

**GLOBAL ECONOMIC CRISIS AND ITS IMPACT
ON THE AGRARIAN SITUATION IN INDIA**

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It is now clear that what started out as a largely financial crisis in the middle of 2007 in the developed industrial countries had by the end of that year transformed itself into a generalised crisis affecting the real economy in those countries. Since then the crisis has begun to affect the rest of the world including some “high performers” among the developing countries like India.

There are a number of questions this trajectory raises. First, what were the changes in the developed countries that led up to the financial boom of the 1990s and later and the subsequent financial instabilities and crises that affected these countries. Second, what exactly is the relationship between the financial boom (that led up to the bust triggered by the subprime mortgage crisis in the US) and the performance of the real economy in the developed industrial countries. Third, has this relationship between the financial and real sectors, during periods of both boom and bust, been replicated in countries like India? If so, what has been the nature of growth in the real economy in India during the boom? Finally, in the light of this, how do we assess the impact that the financial boom and the subsequent crisis has had on the agrarian situation in India.

Liberalization and transformation of finance

Before the financial liberalisation of the 1980s, the financial sector in the developed countries including the United States was seen as serving two primary goals: (i) providing the payments and settlements system necessary to sustain economic activity in a complex economy (or the institutions, instruments and procedures that ensure the circulation of money and facilitate interbank and other settlements resulting from the various economic transactions within a country); and, (ii) ensuring that once appropriate investment decisions are made, the requisite savings are channelled to support those investments.

The financial system then was dominated by the banks and banks in that world were highly regulated. They were prevented from investing in high risk activities like real estate and the securities markets and therefore earned small returns from net interest margins, or the difference between the interest rates they charged their borrowers and the rates they paid the depositors, adjusted for intermediation costs.

Even the US financial sector was an example of a highly regulated and stable financial system in which banks dominated, deposit rates were controlled, small and medium deposits were guaranteed, bank profits were determined by the net interest margin or the difference between deposit and lending rates, and banks were restrained from straying into other areas like securities trading and the provision of insurance. To quote one apt description (OECD 2000), that was a time when banks that lent to a business or provided a mortgage, “would take the asset and put it on their books much the way a museum would place a piece of art on the wall or under glass – to be admired and valued for its security and constant return.” This was the “lend and hold” model.

Liberalization changed all that. It allowed banks to mobilise money from more diverse sources and invest them in a range of areas increasing the risk that banks were exposed to. The understanding was that banks would adopt appropriate strategies and prudential norms

to avoid debilitating losses and risking failure. One consequence of this was a fundamental transformation of the financial sector and of banking as an activity.

This transformation, which unfolded over the next decade and more, had one important consequence. While banks did provide credit and create assets that promised a stream of incomes into the future, they did not hold those assets any more. Rather they structured them into pools, “securitized” those pools, and sold these securities for a fee to institutional investors and portfolio managers. Banks transferred the risk for a fee, and those who bought into the risk looked to the returns they would earn in the long term. This “originate and distribute” model of banking meant, in the words of the OECD Secretariat (OECD 2000), that banks were no longer museums, but parking lots which served as temporary holding spaces to bundle up assets and sell them to investors looking for long-term instruments. This change together with the liberalization-induced diversification into securities trading and insurance, allowed them to earn higher profits through fees and commissions rather than interest margins.

This transformation meant that those who originated the credit assets tended to understate or discount the risks associated with them. Moreover, since many of the structured products created on the basis of these credit assets were complex derivatives, the risk associated with them was difficult to assess. The role of assessing risk was given to private rating agencies, which were paid to grade these instruments according to their level of risk and monitor them regularly for changes in risk profile

The ability of the banking system to “produce” credit assets or financial products meant that the ultimate limit to credit was the state of liquidity in the system and the willingness of those with access to that liquidity to buy these assets off the banks. Within a structure of this kind periods of easy money and low interest rates increased the pressure to create credit assets and expand risk.

Implications for the real economy

This transformation had important implications for the real economy. In a world of the kind that existed before the rise to dominance of finance, the principal domestic stimulus to growth in capitalist economies was public expenditure and investment. Public investment served to both stimulate demand and simultaneously expand supply. The more broad-based public investment was in an economy, the more it was likely to provide the basis for non-inflationary growth.

Financial liberalisation changed the principal stimulus for growth in capitalist economies. On the one hand, the rise to dominance of finance forced governments to adopt a conservative fiscal stance, shifting the focus of macroeconomic management from fiscal to monetary policy. On the other hand, emboldened by its ability to transfer and socialise risk, financial firms were willing to provide households, including less well-to-do households, credit to finance housing investment, consumer durable purchases and even regular consumption.

The availability of credit does not ensure that households would be willing to borrow, since they have to be convinced that they would be able to repay their debt. But an inevitable consequence of credit expansion that goes to finance housing and stock market investment is a boom, however temporary, in stock and real estate markets. This increases the market value of the equity and real estate wealth that individuals hold, enhancing their wealth when valued at current market prices. This induces a wealth effect insofar as individuals,

who find the value of their wealth is greater than they expected to be, are willing to save less for the future and spend more today. The net result is a credit-financed housing and consumption boom that induces investment and fuels growth. Monetary policy plays a role here. Governments opt for easy money policies and low interest rate regimes to push credit and growth even further.

In sum, in the era of finance capital dominance, capitalist growth is crucially dependent on credit finance consumption and investment, especially housing investment. Further, owners of capital in the industrial economy benefit from the speculative boom in stock markets, as the rise in stock values inflates their paper wealth which can be transformed into larger real wealth if the capitalist concerned chooses to exit from stocks and buy material capital when the market is riding high. Thus the real economy rides on the financial bubble so that speculative finance is not seen as an obstacle by industrial capital but as a new means to accumulation.

The financial crisis and its fall out

Needless to say the financial bubble must burst at some point in time. From late 2002 to the middle of 2005, easy access to credit at low interest rates triggered a housing boom in the US, which in turn triggered inflation in housing prices that encouraged more housing investment. Many believed that this process would go on.

Sensing an opportunity based on that belief and the interest rate environment, the financial system worked to expand the circle of borrowers by inducting subprime ones, or borrowers with low credit ratings and high probability of default. Mortgage brokers attracted these clients by relaxing income documentation requirements or offering sweeteners like lower interest rates for an initial period, after which they were reset. The share of such sub-prime loans in all mortgages rose sharply, from 5 per cent in 2001 to more than 20 per cent by 2007. Borrowers chose to use this “opportunity” partly because they were ill-informed about the commitments they were taking on and partly because they were overly optimistic about their ability to meet the repayment commitments involved.

On the supply side, the increase in this type of credit occurred because of the complex nature of current-day finance centred on the “originate-and-distribute” model. Financial players discounted risk because they hoped to make large profits even while transferring the risk associated with the investments that earn those returns. There were such players at every layer involved. Mortgage brokers sought out willing borrowers for a fee, turning to subprime markets in search of volumes. Mortgage lenders and banks financed these mortgages not because they wanted to buy into the interest and amortization flows associated with such lending, but because they wanted to sell these instruments to less regulated intermediaries like the Wall Street banks. The Wall Street banks bought these mortgages in order to expand their business by bundling assets with varying returns to create securities that could be sold to institutional investors and portfolio managers.

Because of this complex chain, institutions at every level assumed that they were not carrying risk or were insured against it. However, risk does not go away, but resides somewhere in the system. And given financial integration, each firm was exposed to many markets and most firms were exposed to each other as lenders, investors or borrowers. Any failure would have a domino effect that would damage different firms to different extents.

The problems began with defaults on subprime loans. As the proportion of default grew, the structure collapsed and all assets turned illiquid. Rising foreclosures pushed down housing prices as more properties were up for sale. On the other hand the losses suffered by financial institutions were freezing up credit, resulting in a fall in housing demand. As housing prices collapsed the value of housing wealth held by many depreciated, and they found themselves paying back loans which were much larger than the value of the assets those loans financed. Default and foreclosure seemed a better option than remaining trapped in this losing deal.

It was only to be expected that soon the securities built on these mortgages would lose value. Since accounting practices required taking account of prevailing market prices when valuing assets, many financial firms had to write down the values of the assets they held and take the losses onto their balance sheets. The extent of the problem was partly revealed when a leading Wall Street bank like Bear Stearns declared that investments in two funds it created linked to mortgage-backed securities were worthless. This signalled that many financial institutions were bankrupt. In time closures, mergers and takeovers became routine. But that too was not enough to deal with rising failure forcing the state to step in and nationalize private finance, even while not admitting it.

Implications for the real economy

There are three immediate effects that the financial crisis had for the real economy. First, it resulted in a collapse of the credit-financed consumption and investment boom since collapsing housing and stock values sharply curtailed demand. The collapse in demand was aggravated by the unwillingness of financial institutions overloaded with defaulting borrowers and worthless assets to lend. And finally, all of this was worsened by the insolvency of financial firms including the banks, which even threatened the payments and settlements system.

Once these effects triggered a recession in the real economy, the real and financial crisis contributed to each other leading to a cumulative disequilibrium which required not merely saving the banks with back-door nationalization but also a huge stimulus aimed at reviving demand directly, as was true in the era when public expenditure was the principal stimulus to growth. However, the stimulus needed now, the magnitude of which remains unclear, is much greater than earlier.

From the point of view of the agrarian sector, the financial boom and bust have a specific relevance because of the impact of financial speculation on primary commodity prices. One feature of the recent past has been the extreme volatility of global commodity markets, which have experienced unprecedented price swings in the course of the past year. Because economic analysts have become more and more short-term and short-sighted in their outlook, each of these rapid movements has been over-interpreted as reflecting structural changes in global demand and supply rather than temporary developments that are liable to change.

For example, when global prices in oil and other commodity markets zoomed to stratospheric levels by the middle of 2008, we were told that it had nothing to do with speculation. Eminent economists joined bankers, financial market consultants and even policy makers, in emphasising that these price rises were all about “fundamentals” that reflected real changes in demand and supply, rather than the market-influencing actions of

a bunch of large players with enough financial clout and a desire to profit from changing prices.

In global food markets the rise in prices of staples was correctly identified to be at least partly related to the medium term policy neglect of agriculture by governments especially in the developing world, but the role of speculation in commodity futures, enabled by financial deregulation, was denied.

Further, it was also argued that the real gainers of this process were the direct producers: not only oil exporting countries but small farmers producing food grains that were becoming highly valued internationally. The commodity price boom was supposed to translate directly to income gains for such producers, to the point where some governments even argued that there was no need to provide any protection to agriculture since cultivators were already gaining from the high crop prices.

But the subsequent collapse of commodity prices - both oil and non-oil - has shown how wrong the earlier explanations were, and how little primary commodity producers are likely to have gained, especially small producers in the developing world. All the price gains of the period January 2007 to mid-2008 have been wiped out by the later fall in prices. Oil prices in November 2008 were back to the nominal level of January 2007, which implies a decline in real terms. And non-oil commodities, specifically agricultural raw materials and metals were actually lower even in nominal terms. It is worth noting that the latter group did not experience much of a price rise even when the commodity price boom of 2007-08 was supposedly operating in full force.

The likelihood of agriculturalists benefiting from such a short-lived price boom is therefore unlikely, especially given the lags of supply response. Indeed, it is even likely that they could face opposite effect: farmers shifting acreage in response to price increases could find that prices have crashed by the end of the growing season.

Consider, for example, the case of cotton, the most widely planted non-food cash crop that directly affects the livelihood of millions of farmers. The index of the Liverpool c.i.f price of middling staple cotton had fallen significantly in the past few years, so that in January 2007 it was less than 60 per cent of the level reached in 2005. The price started to increase around the middle of 2007, and by March 2008 had increased by 44 per cent compared to May 2007. But after that peak there has been quite a sharp crash in prices in just a few months, such that in November 2008 the price was actually lower than it had been in January 2007!

Such volatility can be only very partially explained by real changes in demand and supply. It is true that there was an increase in demand from China, the world's foremost garment exporter, around the middle of 2007. But the rapid price thereafter was because speculators took over. Similarly, while the ongoing global recession has affected demand for clothing and therefore for cotton, the collapse in prices cannot be explained only by this decline, but is also the result of speculators offloading their stocks.

The point is that cultivators who had responded to the price signals of the short-lived boom to sow more cotton will now find themselves stuck with a crop whose price has nearly halved in just eight months. The other major cash crops that dominate cultivation are all oilseeds, and here too, very volatile and sharp swings in prices are evident over the recent period. The behaviour of world trade prices of groundnuts, which are used to make peanut

oil, as well as that of the other major cooking oils (palm oil, soybean oil and rapeseed oil) all show similar trends in prices, with continuous and substantial increases from January 2007 onwards, followed by sharp declines in the second half of the current year.

Only groundnuts prices are still significantly higher than they were at the start of the period, having increased by 70 per cent over 2007 and then fallen by 34 per cent in the current year. Soybean oil prices more than doubled between January 2007 and March 2008, and then fell by 45 per cent, so that in November 2008 the price was only 15 per cent higher than it was at the start of the period. A similar tendency was apparent for rapeseed oil. The sharpest rise and fall occurred in the palm oil price – increasing by 208 per cent to March 2008 and then declining by 62 per cent, such that the price in November 2008 was more than 20 per cent lower than it had been in January 2007.

Once again, cultivators who opted to sow these crops when their prices were at their peak would now have to face a completely different environment with very different configurations of costs and prices that could easily make the cultivation process completely unviable financially. Among the agricultural prices that matter the most, of course, are food grain prices. The world food crisis that briefly grabbed international headlines in the middle of the year was essentially reflected in very dramatic increases in prices of the most important food grains. These too have been subject to significant volatility, especially in the current year.

The most extreme trends have been evident in rice prices, which were broadly stable, increasing only gradually through most of 2007, but then exploded to increase by more than two and a half times between January and May 2008. Rice prices have fallen thereafter but are still 80 per cent higher than they were at the start of the period.

Some of this is attributable to the fact that the world trade market for rice is relatively thin compared to total production, as most rice producing countries are also major consumers of their own output. The sharp rise in prices in early 2008 can be partly attributed to the export bans imposed by two major exporters: India, which the previous year exported around 5 million tonnes and Egypt which exported around 2 million tonnes out of total world exports of around 18 million tonnes. Once again, however, speculative pressures are likely to have pushed up trade prices well beyond anything that could be explained by demand-supply imbalances.

Wheat prices also more than doubled between January 2007 and March 2008 and declined subsequently, although they are still 16 per cent higher than they were at the start of the period. Maize prices went up less sharply but continued to increase until June this year, but thereafter fell so sharply that the maize price is now below what it was in January 2007. While world trade prices of these food grains did fluctuate dramatically, and have now fallen in ways that will adversely affect exporters of these crops, retail prices of these grains have not come down in most developing country markets. Therefore we have a strange situation in which both the direct producers and the final consumers appear to be worse off because of the volatility. In another context it could be concluded that speculators have gained from this boom-and-bust price cycle, but given the chaos in global financial markets even such a conclusion may not be warranted

Global finance and India

Given India's integration with the global economy, it too experienced parallel developments in its financial and real sectors. The perception that India is a leading developing country in the global system derives whatever strength it has from developments during the four years preceding the current recession when India, like other emerging markets, had been the target of a surge in capital flows from the centres of international finance. That is, it emerged as a leader among these markets when India's integration with the global economy has intensified considerably.

This integration with the global economy meant that the Indian economy would become part of the global financial network and that its development path would reflect financial proliferation and be influenced by the rise of finance. The financial boom triggered by the inflow of foreign capital was also reflected in a sharp and long term rise in the Sensex, which rose from around 6000 to more than 20000. Growing FII presence is disconcerting not just because such flows are in the nature of "hot money" which renders the external sector fragile, but because the effort to attract such flows and manage any surge in such flows that may occur has a number of macroeconomic implications. Most importantly, inasmuch as financial liberalization leads to financial growth and deepening and increases the presence and role of financial agents in the economy, it forces the state to adopt a deflationary stance to appease financial interests. Those interests are against deficit-financed spending by the state for a number of reasons. First, deficit financing is seen to increase the liquidity overhang in the system, and therefore as being potentially inflationary. Inflation is anathema to finance since it erodes the real value of financial assets. Second, since government spending is "autonomous" in character, the use of debt to finance such autonomous spending is seen as introducing into financial markets an arbitrary player not driven by the profit motive, whose activities can render interest rate differentials that determine financial profits more unpredictable. Third, if deficit spending leads to a substantial build-up of the state's debt and interest burden, it may intervene in financial markets to lower interest rates with implications for financial returns. Financial interests wanting to guard against that possibility tend to oppose deficit spending. Finally, the use of deficit spending to support autonomous expenditures by the state amounts to an implicit legitimisation of an interventionist state, and therefore, a de-legitimation of the market. Since global finance seeks to de-legitimise the state and legitimise the market, it strongly opposes deficit-financed, autonomous state spending (Patnaik 2005).

Finance and agrarian economy

Efforts to curb the deficit inevitably involve a contraction of public expenditure, especially expenditure on capital formation, which adversely affects growth and employment; leads to a curtailment of social sector expenditures that sets back the battle against deprivation; impacts adversely on food and other subsidies that benefit the poor; and sets off a scramble to privatise profit-earning public assets, which render the self-imposed fiscal strait-jacket self-perpetuating. All the more so since the finance-induced pressure to limit deficit spending is institutionalised through legislation like the Fiscal Responsibility and Budget Management Act passed in 2004 in India, which constitutionally binds the state to do away with revenue deficits and limit fiscal deficits to low, pre-specified levels.

Further, the reduction in customs duties resorted to as part of the import liberalization package and the direct and indirect tax concessions that were provided to the private sector

to stimulate investment, led to a decline in the tax-GDP ratio at the Centre by between around 1.5 percentage points of GDP over the 1990s. This implied that so long as deficit spending by the government did not increase, the demand stimulus associated with government expenditure would be lower than would have otherwise been the case. It was in this background that the government also chose to significantly restrict the fiscal deficit as part of fiscal reform. Success on this front was delayed, but began to be achieved by the late 1990s, making the stimulus provided to industrial growth by state expenditure substantially smaller than was the case in the 1980s. These were among the factors that slowed industrial growth after the mid-1990s.

There was also another feature of economic liberalization that was bound to adversely affect growth: import liberalization which results in some displacement of existing domestic production directly by imports and indirectly by new products assembled domestically from imported inputs. Given these trends, a surprising feature of the financial boom was the parallel spurt in industrial growth. After touching a trough in September 2001, growth as captured by the index of industrial production staged a medium term recovery to peak at 17.6 per cent in November 2006. (Since then, of course, despite fluctuations, the trend is one of decline.)

If the stimulus to industrial growth was dampened, what explains the post-2002 recovery in industrial growth? As in the developed countries in the aftermath of the rise of finance, that recovery was in large measure due to the increases in private consumption and housing investment resulting from two important developments. One is the much faster increase in income in the top deciles of the population. It is known that these do not get effectively reflected in consumption expenditure surveys and inequality calculations based on them, because these surveys inadequately cover the upper income groups. Yet a comparison of the mean real per capita consumption expenditure by decile groups indicates that the rate of growth of mean consumption expenditure in the highest decile in both rural and urban areas rose much faster than in the other decile groups. Moreover, not only did aggregate mean consumption expenditure in the urban areas increase at a rate (22 per cent) much faster than in rural areas (5.5 per cent), but in the urban areas the rates of growth of such expenditure in the top five deciles, (which ranged between 19 and 33 per cent) was much higher than in lower five deciles (between 10.4 and 16 per cent). This meant that there would have been some diffusion of luxury consumption to those below the topmost deciles in the urban areas.

The second development is the sharp increase in credit financed housing investment and consumption, facilitated by financial liberalization, which played an extremely important role in keeping industrial demand at high levels. Credit served as a stimulus to industrial demand in three ways. First, it financed a boom in investment in housing and real estate and spurred the growth in demand for construction materials. Second, it financed purchases of automobiles and triggered an automobile boom. Finally, it contributed to the expansion in demand for consumer durables.

The point to note is that compared to the mid-1990s the growth of credit in recent years has been explosive, facilitated in part by the liquidity injected into the system by the large inflows of foreign financial capital in the form of equity and debt. In the wake of this increase in liquidity, expansion in credit provision has been accompanied by an increase in the exposure of the banking sector to the retail loan segment. The share of personal loans in total bank credit has risen sharply since the beginning of liberalisation, rising from around 2-

3 per cent in the early 1980s, to 8.3 per cent in 1992-93 and then almost trebling to 24.3 per cent in 2006-07. Much of this has been concentrated in housing finance, with housing loans accounting for just above 51 per cent of personal loans in 2007. But purchasers of automobiles and consumer durables have also received a fair share of credit.

This together with the expansion of services has radically changed the pattern of growth in India since the early 1980s. An unusual feature of this growth has received less attention than it deserves: the growing disproportionality between agricultural and non-agricultural growth. Using GDP figures with 1993-94 as base, S. Sivasubramonian estimates that the rate of growth of GDP in the agricultural and allied sectors rose from 1.5 per cent during 1970/71-80/81 to 3.43 during 1980/81-90/91, and then declined to 2.97 per cent during 1990/91-99/00. Over the same periods the rate of growth of non-agricultural GDP accelerated from 4.38 per cent to 6.37 per cent and 7.14 per cent respectively.

What is particularly remarkable is that the acceleration of non-agricultural growth during the 1990s was accompanied by a decline in the rate of agricultural growth. The disproportionality is visible even when the comparison is restricted to industrial and agricultural growth. Figures for the initial years of this decade indicate that this disproportionality in growth has only increased since.

One implication of this is that domestic agricultural growth was not a constraint on the growth of the non-agricultural sector. This does mark a structural shift in the pattern of growth, when compared with the first three decades of post-Independence development, when the agricultural bottleneck was seen as an important factor responsible for the failure of the strategy of development based on the Mahalanobis model. The argument was that the Mahalanobis strategy underestimated the agricultural constraint by treating agriculture as a bargain sector in which output growth could be accelerated without much investment, by making suitable institutional adjustments.

There were three forms of intersectoral linkages between the agricultural and non-agricultural sectors that were seen as important. First, with the agricultural sector accounting for 61 per cent of non-residential GDP in 1950/51 (at constant 1993-94 prices) and 76.2 per cent of employment, demand from the agricultural sector was seen as crucial to sustaining the demand for non-agricultural products and services, especially manufactured products. Second, since agricultural commodities constituted a significant share of input costs in some industries and of the wage basket in most, increases in agricultural prices were variously analysed as affecting industrial production. In particular, if an industry was agro-based or was characterised by a tendency for money wages to rise with increases in the prices of wage goods, it would experience an increase in costs that may not be neutralised by an increase in final product prices. In the event, profits could be squeezed and manufacturing investment affected adversely. Thirdly, increases in agricultural prices would constrain the growth of demand in the manufacturing sector, since consumers would allocate a larger share of their incomes to food consumption and a smaller share to manufactures demand and the government may reduce public expenditure to reduce absorption and dampen price increases. This constraint on demand growth would also adversely affect the ability of firms in industries producing mass consumption goods to raise prices in order to cover higher costs.

These different ways in which agricultural performance was expected to affect non-agricultural growth were predicated on the operation of two transmission mechanisms:

first, increases in non-agricultural growth were expected to result in increases in the direct (inputs) and indirect (wage goods) demand for agricultural products. Second, since, agricultural growth was seen as constrained from the supply side, any disproportionality in industrial and agricultural growth was expected to result in an abnormal increase in the prices of agricultural goods, since those prices were largely determined by the relative levels of supply and demand.

In the aftermath of the agricultural crisis of the mid-1960s, this problem was compounded by the fact that the provision of support to agricultural production in the form of cost-plus remunerative prices, offered a floor price that encouraged speculation. This was because if speculative hoarding was not followed by the expected increase in prices, stocks could be disposed at the cost-plus support price, which reduces the risk of large losses. As a result, increases in demand relative to supply inevitably raised prices, whereas increases in supply in years of a good harvest did not result in any significant decline in market prices.

It needs to be noted that these mechanisms are operative only if there are limits on altering domestic supply with imports. If foreign exchange can be accessed easily to finance such imports, the structure of domestic supply need not be largely determined by the structure of domestic production. Commodities in whose case domestic demand exceeds supply based on domestic production could be imported to hold down the price level. It is in this background that we need to assess the changed circumstances of the 1980s and 1990s, especially the latter decade, when the disproportionality in non-agricultural and agricultural growth widened considerably, without triggering inflation and limiting non-agricultural growth on account of an inflationary barrier. In fact, changes in the environment and pattern of growth triggered tendencies that prevented the realisation of the denouement expected based on the late-1960s and 1970s experience.

The relevant change in the environment was the transformation of the world of international finance that, for the first time, provided “emerging markets” like India access to private international finance. It is now widely held that the Indian government exploited that opportunity during the 1980s, to overcome the development impasse of the 1970s. Deficit-financed expenditure was used to accelerate non-agricultural growth, and the resulting disproportionality between non-agricultural and agricultural growth was managed by using imports financed largely with external debt to change the structure of domestic supplies and dampen inflation. And this was truer of the 1990s than in the 1980s.

A second factor allowing for growing disproportionality between agricultural and industrial growth is a change in the pattern of demand and production, involving a reduction in the direct agricultural-input dependence of the non-agricultural sector. As Sastry et. al. (p. 2392) have shown, the available input-output tables for the Indian economy indicate that: “In 1968-69 one unit of rise in industrial output was likely to enhance demand from agriculture by 0.247 units, which was reduced to 0.087 by 1993-94. On the other hand, in 1968-69, one unit rise in industry was to cause 0.237 units demand from the services sector, which increased to 0.457 units in 1993-94.”

This reduction in agricultural input dependence of the non-agricultural sector would be greater once we take account of the growing share of service in non-agricultural GDP. While services accounted for 43 and 48 per cent respectively on the increment of GDP at current prices in the 1970s and 1980s, the figure rose to 58 per cent and 62 per cent respectively

during the 1990s and the years 2000-01 to 2004-05. Given the much lower agricultural input dependence of services, this would have strengthened the tendency noted above.

Thirdly, growth in both the agricultural and non-agricultural sectors has been such that the employment elasticity of output growth has been falling over time. This means that employment growth has been increasingly short of economic growth and output per worker has risen significantly in the non-agricultural sector where output growth has been particularly high. While a part of this rise in output per worker may have meant an increase in the wages of sections of the already employed, it would principally mean an increase in income inequality because of an increase in managerial salaries and profits. Both these tendencies imply that the indirect demand for agricultural wages goods would grow at a much lower rate than output partly because of the slower growth in employment and partly because increases in per capita incomes accrue to those whose demand for food is satiated.

What is more, an ongoing study by Abhijit Sen based on recent NSS suggests that even among the relatively poor the share of income allotted to food consumption is being squeezed by the growing requirements set by expenditures on health, fuel, transportation and education. The collapse of public provision in some of these areas, requiring purchases from private suppliers, and the increase in prices in others, is responsible for the enforced shift away from food consumption in the household budget.

The net result of all this is that agriculture is increasingly faced with a growing demand constraint at a time when input costs are rising. This is a reversal of the situation prevalent till the 1980s when the agricultural supply constraint constituted a barrier to rapid non-agricultural growth. As a result the input-output price parity in agriculture, which moved in favour of agricultural producers during the 1980s, has stagnated and moved against agricultural production during the liberalisation years since the early 1990s.

These structural developments associated with the increased financialisation of the economy that squeeze demand for agricultural goods sit on top of the massive demand deflation stemming from the rise to dominance of finance noted and analyzed elsewhere.

The consequence of these trends is that the Indian economy can record the observed creditable rates of growth of aggregate GDP even when the agricultural sector languishes. A feature of the growth process in a more open and liberalised environment is that the peasantry has a much smaller a role in sustaining economic growth and can thus be partially excluded from development. This is partly reflected in the fact that agriculture accounted for just 21 per cent of GDP in 2004-05. But neither the peasantry nor the landless labourers dependent on agriculture shrink as fast, given the pattern of agriculture growth. Employment in the agricultural sector amounted to as much as 60 per cent in 1999-2000, a decline of just 16 percentage points since 1950-51. It bears emphasising that these outcomes of the patterns of growth underlie the agricultural crisis and agrarian distress being reported from different parts of the country, at a time when the non-agricultural economy is on a roll and GDP is rising rapidly.

The Financial Crisis and India

It is in this background that we need to assess the impact of the financial crisis on the agrarian economy. Industrial growth is faltering, inflation remains at double-digit levels, the current account deficit is widening, foreign exchange reserves are depleting, the rupee is

depreciating and the Sensex has crashed. All of these developments are not unrelated to the financial crisis in developed country markets, which affects India in many ways.

The most immediate effect of the crisis has been an outflow of foreign institutional investment from the equity market. Needing to retrench assets in order to cover losses in their home countries and seeking havens of safety in an uncertain environment, FIIs have been major sellers in Indian markets. By driving stock indices down, depressing real estate values and contributing to a sharp depreciation of the rupee, this exit of the FIIs has dampened the credit-driven consumption and investment that had been resorted to by upper and middle income households. This is already reflected in a manufacturing recession.

A second indirect fall-out of the global crisis and its ripples in India is the losses sustained by non-bank financial institutions (especially mutual funds) and corporates as a result of their exposure to domestic stock and currency markets. That such losses would be large is to be expected and is signalled by the decision of the central bank to allow banks to provide loans to mutual funds against certificates of deposit (CDs) or buy-back their own CDs before maturity. These losses are bound to render some institutions fragile, with implications that would become clear only in the coming months.

A third effect is that, in this uncertain environment, banks and financial institutions concerned about their balance sheets, have been cutting back on credit, especially the huge volume of housing, automobile and retail credit provided to individuals. According to Reserve Bank of India figures (reported by the *Business Standard*, 17 October 2008), the rate of growth of auto loans fell from close to 30 per cent over the year ending June 30, 2008 as low as 1.2 per cent, loans to finance consumer durables purchases fell from around Rs 6,000 crore in the year to June 2007, to a little over Rs 4,000 crore up to June this year, direct housing loans that rose by 25 per cent during 2006-07, registered a fall in growth rate to 11 per cent in 2007-08 and 12 per cent over year ending June 2008. It is only in an area like credit-card receivables, where banks are unable to control the growth of credit, that expansion was, at 43 per cent, quite high over the year ending June 2008, though lower than the 50 per cent recorded over the previous year. It is known that credit-financed housing investment and credit-financed consumption have been important drivers of growth in recent years, and underpin the 9 per cent growth trajectory India has been experiencing. The reticence of lenders to increase their exposure in markets to which they are already overexposed and the fears of increasing payment commitments in an uncertain economic environment on the part of potential borrowers is bound to curtail debt-financed consumption and investment. This could slow growth significantly.

Fourthly, the recession generated by the financial crisis in the advanced economies as a group and the United States in particular, would adversely affect India's exports, especially its exports of software and IT-enabled services, more than 60 per cent of which are directed to the United States. International banks and financial institutions are important sources of demand and the difficulties they face would result in some curtailment of their demands for services. Further, the nationalisation of many of these banks would increase the pressure to reduce outsourcing in order to keep jobs in the developed countries. And slowing of growth outside of the financial sector too would have implications for both merchandise and services exports. The net result would be a smaller export stimulus and a widening trade deficit.

Finally, the agricultural sector, exposed by liberalisation to global trends, is bound to be affected adversely by the collapse in commodity prices associated with the global recession. With its viability under challenge because of long years of neglect during the era of liberalization and the finance-led boom in the Indian economy, this fall in prices is bound to severely damage the earnings and livelihood of the large mass of the peasantry and the agricultural labourers.

While these trends are still in process, their effects are already being felt. Yet, this does not justify the argument that India's difficulties are all imported. They are induced by domestic policy as well. These "imports" would have been far less if the government had not increased the vulnerability of the country to external shocks by drastically opening up the real and financial sectors. It is disconcerting, therefore, that when faced with this crisis the government is not rethinking its own liberalisation strategy, despite the backlash against neoliberalism worldwide. By deciding to relax conditions that apply to FII investments in the vain hope of attracting them back and by focusing on pumping liquidity into the system rather than using public expenditure and investment to stall a recession, it is indicating that it hopes that more of what created the problem would help solve it. This is just to postpone decisions that may prove critical — till it is too late.

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