

Preface

As a result of economic reforms in the post-1991 period, India became a favourite destination for foreign investment and transfer of new technology. Integration of Indian economy with the rest of the world scaled new peaks in terms of large capital inflows and high rates of growth especially during 2003–2007. The global financial crisis of 2008 dealt a severe jolt to this process. Some attempts have been made to explain the global financial crisis and its impact on the Indian economy, and one may well ask why another book on the same subject.

In comparison with other books on the global crisis, this book is organized in a different way. It goes deeper into the issues—both at the “policy” and the “impact” levels. For examining the role of monetary policy during the recession which accompanied the crisis, an econometric model is specified. For quantifying the impact of the crisis on stock prices in India, an empirical model rooted in the theory of portfolio selection is set up and tested.

The systemic issues responsible for the crisis are treated separately in the book. One such issue is that after the collapse of the Bretton Woods system in 1971, the US Dollar became de facto reserve currency for the world; something, that Finance Minister to French President Charles de Gaulle had called an “exorbitant privilege” for the USA. This systemic problem turned out to be an important reason responsible for the global crisis. On this count, therefore, there is a need for working towards a new international monetary system.

Another systemic issue is that unlike the commodity markets, financial markets are no candidates for unfettered and unregulated market mechanism. Market failures of financial institutions carry huge negative externalities. Even the diehard votaries of free markets cannot dismiss the merits of prudential regulation of financial markets. Financial innovations by highly trained specialists keep on creating new financial products which at times promise very high expected returns. Low rates of interest often lure profit-seeking firms to indulge in trading financial derivatives and other assets involving unknown levels and types of risk. This makes it necessary to regulate and monitor investments in financial markets.

Inept and dishonest rating agencies contributed to the global crisis by handing down false ratings. The regulators, some of whom were also under the spell of

regulatory capture, did a bad job of regulation and further messed up the situation. On top of this, both regulators and rating agencies were virtually incapable of accurately assessing the risks of newly engineered complex financial products. The number of unsecured and risky financial securities in circulation increased which triggered the financial crisis. For ensuring financial stability, therefore, tackling these problems is an important systemic issue.

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