

# For Illiberal Finance: Building Dams, Constructing Conduits

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**Footnote: Lest we forget ...**

Scheduled Commercial Banks (percentage change)	'05-'06	'06-'07	'07-'08
Bank Credit	30.8	28.1	22.3
Non-food Credit	31.8	28.5	23.0
Investment in Government Securities	-2.7	10.7	23.5

Source: Reserve Bank of India, 2008, *Annual Report, 2007-'08*, Appendix Table 1

## Finance as Handmaiden

### ☐ Savings Investment Dynamics

#### ▪ Savings

Deposits are rising steadily as a percentage of total financial savings to around 56 % in 2007-'08.

However, the trend break came in 1975, the trigger being bank nationalisation in 1969.

#### ▪ Investment

The growth rate of the capital stock in China is more than double that in India.

During 1980-2003, investment in China grew at annual average rate of 11.7 % ; in India, 6.8%.

New capital issues by non-government public limited companies has steadily declined from the late nineties only to pick up over the last few years.

Bonds issued by Public Sector Undertakings has tapered off since the beginning of the century.

Absorption of private capital issues has been fluctuating in a downward direction since the later part of the last century.

## Finance and Growth

The neoclassical thesis finds little support.

- ❑ Two theses

- ❑ The limits of cross-country studies

- ❑ Time series analyses are not conclusive

Financial repression impacted negatively on growth in India and Malaysia, just the reverse in Korea.

Finance as engine thesis finds little support in Mauritius, Pakistan, and Thailand.

In a study for India over 1951-1995, financial aggregates preceded increases in investment and growth, while finance had no impact on TFP of manufacturing industry.

Annual data for 10 Asian countries: finance pushes investment, not output.

## **The Dilemma of Regulation: Basel I and II**

Short run effects are a reduction in individual bank lending.

Bank activity is procyclical. Regulation augments the cycle.

## **Employment as an objective**

Public Sector employment was more or less constant at around 19 million annually through the 1990s. Likewise, private sector employment was steady at around 8 million per year since the mid 1990s.

## **Building Dams: Deposit-Creating Institutions**

## Constructing Conduits: Monetary-Fiscal Coordination

□ Keynes through the 1930s-40s recommended the establishment of a National Investment Board.

Regulate the flow of private investment through the control of long-term financing

Distinction between current budget and capital budget. The former balanced or in surplus in the short run. A policy of direct public investment accounted for by the public budget would generate surpluses in the ordinary budget. Thereby, deadweight debt would be replaced by productive debt.

The State would not use its surplus to extinguish its debt but to expand capital expenditure further. Productive State expenditure would be immune to the charge of crowding out which might be made of deficit-financed current expenditure.

The expectation was that  $2/3^{\text{rds}}$  to  $1/3^{\text{rd}}$  of total investment would be directly influenced by public bodies.

The programme is not antithetical to the traditional “motive of private exchange” but would include “technical social” motives.

Interest rates would fall through capital saturation.

## ❑ The “Employer of Last Resort Function”

After the Industrial Revolution, it was found that entrepreneurs were loath to generate employment.

In 1662, William Petty recommended a scheme of public employment to develop infrastructure.

The government was to build up a “buffer stock of labour”. Purchase all the unemployed at a fixed price or sell them to the private sector at a higher price.

## ❑ Asset Based Reserve Requirements (Thomas Palley)

CRR: Liabilities → Assets

Risk-Based Capital Standards: Assets → Liabilities

Debt-Equity ratios: Liabilities → Liabilities

ABRR: Assets → Assets

## Financialisation in India?

Sector	Growth Rate		
	'05-'06	'06-'07	'07-'08
Agriculture & Allied Activities	5.9	3.8	4.5
Industry	8.0	10.6	8.1
Services	11.0	11.2	10.7

Bank Group-Wise Lending to the Sensitive Sectors, exposure to the capital market by Other Public Sector Banks, has increased from 2.80% to 4.16%. The comparable figures for the New Private Sector Banks are 2.30% and 2.19%!

All banking groups increasingly advance to the real estate sector. The net resources mobilised by mutual funds display erratic year-on-year fluctuations.

High turnover in the equity derivatives market, index futures and options, and stock futures and options