Chapter 17

Effect of Recent Global Financial Crisis on South Asian Economy with Special Reference to India

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ABSTRACT

Most of the Asian countries were affected adversely for the recent global financial crisis, especially those economies whose growths are largely depended on the external trade. It has been observed over time and again that Indian economy has not been significantly harmed by the waves of global financial and economic crises because of its large domestic market, which can accommodate any external shock. During the phase of shrinking world demand of domestic goods and services, efforts to raise productivity and competitiveness helps countries to protect export market. This chapter investigates the dependence on the external market and the effect of global financial crisis on the trade structure of some Asian countries. Some detail studies will be done for India in respect of compositional changes and productivity and efficiency changes of different industries within manufacturing sector during pre and post crisis period. Efficiency and productivity will be analyzed using frontier model.

INTRODUCTION

The world economy in the recent years is in the path of recovery after facing a severe financial crisis following the sub-prime mortgage in the United States during the end of last decade. While exact reasons are yet to be known at a fundamental level, the crisis could be ascribed to many factors including gross financial irregularities, excessive risk taking, large and persistence global imbalance, which, in turn, is the outcome of long periods of excessively loose monetary policy in the major advanced economies during the early part of this decade. The crisis threatened to undo the economic development achieved by many countries and to erode people’s faith in open economic system (Lamy, 2009). In fact, that was the first global recession of the new era of globalisation (Stiglitz, 2008). In a paper by Bosworth and Flaaen (2009) argued that the enormous growth of the subprime mortgage market, and the lack of regulation and prudent lending procedures that characterized this...
market, appear to be the most decisive factors of recent financial crisis. They have suggested that a low level of global interest rates helped create an environment conducive to the bubble in housing markets but this was a contributing rather than fundamental factor.

Since 1991, after taking the path of liberalization, India had grown rapidly till the financial crisis appeared in mid. 2007. The globalization process has resulted in an increase in international trade in goods and services in both extensive and intensive margins in India. Indian economy has become part of growing international production networks through exchange of goods, services and capital. Eventually, India is more integrated with the world economy than what was in 1980s or early 1990s. India presently accounts for over 3 percent of world trade in goods and services, about 2.8 percent of world GDP, and 21 percent of world population, respectively.

Unlike many other developing countries of the world, particularly the East Asian countries, India has shown enough confidence to the global economic crisis by maintaining high growth rates during the post crisis period. However, the main reason of India’s growth during the global economic crisis has been the growth of services sector. While the services sector grew at a fast rate the agriculture and industry recorded a steep decline in growth. In a seminal paper by Choudhri and Hakura (2000) an empirical relation based on Krugman’s “technological gap” model was estimated to explore the influence of the pattern of international trade and production on the overall productivity growth of a developing country.

In part India’s ostensible resilience in the face of the global crisis, reflected in a much smaller proportionate decline in its GDP in 2008 relative to China because of its much smaller export dependence on manufacturing. Therefore, the fall in import demand in advanced economies has led to corresponding fall in exports of India in the crisis period but for a very short period.

It was argued in many studied, particularly just after the financial crisis of 2007 that the temporal export slowdown surely has some long-term implications on trade and industrial development in India. A common hunch was that if the crisis continues, there might be a drastic change in composition of traded goods and subsequently their productions in Asia and in other counties also (Bhaskaran, Ghosh & Kohli, 2010). To ascertain whether or not such compositional change is matter for industrial restructuring, we attempt to find out change in composition of Indian export and production.

In a recent study by De and Neogi (2013) Vector Auto Regression method is used to investigate how shocks are transmitted from one entity (say, USA) to another (say, India). using this method they examine separately the impact of a shock that originates in USA, the EU, and Japan on Indian industrial composition and trade openness. They concluded that India’s trade with USA, coupled with USA GDP, significantly contributes to the variability of India’s trade openness in the crisis period, accounting for 40% of the variation of the trade-GDP ratio of India, where India’s trade with EU and Japan and their GDPs have either no effect or insignificant effect on India’s trade openness.¹

Over the past decade of globalization, economies of South Asia and South East Asia had grown rapidly till the financial crisis in mid-2007. However, if we compare the damages of the economies due to the financial crisis of 2007 in respect of trade and GDP growth the South Asian countries are in much better position compared to the East Asian countries. It has been observed over time and again that Indian economy has not been significantly harmed by the waves of global financial and economic crises. The basic reason for this stability is the large domestic market of India, which can accommodate any external shock that destabilize the external trade. But many countries like Japan, China and other developing countries of Asia succumbed to the financial recession of 2007.
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