

National Policy Responses to the Financial and Economic Crisis: The Case of India

Prepared for the ILO

by

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1. BACKGROUND

The Indian economy, which was widely believed to be less integrated with the global economy, felt the aftermath of the financial crisis emanating from the US rather quickly. First the crisis appeared as a crash in the stock market following the steady withdrawal of funds by the Foreign Institutional Investors. This in turn led to a credit crunch giving rise to soaring interest rates especially in the money market. As External Commercial Borrowings (ECBs) got dried up, many Indian corporate firms turned to the domestic market for their credit needs thus compounding the problem. Sectors which were exposed to the global market to a high degree such as civil aviation, textiles, leather, gems and jewellery and so on were suddenly faced with a decline in demand that led to job loss and/or adjustments in wages and salaries. Suddenly it was realized that the economy was not going to realize its expected growth rate of 9 percent. Official circles talked about a 7 percent growth rate while independent estimates came out with predictions that were less than this rate. It is in this background that the Government of India came out with two stimulus packages.

These stimulus packages were intended to rebuild confidence in the economy basically to a) support most affected sectors, b) improve access to credit and liquidity for enterprises and c) to boost local demand for selected goods and services. A Stimulus Package for US \$ 4 billion was announced on 6 December 2008 and was followed later by a second package on 2 January to prevent a further slow down of the economy. The overall stimulus package adds up to around US\$8 billion that is less than one percent of the GDP. There is some concern that these measures would lead to an increase in the fiscal deficit significantly (approx. 3-5%) which is a concern to many stakeholders, given the already growing fiscal deficit of India. Even though measures like further tax cuts is unlikely to be announced, Government is aware that announced measures (providing an economic stimulus to economy) need to be extended beyond the current financial year. Hence, Government is finalising Plan and Non-plan expenditure that will be required for the next financial year to maintain the same momentum. Amongst other proposals, the plan will include recapitalisation of public sector banks with an app. amount of another 20'000 Crore for the next 2 years. This should keep the potential for liquidity constraints in banks minimal.

The Prime Minister of India had a review meeting with captains of Industry on the impact of the ongoing global financial crisis and constituted an apex group under his chairmanship to monitor and coordinate the government's response to the crisis. The other members of this high powered committee are the Ministers of Commerce and Industry, Finance, Deputy Chairman, Planning Commission and the Governor of the Reserve Bank of India, India's central bank (The Hindu, 5 November 2008). The Prime Minister also approved a Committee of Officers under the chairmanship of the Finance Secretary to consider the issues raised by the Industry on daily basis.

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2. FISCAL AND MONETARY POLICY PACKAGES

Stimulus Package I

Amount : First Package US 4. billion (Rs. 20,000 crore) (the Indian News: 7 December 2008)

The first fiscal package, a modest one, was intended to keep the domestic demand high as well as to provide incentives to some selected export sectors. This included enhanced credit for exports, cut in excise duties, relief to the booming housing sector and SMEs. According to the Deputy Chairman of the Planning Commission Mr. Montek Singh Ahluwalia, the package will, “minimize the impact of weak global economy on the Indian economy” and help achieve a 7% growth rate. (First Fiscal Stimulus Package : December 26, 2008 [www. Econmicssubboxed.blogspot. Com](http://www.Econmicssubboxed.blogspot.com))

Monetary /Fiscal

- A cut in interest rates by India’s central bank: The Reserve Bank of India reduced its repo rate, the rate at which it lends to commercial banks -to 6.5 percent, and its reverse repo rate — the rate at which it borrows overnight — to 5.0 percent. (Flash Comment, Danske Bank: 8 December 2008)

- Interest subvention of two percent on export credit for labour intensive sectors
- Additional allocations for export incentive schemes
- Full refund of service tax paid by exporters to foreign agents
- Incentives for loans on housing for up to Rs.500,000, and up to Rs.2 million
- Limits under the credit guarantee scheme for small enterprises doubled
- Lock-in period for loans to small firms under credit guarantee scheme reduced
- India Infrastructure Finance Co allowed to raise Rs.100 billion through tax-free bonds
- Norms for government departments to replace vehicles relaxed
- Import duty on naphtha for use by the power sector is being reduced to zero
- Export duty on iron ore fines eliminated
- Export duty on lumps for steel industry reduced to five percent

The RBI also announced that it will extend a line of credit to small scale industries and housing finance banks:

The government announced a cut in Centrally-imposed Value Added Tax by 4% to increase spending across-the-board (www.financial.express.com) (www.topnews.in) (livemint.com) (www.Indiabriefing.com). In addition:

- To boost exports, govt. announced extra allocation of 70 million dollars.
- To boost infrastructure spending, the government authorized a recently created India Infrastructure Finance Co. Ltd to raise Rs. 10,000 crores through tax free bonds.
- The government also announced that initiatives are being taken to support Public Private Partnership programme of Rs. 100,000 core to the highway sector.

- To boost housing sector, public sector banks were urged to announce attractive home loan packages.
- The government decided to seek authorization for additional plan expenditure of upto Rs. 20,000 crore in the current year mainly for critical rural infrastructure and social security schemes such as Pradhan Mantri Gram Sadak Yojana, Jawaharlal Nehru National Urban Renewal Mission, National Rural Employment Guarantee Scheme, India Awas Yojana, Accelerated Irrigation Benefit Programme and National Social Assistance Programme.

In the light of the decline in exports by 12%, the government has decided to subsidize this sector with an interest subvention of 2% upto March 2009 to pre and post shipment export credit for labour intensive exports like textile, leather, marine products and SME sector. Concession is subject to a minimum rate of interest.

Stimulus Package II

Amount: US \$ 4.1 billion

The second stimulus package liberalized overseas borrowing norms, restored benefits to exporters, set up an alternative channel of finance for non-banking finance companies and allowed state-run India Infrastructure Finance Company Ltd (IIFCL) to issue additional tax-free bonds. The fiscal incentives announced so far will continue till a new government gets the opportunity to present a full budget after General Elections during mid 2009 (The Financial Express dt. 5 Jan 2009)

Monetary/Fiscal

1. Ease Access to Overseas Loans and investments

- Additional steps are being taken on the monetary, credit and fiscal front to further strengthen the contra-cyclical stance of policy. The RBI has on 2.1.09 announced a set of measures, as second fiscal stimulus package. In addition, with view to further liberalizing the policy on External Commercial Borrowing (ECB) the Government and the RBI have decided:
 - (a) The “all-in-cost” ceilings on such borrowing would be removed, under the approval route of RBI: for particular industries;
 - (b) To facilitate access to funds for the housing sector, the ‘development of integrated townships’ would be permitted as an eligible end-use of the ECB, under the approval route of RBI; and
 - (c) Non-Banking Finance Companies (NBFCs), dealing exclusively with infrastructure financing, would be permitted to access ECB from multilateral or bilateral financial institutions, under the approval route of RBI: ([www.financial express.com](http://www.financialexpress.com), 5 January 2009)

2. To Enhance Credit Flows

- In order to give a boost to the corporate bond market Foreign Institutional Investments (FII) limit in rupee denominated corporate bonds in India would be increased from US \$ 6 billion to US \$ 15 billion.
- A Special Process Vehicle (SPV) will be designated shortly to provide liquidity support against investment grade paper to Non-Banking Finance Companies (NBFCs) fulfilling certain conditions. Details will be announced separately. The scale of liquidity potentially available through this window is Rs. 25,000 crores (6 billion USD)
- An arrangement will be worked out with leading Public Sector Banks to provide line of credit to NBFCs specifically for purchase of commercial vehicles.
- Recently, the guarantee cover under Credit Guarantee Scheme for MSME on loans was extended from Rs. 50 lakhs to Rs. 1 with a guarantee cover of 50%. In order to enhance flow of credit to micro enterprises, it has been decided to increase the guarantee cover extended by Credit Guarantee Fund Trust to 85% for credit facility up to Rs. 5 lakh.

3. For Infrastructure Capex

- o States will be allowed to raise in the current financial year add. Market borrowings of .5% of Gross State Domestic Product) amounting to about 30,000 Crore for capital expenditure.
- o Authorizing India Infrastructure Finance Company Limited (IIFCL) being enabled to access additional in trenches an additional Rs 30 000 Crore through tax-free bonds to fund additional projects of about Rs. 75000 Crore at competitive rates over the next 18 months.

4. For Exports

Exporters are especially hit by the recessionary conditions globally. To support exports, a number of steps have been taken:

- Taking into account the fact that the rupee has appreciated nearly 4% against the dollar since November 2008, it has been decided to restore DEPB rates to those prevailing prior to November 2008. In order to provide predictability and stability of regime in the short term for future contracts, the DEFB scheme would be extended till 31.12.09.
- Duty drawback benefits on certain items including knitted fabrics, bicycles, agricultural hand tools and specified categories of yarn are being enhanced with retrospective effect from September 1 2008.

- EXIM Bank has obtained from RBI a line of credit of Rs. 5000 crore and will provide pre-shipment and post-shipment credit in rupees of dollars to Indian exports at competitive rates.

5. For Commercial Vehicles

- States, as a one time measure up to June 30 2009, will be provided assistance under the JNNURM to buy buses for their urban transport systems
- Accelerated depreciation of 50% to be provided for commercial vehicles to be bought on or after January 1 2009 and up to March 31 2009.
- Arrangement to be worked out with leading government-owned banks to provide credit to NBFCs specifically to buy commercial vehicles.

6. Other Measures

- Exemption from Counter veiling duties (CVD) on particular construction materials/cement which were given to contain inflation is being withdrawn.
- Full exemption from basic customs duty for zinc and ferroalloys, which was also provided to contain inflation, is being withdrawn.

REACTIONS : Mixed reactions from the Industry.

A leading industry lobby said, “The second stimulus package unveiled Friday is in the right direction but falls short of expectation that it would be around Rs. 1 trillion (US\$20 bn), as against the Rs. 200 billion (US\$4 billion). This would amount to app. 2 percentage as a proportion to the GDP, which is required to be a real booster.

Further, there are concerns that stimulus packages are not sufficient to boost economic growth, as fiscal incentives and monetary policies delay the process and further, nor do they ensure outreach within a given time due to a slow and weak delivery system or a change in confidence in the market hence increased demand.

The urban development ministry has asked for additional changes at the last minute to the second stimulus package to make the package beneficial for the end-user. The ministry has demanded specific sops, like interest rates for home loans upto Rs. 5 lakh be reduced to 6.5%, while loans between Rs. 5 lakhs (Rs. 3 million) be 7.5 percent annually – a senior official’s quote.

Particularly representatives of Industries and Exporters and SMEs stated that both the stimulus packages announced by the Central Government are inadequate and negligible for the Indian Industry when compared to the relief packages offered to the textile Manufacturers in the competing countries like China and Pakistan to manage the global recession.

The second stimulus package evoked disappointment in the textile sector as it doesn’t contain anything to stimulate the slugging exports in the sector. Major textile trade bodies

(Texprecil, CMAI, SIMA and TEA) have requested the government to have a re-look at the various proposals they made for relief and potential bailout.

Overall: The fiscal package in India does not have an explicit employment target; it primarily focuses on measures to augment liquidity in the system in addition to providing some fiscal incentives especially to the export oriented sectors.

3. MEASURES PROTECTING THE POOR AND THE VULNERABLE:

An important agenda for providing a measure of social security to the informal workers in the Indian economy has been pending with the government for quite sometime. This has now been set in motion, albeit in a limited form, by way of legislation. The Unorganized Workers Social Security Bill, earlier passed by the Rajya Sabha (Upper House) was subsequently passed by the Lok Sabha (Lower House) in December 2008 through which a statutory body will be established under the chairmanship of Ministry of Labour and employment which will formulate welfare schemes through a consultative process with the state governments.

Government intensified efforts for accelerated delivery and more efficient implementation of existing schemes and programmes (housing, NREGS, RURAL INFRASTRUCTURE, Rashtriya Swasth Bhima Yojana for BPL families. About 14 states have initiated implementation of this scheme.).

There are discussions to intensify and put into practice the existing social security schemes (eg Rajeev Gandhi Shramik Kalyan Yojna which has been put in practice in 2007 and provides 6-months unemployment benefits and ESI for retrenched workers).

4. MEASURES SAFEGUARDING WORKER'S RIGHTS

Government is strong against lay offs and job cuts of the private sector. This has very strongly emerged by the words of the PM and the Finance Minister in two occasions (RIT News and Asia Pulse Date Source via COMTEX)

With the exception of the PM's announcement (3 Nov) where he urges corporates and Industries to refrain from "knee jerk reactions" such as large-scale layoffs and emphasized the societal obligation the corporate offices have and the potential that large lay-offs might lead to a negative downward spiral. (Rediff News, 3rd Nov, 2008, RIT News), and few selective incidences where the Government had to interfere (eg. Case of Airlines in November 2008), most of the employment adjustments have been at the enterprise level. No particular measures have been taken to safeguard worker's rights.

Working groups have been established in Employers' associations to seek alternatives to layoffs by taking rational decision and by cutting prices, while dubbing the decision of some companies to shut down their plants for a few days to combat the economic crisis as "short-sighted."(Asia Pulse Date Source via COMTEX)

However, there is a clear tendency in all the industries towards rationalization of employment and stop of further expansion of employment (no new hiring).

One incidence has been particularly delicate which is mentioned below:

Jet Airways, which controls nearly 30 percent of the domestic market share, reversed its decision, after the sacked 1900 employees staged protests and demonstrations in Mumbai, Kolkata, and other parts of India and garnered the support of regional political parties. Especially, in both Mumbai and Kolkata, the political parties sympathized with the Jet staff, threatening to ground Jet Airways flights in their states.

Initially, Jet Airways chairman Naresh Goyal said the layoffs were inevitable because "everybody is bleeding" as the cost of business has gone up by 30 percent and the airlines is looking to reaping "maximum synergies" from its alliance with Kingfisher Airlines. The layoffs, Goyal said, are "unfortunate" but necessary to ensure proper salaries are paid to existing employees.

However, reportedly under pressure from trade unions and political parties, Goyal did a U-turn on Thursday, announcing that all the employees are requested to "join the family" and the airlines would try and find some other way of putting the finances back on track.

Apologizing to the sacked employees for the mental trauma caused to them, Goyal said he was under no political pressure while taking the decision to hire them back.

Union Civil Aviation Minister Praful Patel, who earlier termed the retrenchment decision as "tragic," has welcomed the new move. "I am happy for the employees. I think Jet has done the right thing," Patel said, adding his ministry would explore ways of helping the ailing aviation industry get back on its feet.

"I will hold talks with all airlines to find a way out of the downturn in the industry caused by high fuel costs and the economic slowdown. Immediate steps are required to rationalize taxes to help the industry come out of the losses. Steps like reducing the basic price for aviation turbine fuel, reduction in Central excise, customs levy and state sales taxes as well as cuts in landing, parking and route-navigation charges are needed," he said. According to Union Petroleum Minister Murli Deora, "The timing of the decision (to retrench) is in bad taste."

Elsewhere, national carrier Air India is reportedly planning to allow employees to take up to three to five years' unpaid leave to save on employee costs. Though initial reports talked of up to 15,000 employees being targeted for this unpaid leave, the airline clarified later that the entire program was voluntary.

"It will take about six weeks for us to launch the scheme as it has to get a formal approval from the Air India board. We would also have to hold discussions with employee unions. About 15,000 people, who are working in the non-operational areas, will be eligible to opt for this scheme," said Jitender Bhargava, executive director (corporate communication), Air India. (International Times, 17 December 2008)

6. SOCIAL DIALOGUE

- End of December, Ministry of Labour and Employment has constituted Industrial Tripartite Committees (ITCs), one each for Cotton Textiles, Jute, Road transport, Electricity Generation and Distribution, Engineering, Sugar and Plantation industry. These are non-statutory Standing Committees constituted with the objective of providing a forum whereby the social partners through dialogue can appreciate the problems of industries and workers affected by economic reforms.
- There have been incidences of adjustments at enterprise/industry levels, which were based on social dialogue but no particular incidences to solve employment retrenchment at a tripartite level till date.

7. CONCLUDING REMARKS

Contrary to expectations, the Indian economy felt the shocks of the financial and economic crisis in the developed countries rather quickly. This has resulted in lowering the expectations for growth during the current financial year ending 31 March 2009 as well as in the next year. Not surprisingly, export oriented industries and services felt the shock suddenly and in significant measure. The government has responded with two stimulus packages that are largely in conformity with its policies of economic reforms and reliance on the market mechanism. Although no direct measures have been taken to create additional domestic demand, the expectation is that employment will be protected to some extent by these stimulus packages. Given the overwhelming presence of the informal sector in the Indian economy, special measures are called for to protect the informal workers.