazardous work involving acids and chemicals.

Surveys show that most of them are very poorly paid piece-rate workers providing specific products or intermediate goods for manufacturing industries such as textiles and garments, engineering and chemical industries, leather and miscellaneous production such as imitation jewellery and petty cosmetic items. Such work typically does not get incorporated in the employment statistics which are based on employers' records. Very recent micro-evidence confirms the poor and sometimes even deteriorating conditions of such work. Even during the boom, there was pressure on piece rate wages because of competition from other and newer centres of such production, both inside the country and outside (such as from China).

The marginal utilisation of women workers in manufacturing industry is typically at the lowest and poorest-paid parts of the production chain. Such women workers are effectively deprived of all the benefits that may accrue from outside employment except for the low nominal returns that they receive from piece-rate work. They are therefore obviously excluded from any security of contract, and this means that any downswing is directly reflected in both declining orders or contracts and falling rates of remuneration.

Very recent evidence suggests that as export-based industries such as garments face heightened competitive pressure, they pass this pressure on to home-based women workers by reducing the effective rates for piece-rate work. Thus even nominal piece rate wages have fallen in many such activities, even as prices of necessities such as food have continued to increase.

Food security and the price of essentials

Much has been made of the slowdown in inflation rates to almost zero, and there are those who have pointed out that this reflects the declining rate of economic growth and could even lead to a deflation that is damaging for growth. But what is often not noted is that even within this overall stagnation in prices, food prices have continued to increase. Food grain prices have gone up the most, by more than 10 percent in the year April 2008 to March 2009. This cannot be blamed on higher procurement prices alone, since the prices of pulses, which are not covered by public procurement, have also gone up just as much.

The prices of fruits and vegetables and eggs, fish and meat have also increased, even if not by as much as for food grains. The only food category for which prices have fallen is edible oils, which reflects the decline in oilseed prices as world prices have crashed. Other food articles' prices have increased by more than one-fifth in this one year.

This obviously affects household budgets, especially among the poor for whom food still accounts for more than half of total household expenditure. Meanwhile, non-food primary product prices have hardly changed. The prices of fibres – mainly cotton, jute and silk – have barely increased at all. Oilseed prices have fallen by more than five percent. This immediately affects all the producers of cash crops, who will be getting the same or less for their products even as they pay significantly more for food. They are also paying more for fertilizer and pesticides, whose prices have increased by more than five percent.

Another major item of essential consumption has also increased in price: that of drugs and medicines has gone up by 4.5 percent, which obviously impacts upon the entire population, but especially the bottom half of the population who may find it extremely difficult if not impossible to meet such expenditures in times of stringency. A worrying combination of falling prices faced by agriculturalists who produce cash crops as well as petty producers and others who produce manufactured goods, even as the prices of essential items like food and medicines continue to rise. These groups and their families alone account for the majority of the population in the country.

Another little noticed but extremely serious consequence of the downswing is the impact on the finances of state governments, who are responsible for the bulk of the public spending which affects human development, such as basic infrastructure, health, sanitation and education. State governments' tax receipts have fallen and so they are increasingly strapped for cash and unable to meet even essential spending on basic services, not to mention development.

What is to be done?

Clearly, much more creative and imaginative policy responses are required, in terms of changing directions of investment and consumption in the home market to emphasize wage-led growth, diversifying exports and generally making moves designed to turn economic adversity to advantage.

What is immediately required is significantly increased public expenditure, directed towards particular areas: expansion of the employment guarantee scheme within rural areas and extension to urban areas; creative use of the scheme, especially in urban areas, to enable productive use of the tremendous wealth of labour resources available, especially women workers; more resources provided to state governments to enable them to meet basic development and social expenditures; a package for agriculturalists to protect them from volatile crop prices and to deal with the burden of debt.

In the medium term, the government needs to encourage moves towards more sustainable patterns of consumption and production, both through newer technologies and by re-orienting demands. If this can be done, the current crisis might even be worth the pain that it is now delivering to so many millions.

Impact of the Economic Downturn on Non-farm Sector Workers

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The impact of the global economic downturn is beginning to be pervasive. However, its impact for the lower income segments of the population in India seems to be the largest for those employed in export-oriented sectors like diamond polishing, garments, carpets and hosiery. In sectors which cater to the lower end of domestic demand of roti (food), kapda (clothing) aur (and) makaan (shelter) there has been little or no impact. The good news is that the demand for cereals remained robust, despite the slowdown. There does not seem to be any danger of job losses in the food and agriculture sector. In the clothing and textile sector, while demand in the lower end of the market continues to be buoyant, it is not so up-market. The same contrast – stable demand and employment at the lower end and a downturn at the higher end – can be seen in the makaan or the building materials and construction sector. Going beyond roti, kapda aur makaan, the non-farm sectors most affected are the export-oriented handmade carpet industry, tourism and retail.

Introduction

The impact of the financial sector crisis and the resulting economic downturn on the lower income segment of the population has been varied in India. In some sectors, particularly export dependent sectors such as diamonds and carpets, there have been a lot of shutdowns and layoffs, and thus a corresponding loss of livelihoods. In those sectors in which demand was derived from export and domestic growth (i.e. mainly higher end construction, trade, transport, hotels and restaurants, and personal and domestic services) there has been a downturn with its impact on employment and wages, but it is not a case of mass lay-offs.

In sectors which cater to the lower end of domestic demand of *roti, kapda aur makaan* there has been little or no impact. A large number of the jobs for the lower income group come from these sectors, so at least wage incomes here have been protected. However, quality of life is a function of real income, which has come under pressure because of a rise in the prices of wage goods, particularly food items. Thus the effects of the economic crisis are amplified for the lower income segments of the population due to (i) reduction in wage employment opportunities; and (ii) increase in cost of food.

Food and agriculture sector

Let us look at *roti* or food and agriculture sector. The good news is that the demand for cereals remained robust, despite the slowdown. While income elasticity of demand for cereals for the Indian population as a whole is declining and may now be near zero, low-income groups still show positive income elasticity of demand for cereals⁹. Thus, even if average incomes fall marginally, the demand for cereals will not decline, as people switch to basic foods. This ensures that the demand for farm produce remains buoyant and thus the demand for labour in agriculture remains strong. While 80 percent of farmers in India are small or marginal farmers, producing little or no marketable surplus, and employing little labour outside the family, the 20 percent of the middle and large farmers who produce 80 percent of the marketable surplus of wheat and rice, all need and use labour. Reports from the field in Punjab and Haryana indicate that, in fact, the demand for labour outstrips supply in many areas and labourers are negotiating wages not in terms of daily rates but in terms of per acre work contracts. The shortage of agricultural labour is partly attributed to the staying back of

⁹ Indian Wheat and Rice Sector Policies and the Implications of Reform, ERR-41 Economic Research Service, USDA

labourers in their homes due to increased work opportunity in their villages due to the National Rural Employment Guarantee Scheme.

However, the 10 percent rise in the wholesale price of cereals over December 2007 to December 2008 period, and the likely higher increase in retail prices, is a cause for concern. Wheat and rice remain the dominant source of calories in the diets of most Indian consumers, and together still account for about 22 percent of household expenditure in rural areas and 13 percent in urban areas — more than any other item. All urban households and a large segment of the rural population, landless households and small and marginal farmers, are net buyers of cereals. Thus an increase in the price of these staple food items amounts to reduction in real income. Politicians of all hues have sensed this and that accounts for one party after another offering rice or wheat at Rs. 2 or Rs. 3 per kg to lower income households.

The same is true of pulses, the staple protein of poor people. The Government of India has extended the import of pulses at zero customs duty for one more year even as it extended the ban on its exports excluding chickpeas (or *kabuli chana*) till March 2010 to help improve domestic supply and keep price in check. Finally, India continues to import large tonnages (5.60 million ton in 2007-08) of edible oils, and the government has reduced import duties to ensure that domestic price of edible oil is kept low.

There does not seem to be any danger of job losses in the food and agriculture sector. Nor are there any significant news reports about jobs being lost in these sectors. The jobs involved in the production, procurement, transport, storage, processing and retailing of cereals, oilseeds and pulses, remain largely intact whether the volumes are due to domestic production being exported or due to imports. Interestingly, in the food and agriculture sector, even the segment catering to the higher income segments and exports has remained buoyant. For example, over a thousand cashew processing units in the Palasa area of Srikakulam district of AP are unaffected and continue to thrive. This is partly because the Indian food processing industry exports commodities like basmati rice, pulses, herbs, ready to eat products, pickles, chutney, gravies, poultry, meat, fruits and vegetables, which have a steady demand. These products are traveling around the world - Europe, US, Middle East and South East Asia. Demand is robust.

"The economic slowdown does not appear to have affected investments in the food and agricultural processing industry. The sector is expected to attract fresh investments of over Rs. 5,000 crore in the next two-three years, according to an industry estimate. The Ministry of Food Processing Industries has received 42 expressions of interest (EoIs) after announcing the revised Mega Food Park Scheme in October 2008:" Business Standard, 27 February 2009.

Clothing and textile sector

Moving on to the *kapda* sector, we find the story is more mixed. While demand in the lower end of the market continues to be buoyant, it is not so up-market. For example, in the low-cost garment production centre in Pamidi and Anantapur district of Andhra Pradesh, 200 km north of Bangalore, there is no effect at all of the slowdown and over 3,000 units continue to thrive. The same is true of Raidurg in the neighbouring Bellary district of Karnataka, which is known as the "jeans junction" of India, producing low-cost imitations of all the well-known branded denim jeans. A similar story emerges from the *saree* weaving clusters of Maheshwar and Chanderi in Madhya Pradesh. Reports indicate unabated demand and no reduction in employment.

In contrast, a severe slowdown has been reported from the garment export units in Bangalore, with thousands of workers having been laid off. The sector employs about seven million workers in readymade garment manufacturing -- 3.9 million for exports and the rest for domestic market.

"Many importers have cancelled orders or postponed their delivery schedules. The market sentiment is very weak. The expected export performance is thus expected to be only 8.8 billion dollars or about 90 percent of

the actual achievement in 2007-08. There has been about 25 percent drop in the winter business during April to September this year as compared to the corresponding period of 2007-08. According to industry estimates, nearly 700,000 workers in the clothing and textile sector have lost their jobs in the past five months. By March 2009, another 500,000 could lose their work due to falling sales overseas:" Apparel Export Promotion Council (AEPC), Press Release, 27 November 2008.

The export part of the *kapda* category has felt the downturn, not just in Bangalore but also in Tamil Nadu's Tirupur hosiery cluster, which saw a reversal in trend with exports slipping from Rs. 110 billion in 2006-07 to Rs. 99.5 billion the following year and anticipated a further drop of 10 percent in 2008-09 compared to the 2007-08-level. More than 300,000 people are employed in the hosiery export sector in Tirupur. The Tirupur Exporters' Association expects that there would be big job losses in Tirupur – anything between 10,000 and 15,000 jobs in the coming months.

Housing and Construction

The same contrast -- stable demand and employment at the lower end and a down turn at the higher-end -- can be seen in the *makaan* or the building materials and construction sector. For example, flooring materials derive their demand from the construction sector. In the Bethamcherla stone polishing cluster in Kurnool district of AP, again the slowdown effect has been marginal. The Kadappa stone that it produces is mainly used by middle and lower middle class homes and its demand is unabated.

"The Indian granite and natural stone industry is in dire straits, with its major market - the US - badly hit by recession. It is estimated that granite exports this year will be Rs. 800 crore less than in 2007-08 (Rs. 6,071 crore)...At stake is the livelihood of lakhs of people hailing from the most backward districts. Some 300 units in Hosur, Bangalore and Hyderabad are about to close down. In Tamil Nadu, some 30 quarries (of the 165) are closed:" The Hindu, Chennai, 22 March 2009.

There are some occupations which have seen lower employment because of reduction in domestic demand and the most important of these is construction. Thus districts like Mahaboobnagar in Andhra Pradesh, from where a large number of construction workers migrate to big cities like Hyderabad and Mumbai, have seen a reduction in migration. But some observers attribute this to the intensive implementation of the National Rural Employment Guarantee Scheme (NREGS). In contrast, in the Bundelkhand areas of Uttar Pradesh and Madhya Pradesh, where the NREGS is not as intensively implemented as in AP, and from where a large number of workers migrate to Mumbai, Delhi and other big cities in the west and north, there has been no reduction in migration. Enquiries locally indicate there is adequate demand for migrant low-skill manual labourers and people continue to migrate.

Other Sectors

Going beyond *roti, kapda aur makaan* let us look at how the impact is being felt in the other sectors. The most well-known downturn affecting a single cluster was in the diamond polishing cluster of Surat. Nearly 50 percent of the 400,000 workers in Surat's diamond cutting and polishing industry have already lost their jobs due to the global slowdown by the end of 2008: The Economic Times, 17 March 2009. Perhaps we can take solace in the fact that negative impact of this magnitude has not been seen in any other cluster. But smaller effects can be seen in many of the other non-farm sub-sectors, which are export-oriented, such as carpet weaving.

The export-oriented handmade carpet industry has a major share in the international markets, and provides employment to millions of people in the country. More than two million rural artisans depend on this industry for their sustenance. Over Rs. 35 billion worth handmade carpets are exported to various countries by small and mid-sized carpet manufacturing and supplying units. However, declining demand from international

clients has led to an uncertain future for the carpet weavers and exporters. According to All India Carpet Manufacturers' Association (AICMA) report, export orders worth about Rs. 3 billion have been cancelled recently. Thus hundred thousands of workers have been rendered jobless in the Bhadoi cluster of Mirzapur district, Uttar Pradesh, which accounts for 65 percent of India's carpet exports.

Another non-farm sector which accounts for a large number of jobs is tourism. It is a composite service sector, where transport, hotels and restaurants, handicraft retailers, tour guides, and performers, all provide services around a tourist destination. As per Government of India figures in January 2009, only 487,262 tourists came to India, which was a 17.6 percent decline compared to the same month of 2008. The impact of this on jobs in areas like Jaisalmer in Rajasthan, which depend substantially on tourism, was quite devastating. Tour operators in Jaipur and Agra, which see a lot of domestic tourists in addition to foreigners, reported a slow down in business. They also said as a result drivers, hotel and restaurant workers and shop assistants were being laid-off.

Slowdown in domestic demand also caused job losses in the retail sector. As the financial crisis in the West deepened, its first visible impact was felt in the organized retail sector, whose demand was fueled by people working in boom sectors like IT. The dramatic collapse of a well-known retail chain like Subhiksha and the closure of several dozens of Reliance retail stores, brought the slowdown home for real. The organised retail sector in the country has witnessed an 11 percent decline in sales in 2008 and the slowdown is likely to continue for the next 12-18 months, says global consultancy firm KPMG¹⁰. The result of this on employment in this sector can be easily inferred. Wage rates for shop assistants and support staff like security guards, loaders, packers, drivers and housekeeping staff, have started falling have fallen in places like Gurgaon, Bangalore and Hyderabad.

Conclusion

To summarize, the impact of the global economic downturn is beginning to be pervasive. However, its impact for the lower income segments of the population seems to be the largest for those employed in export-oriented sectors like diamond polishing, garments, carpets and hosiery. There have been large scale job losses and mass unemployment in many such clusters like Surat, Bangalore, Bhadoi and Tirupur. In the middle are those who are employed in the sectors which had witnessed a high growth due to derived demand – such as construction, retail trade, transport, personal services, etc. Here the demand has gone down and so have jobs but there are no mass closures or lay-offs. The situation in the *roti, kapda aur makaan* producing sectors has remained stable, with little job loss. However, the 11.1 percent per annum increase in the consumer price index for agricultural labourers over the December 2007 – December 2008 period has had a negative effect even on the workers in these sectors whose jobs are intact.

¹⁰Hindu Business Line, 31 March 2009

Impact of Financial Crisis on India's March Towards MDGs

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As the full implications of the global financial crisis unfold, questions are being raised on its impact on India's human development and achievement of the Millennium Development Goals (MDGs). If the national poverty line is used as the definition, the country is generally considered to be well on track to reduce the headcount ratio of poverty, but not if the World Bank's estimates of proportion of population below the newly defined extreme poverty line USD1.25 per day is considered.

Moreover, irrespective of the poverty estimate one uses, there is a distinct possibility that poverty levels may be higher than expected in the next couple of years till the economy resumes a higher growth path. Higher food prices would aggravate the situation and push back further the possibility of India reaching the target within Goal 1 which aims at eradication of hunger by 2015.

With respect to Goal 2, the objective of achieving universal primary enrolment is widely recognized as being attainable with some effort. However, the other targets of ensuring progress such as primary school completion rates and adult literacy rates seem more challenging. As far as health related Goals 4 and 5 are concerned, the situation is not promising as the health outcomes of women and children have deteriorated even during the period of rapid economic progress prior to the financial crisis. To expect an improvement in health outcomes when the economic situation of many of the poor households is deteriorating and when public expenditure on health constitutes less than a quarter of total health spending is unrealistic.

At the macro-level, the Government of India has initiated several schemes such as the National Rural Employment Guarantee Scheme (NREGS) in the last couple of years that could cushion to some extent the extent of distress for poorer households, particularly in rural areas. The financial crisis offers scope and the opportunity to revamp the social sector programmes in the country. Innovative design and implementation of mutually complementary schemes within an integrated policy framework would enable the reaping of associated synergies and fast track the achievement of MDGs in the country.

Introduction

As the repercussions of the financial crisis on the Indian economy unfold, some of the questions uppermost in the minds of development practitioners are: What will be the impact of the financial crisis on the poor in India? Will we achieve the globally agreed MDGs? Will human development outcomes be affected? Though it is too early to measure actual impacts, some likely trends are already emerging and are highlighted here for their policy implications.

While India is considered to be on track with respect to MDGs relating to poverty, safe drinking water and sanitation (though on some measures all three could be disputed), shortfalls on a number of other targets, mainly gender, health and environment related, are a matter of grave concern. India's HDI value of 0.609 in 2006 (published in the 'HDI Update of 2008') and its rank of 132 out of 179 countries highlights the fact that improvement in human development outcomes and achievement of national and international goals would need accelerated efforts.

Can India reach MDG1?

For Target 1 of Goal 1, reducing the proportion of people below poverty by half by 2015, the country is generally considered to be well on track to reduce the headcount ratio of poverty if the national poverty line is used. With 1990 as the baseline, the MDG goal is to reduce the proportion of poor people to 19 percent by 2015. With the head count ratio down to 27.5 percent in 2004-05 from 36 percent in 1990, despite prospects of moderate growth of over five percent over the next few years, but with massive investments in anti-poverty programmes such as the NREGS, it is likely that the country will meet this MDG target with respect to poverty reduction in the medium-term.

However, the picture that emerges is different if the World Bank's estimates of proportion of population below the newly defined extreme poverty line USD1.25 per day is considered. As per this definition, the proportion of population in extreme poverty in India in 2008 was 39.26 percent. UNDP estimates using the trend rate of reduction in poverty of 1.9 percent, which is rate of reduction between 1990 and 2005, for the years 2005-2015, indicates that population in extreme poverty is likely to decline to 34.31 percent by 2015 which is higher than the target rate of 25.65 percent in 2015. This means that India will not be on track to meet the MDG goal on poverty reduction.

Moreover, irrespective of the poverty estimate one uses, there is a distinct possibility that poverty levels may be higher than expected in the next couple of years till the economy resumes a higher growth path. In fact UNDP projections for South Asia (UNDP, 2008¹¹) do point out those countries in the region may experience a one percentage point higher poverty level in 2009 due to the slow down in economic growth. Quick 'back of the envelope' calculations indicate that given a 302 million strong poor population in 2004-05, and making no allowance for increase in population since then, at the very least around three million poor people will not be able to cross the poverty line in 2009. The same trend may continue in 2010 as well if the growth rate does not resume its upward trend by then – with six million poor potentially left behind over the two years. The estimates of people left behind in poverty could be more than double this figure if the current lower growth projections of the International Monetary Fund (IMF) are indeed correct¹².

In addition, there is the possibility that some proportion of the 'near poor' (with one to 1.25 times the consumption expenditure of the poor) whose numbers have been estimated to be around 200 million at the all-India level in 2004-05 by the National Commission for Enterprises in the Unorganised Sector (NCEUS) might slip into poverty temporarily on account of loss of livelihoods due to the financial crisis. This group depends mainly on informal casual employment which is precisely the sector being hit badly by the financial crisis. Reports indicate that 45 percent of the employment in the formal sector is of an informal nature and it is these workers who are the prime targets for being laid off due to the slowing down of the economy. It is likely that the informal workers in the export oriented sectors who have lost their jobs could slip below the poverty line though the magnitude of the job loss is not yet known.

A third factor aggravating the slide into poverty is higher food and fuel prices. Though food prices have declined from their peak levels of mid 2008, they are nonetheless higher than those prevailing two years ago.

¹¹ UNDP 2008, *Rising Food and Fuel Prices in Asia and the Pacific: Causes, Impacts and Consequences*, Regional Centre in Asia and Pacific, Colombo

¹² The IMF projected in April 2008 that the growth rate of GDP in India would be 5.4 percent in 2009 and 6.2 percent in 2010. Using the national poverty line and a poverty elasticity of growth of - 0.59 recorded during 1993-2004, this growth rate implies that the poverty rate would be 22.3 percent and 21.5 percent in 2009 and 2010 respectively. The number of poor would be 268 million in 2009 and 262 million in 2010. However, in April 2009, the IMF revised downwards its GDP growth projections for the country to 3.0 percent for 2009 and 4.1 percent for 2010. The immediate implication is that the rate of poverty reduction would be slower, which in turn means that there would be a higher number of people below the poverty line than projected in April 2008. The revised forecast indicates that the poverty rate would be 22.7 percent and 22.1 percent, respectively for 2009 and 2010 and the number of people below the poverty line would be higher at 273 million in 2009 and 270 million in 2010. This means that 13 million more people (five million more in 2009 and eight million more in 2010) than projected by IMF in April 2008 would continue to be poor (Poverty calculations by UNDP Regional Centre, Colombo).

Studies indicate that the pass-through ratio¹³ which measures the extent of transmission of global food prices to domestic prices of food, has been lower in India (30.4 percent) than in other Asian countries such as Lao PDR (112 percent), or even Vietnam (72 percent) and Cambodia (66 percent), indicating that policies to protect the domestic consumer from escalating global food prices have had a positive impact. Nonetheless, the repercussions of the higher prices are not insignificant. The rise in prices has been sharpest for cereals which is the main item of consumption of the poor. For example, the retail price of rice was 60 percent higher in January 2009 as compared to the level two years earlier. Given that expenditure on food constituted over 62 percent of the total consumption expenditure of the bottom 20 percent in 2006-08, the soaring cost of cereals led to 24.7 percent increase in food cost for the poor. This, in turn, meant that their purchasing power declined by 14.3 percent due to higher food prices alone (UNDP, 2008¹⁴).

Higher food prices would aggravate the situation with respect to hunger and push back further the possibility of India reaching the target within Goal 1 which aims at eradication of hunger by 2015. Bulk of the rural poor are net purchasers of food and higher food prices would mean that they would have to spend more out of their incomes to meet the daily food requirements as the functioning of the public distribution system in the country is less than satisfactory. A recent UNDESA working paper points out that in the four states of Bihar, Madhya Pradesh, Jharkhand, and Chhattisgarh (which collectively account for nearly 28 percent of poor households in the country) the majority of households termed officially poor were without a BPL or Antyodaya card. The degree of such exclusion from the PDS was 77 percent in Bihar, 67 percent in Jharkhand, 54 percent in Madhya Pradesh and 54 percent in Chhattisgarh (Swaminathan, 2008¹⁵).

Official sources also concede that it is not possible to reach the target of halving hunger by 2015. The situation may even be termed as alarming, going by the International Food Policy Research Institute (IFPRI) hunger index calculated in 2008 that places the extent of hunger in India at 23 percent with some states such as Madhya Pradesh recording even higher levels than some countries in sub-Saharan Africa. The main cause for India's dismal record is the high level of malnutrition of children. The National Family Health Surveys (NFHS) indicate that between 1998-99 and 2005-06, coinciding roughly the period of rapid economic growth, the proportion of underweight children remained virtually unchanged at 46 percent (declining marginally from 47 to 46 percent). Under the circumstances, a rise in food prices is bound make the target of eradicating hunger even more of a challenge than at present. Among the poor who are undernourished, the most vulnerable groups have been identified to be single women, the elderly, persons with disability, urban homeless, urban slum dwellers and primitive tribes. It has been observed by the 'Eighth Report of the Commissioners of the Supreme Court' that 70 percent of slum children are malnourished compared to the national average of 46 percent. Due to low calorie intake, children suffer the most as they need a proportionately higher intake for their growth and development. Long-term food security is dependent on livelihood security. However, most slum dwellers continue to work in the informal sector, with harsh work conditions and payment much below minimum wages (p.62). The jobs of these very segments are at risk as a result of the financial crisis and hence the prospects of a deterioration in food security of the vulnerable sections of the population is likely unless much wider distribution of cheaper foodgrains is made possible through public policy. In addition there has been a rise in the cost of fuel since 2006 and more particularly in 2008 which has contributed to a rise in the Consumer Price Index. Despite subsidies on kerosene and LPG, India has the highest retail prices of fuel due to high level of taxes and duties. A household survey in 2006 indicated that the expenditure of rural households on transport increased by over 60 percent. The rise in fuel prices since 2006 would have impacted the poor adversely through a rise in the prices of goods of mass consumption (UNDP, 2008).

India's Prospects for Achieving MDG 2

¹³ UNDP 2008 defines the 'pass-through' ratio as the ratio of the cumulative annual rates of change in domestic retail prices over a given period to the cumulative annual rates of change in corresponding international prices during the same period

¹⁴ UNDP 2008

¹⁵ Swaminathan, Madhura, 2008, 'Programmes to Protect the Hungry: Lessons from India', UNDESA working paper No. 70

With respect to Goal 2 the objective of achieving universal primary enrolment is widely recognized as being attainable with some effort. Recent independent reports corroborate the government's claim that enrolment has been rising. The latest Annual Survey of Education Report¹⁶ (ASER) released in 2009 states that 95.7 percent of children between the ages of 6-14 in rural areas were enrolled in schools in 2008. Another independent report released in 2009, the PROBE report, tracing progress in the education sector between 1996 and 2006 also confirms the trend of increased enrolment. It finds that against 20 percent children who were out of school in 1996, there were only five percent of children out of school in 2006. More importantly, enrolment rates among Scheduled Caste children (94 percent) and Muslim children (95 percent) were as high as the sample average for all children (95 percent). The main factors responsible for this positive outcome have been massive infusion of public funds facilitating the large-scale recruitment of teachers and improved teacher-student ratio, implementation of mid-day meals schemes and improved policy environment for universalisation of elementary education. The imposition of a two percent cess, apart from making available large sums of money to the exchequer, has demonstrated the political commitment to ensuring education for all.

However, despite progress in enrolment, the other targets of ensuring progress such as primary school completion rates and adult literacy rates seem more challenging. The official data indicate a drop out rate of 49 percent at the elementary school level which may increase further as the households of those most hit by the financial crisis, eg., garments, gems and jewellery, mobilize children to support the family income. A contrary trend that may reduce the number of children working for wages comes from declining export orders for goods such as carpets which traditionally have been a major source of employment of child labour. The exact strength of the two opposing forces is difficult to predict currently.

Challenges in Meeting Health Related Goals

With respect to health, related Goals 4 and 5 dealing with reduction in infant mortality rates and maternal mortality rates, respectively, it must be remembered that health is a sector that traditionally bears the brunt of the impact of any economic crisis. The collapse in public expenditure along with a decline in private incomes combine to lead to a deterioration in health outcomes of which infant mortality rate is a telling indicator. For example, the economic crisis in Peru during the 1980s led to an increase in infant mortality by 2.5 percentage points for children born during the crisis implying that about 17,000 more children than normal died. Closer home in Asia, the financial crisis of 1997 had devastating impacts on health outcomes in Indonesia. The World Health Organisation (WHO) reports indicate that there was a decline in immunization by 25 percent between 1995 and 1999 in Indonesia, the reduction being most marked in 1997-98, the worst year of the crisis. Private expenditure on primary health care declined by 20 percent and government spending was cut by 25 percent. The use of health services by poor children dropped by 17 percent compared to eight percent drop that was recorded for children from richer households (Lindsay Morgan, 2009¹⁷).

Such a predicament may well face the Indian health sector. What is puzzling about the Indian situation is that the health outcomes of women and children have deteriorated even during the period of rapid economic progress. For example, NFHS data indicate that between 1998-99 and 2005-06, anaemia among women rose from 52 to 56 percent and among children (six to 36 months-old) from an already high 74 to 79 percent. To expect an improvement in health outcomes when the economic situation of many of the poor households is deteriorating is unrealistic as public sector spending accounts for less than a quarter of health spending in India.

¹⁶ <http://www.asercentre.org/asersurvey/asers08/pdfdata/asers08.pdf>

¹⁷ Morgan, Lindsay, 2009, – *The Financial Crisis and Global Health*, Centre for Global Development - <http://www.cgdev.org/content/opinion/detail/1421000/>

Government's Policy Initiatives

At the macro-level, the Government of India has initiated several schemes in the last couple of years that could cushion to some extent the extent of distress for poorer households in rural areas. The NREGS is the foremost among such measures that could offer succor. In 2007-08, the scheme provided employment to 33.9 million households generating an employment of 1,435 million person days in 330 districts. The importance of the NREGS stems from the fact that it is self-selecting in nature and attracts high participation from the disadvantaged sections of the population. The participation of scheduled castes and scheduled tribes has been as high as 57 percent and that of women is 43 percent, making it a valuable tool for promoting inclusive growth in rural areas.

Many Latin American countries faced with economic crises have adopted Conditional Cash Transfer (CCT) schemes as a means to overcome the twin challenges of declining demand for services and the need to maintain human capital in the medium to long-run. These schemes are particularly useful for the urban poor who have to bear the direct impact of the financial crisis but for whom there is a dearth of safety net schemes. CCT initiatives require well-functioning infrastructure and efficient targeting and monitoring mechanisms. Many skeptics have pointed out that large exclusion and inclusion errors characterize the operation of government schemes in India. However, there are also several success stories such as NREGS implementation in Andhra Pradesh where extensive use of ICT technologies and social audits has minimized leakages.

The commitment of the Government of India to ensuring adequate funding for flagship programmes promoting rural employment and related human development programmes is evident in the enhanced allocations including for the NREGS in the interim budget of 2009. This belies any fears of fiscal stringency limiting resources for social safety net schemes. If at all the bottle neck is at the implementation stage where allocations are not being spent to the extent required. However, each of these flagship schemes addresses specific components of human development and they do not as yet form parts of an integrated strategy. The recent bill to provide social security for unorganized sector workers is yet to take off and would take time for implementation. Moreover, the schemes do not address demand side issues or incentivize the use of public services.

There is no gainsaying that implementation must be given a much higher priority if the government is serious about ameliorating the distress of the poor. The financial crisis offers scope and the opportunity to revamp the social sector programmes in the country. Innovative design and implementation of mutually complementary schemes within an integrated policy framework would enable the reaping of associated synergies and fast track the achievement of MDGs and national development goals.

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