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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

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   APPENDIX/ANNEXURE

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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
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INDIA AND CHINA: POST CRISIS REBALANCING STRATEGY

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ABSTRACT
The objective of this paper is to analyze the impact of the 2008 financial crisis on the Indian and Chinese economy and to study the effects of the various measures taken by the Government's to revive the economies. The global financial crisis and consequent economic recession in developed economies, has been a major factor in the global economic slowdown. The crisis had its impact on the developing countries as well, though in varying degree. No country, including India and China, remained immune to the global economic shock. This paper aims to address a number of pertinent issues in relation to the possible outcomes and adjustments being made by India and China in response to the global economic crisis. The research is based on the information available in public domain and primarily focuses on the financial crisis in terms of its types, causes and 2008 Global financial meltdown in particular .The study depicts how India and China have been hit by the crisis through various channels i.e. the financial channel (i.e. equity markets, money markets, foreign exchange markets and credit markets); the real channel (i.e. trade flows); and importantly the confidence channel (i.e. increased the risk aversion of the financial system and banks being more cautious about lending).Finally, it analyzes the various lessons learnt from the financial turmoil and the policy responses to overcome the weaknesses in the corporate governance practices so as to reduce the impact of such crisis, if at all they occur in future.

KEYWORDS
financial crisis, Indian economy, Chinese economy.

INTRODUCTION
The world has witnessed a number of financial crises in the precedent few decades, such as the OPEC oil crises of the 1970s, the United States Savings and Loan crisis of the 1980s, the prolonged economic downturn in the Japanese economy in the 1990s, the Asian financial crisis in the latter part of the 1990s, and the evils following the crash of the dot com bubble in the last decade. Each of these events had been accompanied by shocks to the economies of one or more markets or regions and it took several years of rigorous economic and regulatory policy adjustments for the affected markets to return to stability. While it is normal for financial crises to occur frequently and the affected economies to recover subsequently, it nevertheless results in economic losses for the countries involved and for the people, businesses and institutions in those countries. [1]

OBJECTIVES OF THE STUDY
The study on "India and China: Post crisis rebalancing strategies" has been conducted with the main objectives as hereunder:
1) To study financial Crisis and their causes.
2) To describe the impact of global meltdown (2008) on India and China.
3) To identify the reforms undertaken by India and China to overcome the impact of crisis.
4) To recommend the appropriate policy response to overcome the weakness in the existing corporate governance practices so as to reduce the impact of such crisis, if at all they occur in future.

RESEARCH METHODOLOGY
The research is based on the information collected from various secondary sources.
1. Books, journals, working and white papers are used for reviewing the academic literature on the topic.
2. Newspapers, on line news channels, industry reports and websites are accessed for the collection of any other required information related to the topic.

FINANCIAL CRISIS
A financial crisis is a disturbance to financial markets that disrupts the market's capacity to allocate capital – financial intermediation and hence investment comes to a halt.[2] The term financial crisis is applied broadly to a variety of situations in which some financial institutions or assets suddenly lose a large part of their value. In the 19th and early 20th centuries, many financial crises were associated with banking panics, and many recessions coincided with these panics. Other situations that are often called financial crises include stock market crashes and the bursting of other financial bubbles, currency crises, and sovereign defaults.[3]

TYPES OF FINANCIAL CRISIS
a) **BANKING CRISIS:** When a bank suffers an unanticipated rush of withdrawals by depositors, this is called a bank run. Since banks lend out most of the cash they receive in deposits, it is hard for them to quickly pay back all deposits if these are suddenly demanded, so a run may leave the bank in bankruptcy, causing many depositors to lose their savings unless they are covered by deposit insurance. A situation in which bank runs are widespread is called a systemic banking crisis. A situation without widespread bank runs, but in which banks are reluctant to lend, because they worry that they have insufficient funds available, is often called a credit crunch. In this way, the banks become an accelerator of a financial crisis.[4]

Examples of bank runs include the run on the Bank of the United States in 1931 and the run on Northern Rock in 2007. The collapse of Bear Stearns in 2008 has also sometimes been called a bank run, even though Bear Stearns was an investment bank rather than a commercial bank. The U.S. savings and loan crisis of the 1980s led to a credit crunch which is seen as a major factor in the U.S. recession of 1990-91.[5]

[1] Viswanathan(2010),"The Global Financial Crisis And Its Impact On India", available at http://law.hofstra.edu/pdf/Academics/ Journals/JIBL_vol9no1_ Viswanathan_GFC_India.pdf
[2] Eichengreen, B., and R. Portes, 1987, 'The Anatomy of Financial Crises', in Threats to International Financial Stability, ed. R. Portes and A. Swoboda, Cambridge University Press, Cambridge, pp. 10-58.
[3] Charles P. Kindleberger and Robert Aliber (2005), Manias, Panics, and Crashes: A History of Financial Crises, 5th ed. Wiley, ISBN 0471467146
[4] Fratianni, M. and Marchionne, F. 2009. The Role of Banks in the Subprime Financial Crisis available on SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=138347
[5] Ibid

b) **SPECULATIVE BUBBLES AND CRASHES:** Economists say that a financial asset (stock) exhibits a bubble when its price exceeds the present value of the future income (such as interest or dividends) that would be received by owning it to maturity. If most market participants buy the asset primarily in hopes of selling it later at a higher price, instead of buying it for the income it will generate, this could be evidence that a bubble is present. If there is a bubble, there is also a risk of a crash in asset prices: market participants will go on buying only as long as they expect others to buy, and when many decide to sell the price will fall. However, it is difficult to tell in practice whether an asset's price actually equals its fundamental value, so it is hard to detect bubbles reliably. Some economists insist that bubbles never or almost never occur.[6]

Well-known examples of bubbles (or purported bubbles) and crashes in stock prices and other asset prices include the Dutch tulip mania, the Wall Street Crash of 1929, the Japanese property bubble of the 1980s, the crash of the dot-com bubble in 2000-2001, and the now-deflating United States housing bubble.[7]

c) **INTERNATIONAL FINANCIAL CRISES:** When a country that maintains a fixed exchange rate is suddenly forced to devalue its currency because of a speculative attack, this is called a currency crisis or balance of payments crisis. When a country fails to pay back its sovereign debt, this is called a sovereign default. While devaluation and default could both be voluntary decisions of the government, they are often perceived to be the involuntary results of a change in investor sentiment that leads to a sudden stop in capital inflows or a sudden increase in capital flight.[8]

Several currencies that formed part of the European Exchange Rate Mechanism suffered crises in 1992-93 and were forced to devalue or withdraw from the mechanism. Another round of currency crises took place in Asia in 1997-98. Many Latin American countries defaulted on their debt in the early 1980s. The 1998 Russian financial crisis resulted in a devaluation of the ruble and default on Russian government bonds.[9]

d) **WIDER ECONOMIC CRISES:** Negative GDP growth lasting two or more quarters is called a recession. An especially prolonged recession may be called a depression, while a long period of slow but not necessarily negative growth is sometimes called economic stagnation.[10]

Since these phenomena affect much more than the financial system, they are not usually considered financial crises per se. But some economists have argued that many recessions have been caused in large part by financial crises. One important example is the Great Depression, which was preceded in many countries by bank runs and stock market crashes. The subprime mortgage crisis and the bursting of other real estate bubbles around the world have led to recession in the U.S. and a number of other countries in late 2008 and 2009.[11]

CAUSES OF FINANCIAL CRISIS [[12]] [[13]]

It is very hard to determine the main cause of the financial crisis. However economists and analysts indicate that a combined effect of many factors has led to the explosion in the credit markets in the U.S. and later to the rest of the world.

These factors are:

1. Strategic Complementarities in Financial Markets
2. Leverage
3. Asset-Liability Mismatch
4. Uncertainty and Herd Behavior
5. Regulatory Failures
6. Fraud
7. Contagion
8. Recessionary Effects
9. Unethical conduct on the part of Chairman/CEO
10. Heavy pay packages drawn /Compensation follies
11. Bad Risk Management and role of rating agencies and other watchdogs.

2008: YEAR OF GLOBAL FINANCIAL CRISIS[14]

The global financial crisis of 2008–2009 is a major financial crisis. It became prominently visible in September 2008 with the failure, merger or conservatorship of several large United States-based financial firms. The underlying causes leading to the crisis had been reported in business journals for many months before September, with commentary about the financial stability of leading U.S. and European investment banks, insurance firms and mortgage banks consequent to the subprime mortgage crisis. Beginning with failures of large financial institutions in the United States, it rapidly evolved into a global credit crisis, deflation and sharp reductions in shipping resulting in a number of European bank failures and declines in various stock indexes, and large reductions in the market value of equities (stock) and commodities worldwide. The credit crisis was exacerbated by Section 128 of the Emergency Economic Stabilization Act of 2008 which allowed the Federal Reserve System to pay interest on excess reserve requirement balances held on deposit from banks, removing the longstanding incentive for banks to extend credit instead of hoard cash on deposit with the Fed. The crisis led to a liquidity problem and the de-leveraging of financial institutions especially in the United States and Europe, which further accelerated the liquidity crisis, and a decrease in international shipping and commerce. World political leaders and national ministers of finance and central bank directors have coordinated their effort to reduce fears but the crisis is ongoing and continues to change, evolving at the close of October into a currency crisis with investors transferring vast capital resources into stronger currencies such as the yen, the dollar and the Swiss franc, leading many emergent economies to seek aid from the International Monetary Fund. The crisis was triggered by the subprime mortgage crisis and is an acute phase of the financial crisis of 2007–2008. (Global financial crisis of 2008–2009 begins).

IMPACT OF GLOBAL FINANCIAL CRISIS

INDIA[15]

While the overall policy approach has been able to mitigate the potential impact of the turmoil on domestic financial markets and the economy, with the increasing integration of the Indian economy and its financial markets with rest of the world, there is recognition that the country does face some downside risks from these international developments.

The contagion of the crisis has spread to India through all the channels – the financial channel, the real channel, and importantly, as happens in all financial crises, the confidence channel.

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[6] Peter Garber (2001), Famous First Bubbles: The Fundamentals of Early Manias. MIT Press, ISBN 0262571536.

[7] Ibid

[8] http://en.wikipedia.org/wiki/Financial_crisis#cite_ref-4

[9] Ibid

[10] Milton Friedman and Anna Schwartz (1971), a Monetary History of the United States, 1867-1960. Princeton University Press, ISBN 0691003548.

[11] Ibid

[12] Adrian Blundell-Wignall and Paul Atkinson (2008), "The Subprime Crisis: Causal Distortions and Regulatory Reform", in: Paul Bloxham and Christopher Kent, Lessons from the Financial Turmoil of 2007 and 2008, Proceedings of a Conference held at the H.C. Coombs Centre for Financial Studies, Kirribilli, on 14-15 July 2008; Reserve Bank of Australia; available at http://www.rba.gov.au/PublicationsAndResearch/Conferences/2008/Blundell- Wignall_Atkinson.pdf.

[13] http://www.alde.eu/fileadmin/webdocs/key_docs/Finance-book_EN.pdf

[14] http://www.economictimes.indiatimes.com

[15] http://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/87784.pdf

India's financial markets – equity markets, money markets, forex markets and credit markets – had all come under pressure from a number of directions. First, as a consequence of the global liquidity squeeze, Indian banks and corporates found their overseas financing drying up, forcing corporates to shift their credit demand to the domestic banking sector. Also, in their frantic search for substitute financing, corporates withdrew their investments from domestic money market mutual funds putting redemption pressure on the mutual funds and down the line on non-banking financial companies (NBFCs) where the MFs had invested a significant portion of their funds. This substitution of overseas financing by domestic financing brought both money markets and credit markets under pressure. Second, the forex market came under pressure because of reversal of capital flows as part of the global deleveraging process. Simultaneously, corporates were converting the funds raised locally into foreign currency to meet their external obligations. Both these factors put downward pressure on the rupee. Third, the Reserve Bank's intervention in the forex market to manage the volatility in the rupee further added to liquidity tightening.

THE REAL CHANNEL: The transmission of the global cues to the domestic economy has been quite straight forward – through the slump in demand for exports. The United States, European Union and the Middle East, which account for three quarters of India's goods and services trade are in a synchronized down turn. Service export growth is also likely to slow in the near term as the recession deepens and financial services firms – traditionally large users of outsourcing services – are restructured. Remittances from migrant workers too are likely to slow as the Middle East adjusts to lower crude prices and advanced economies go into a recession.

THE CONFIDENCE CHANNEL: In sharp contrast to global financial markets, which went into a seizure on account of a crisis of confidence, Indian financial markets continued to function in an orderly manner. Nevertheless, the tightened global liquidity situation in the period immediately following the Lehman failure in mid-September 2008, coming as it did on top of a turn in the credit cycle, increased the risk aversion of the financial system and made banks cautious about lending.

Overall, the Indian economic outlook is mixed. There is evidence of economic activity slowing down. Real GDP growth has moderated in the first half of 2008/09. Industrial activity, particularly in the manufacturing and infrastructure sectors, is decelerating. The services sector too, which has been our prime growth engine for the last five years, is slowing, mainly in construction, transport & communication, trade and hotels & restaurants subsectors. The financial crisis in the advanced economies and the slowdown in these economies have some adverse impact on the IT sector. According to the latest assessment by the NASSCOM, the software trade association, the developments with respect to the US financial markets are very eventful, and may have a direct impact on the IT industry. About 15 per cent to 18 per cent of the business coming to Indian outsourcers includes projects from banking, insurance, and the financial services sector which is now uncertain. For the first time in seven years, exports had declined in absolute terms in October. Data indicate that the demand for bank credit is slackening despite comfortable liquidity. Higher input costs and dampened demand have dented corporate margins while the uncertainty surrounding the crisis has affected business confidence.

CHINA[16]

TRANSMISSION CHANNELS OF ECONOMIC SHOCKS FROM THE GLOBAL CRISIS:

There are four major channels via which the global financial crisis impacted the Chinese economy:

1) **DIRECT LOSSES IN THE AMERICAN CAPITAL MARKET**: Before the subprime crisis, China's commercial banks had bought a moderate amount of mortgage-backed securities (MBS) and collateralized debt obligations (CD0s). The total direct loss suffered by China's four most important commercial banks on these securities amounted to $20 billion. It seems that the underdevelopment of China's overseas indirect investment spared China from bigger losses. However, in August 2008, China was on the edge when Fannie Mae and Freddie Mac were on the brink of collapse. If these two US mortgage companies had collapsed, China would have lost some $400 billion in its official foreign exchange reserves. The decision by the US government to place Fannie Mae and Freddie Mac into conservatorship not only saved the two companies but also spared China a very big disaster. Since then China's State Administration of Foreign Exchange (SAFE) has started to gradually change its holdings of government agency bonds into government securities, and from longer-term US government bonds to shorter-term Treasury bills.

As of June 2008, Chinese commercial banks' holdings of Fannie Mae and Freddie Mac bonds and mortgage-backed bonds guaranteed by Fannie Mae and Freddie Mac amounted to $25.3 billion .The direct losses seem limited. As of August 2008, Bank of China, which was the most exposed to the subprime crisis among all Chinese commercial banks, had written off $2 billion of subprime-loan- related assets. It was reported that, by the end of 2007, Bank of China's total holdings of subprime loans were $4.9 billion. According to a study by Henseng Bank, as of the end of November 2007, Chinese commercial banks' total holdings of subprime-loan-related bonds came to $18.2 billion. As of January 2008, the total holdings had been reduced to $15.9 billion. In line with Bank of China's write-off rate (40 percent), roughly speaking, Chinese commercial banks should have written off some $7.28 billion in losses. Taking into consideration the fact that since early 2008, more and more MBS and CDOs were turning bad, and Chinese commercial banks' losses can be significantly larger. But on the whole and relatively speaking, China's direct losses on MBS and CDOs should be limited. This is mainly because China, as a latecomer, failed to jump on the bandwagon in time to purchase more MBS and CDOs. On top of the abovementioned losses, seven Chinese commercial banks brought $0.76 billion in Lehman Brothers bonds. Of course, all these investments have had to be written off.

China's total foreign exchange reserves amounted to $2.1 trillion as of the end of the first quarter of 2009. Of these, some $1 trillion was in the form of US government securities, and the bulk of the securities were short-term US Treasury bills. At this moment, the book losses on China's foreign exchange reserve holdings are moderate. In any event, the safety of the value of China's foreign exchange reserves is one of the biggest worries of the Chinese authorities.

2) **CHANGES IN CROSS-BORDER CAPITAL FLOWS:** Since China only partially liberalized its capital account, theoretically speaking, cross-border capital can only flow into and out of China via the channels of foreign direct investment (FDI), officially approved foreign borrowing, and portfolio investment by qualified foreign institutional investors and qualified domestic institutional investors, respectively. Soon after the outbreak of the US subprime crisis, Chinese economists began debating the question of whether international capital would flow into or out of China. Some argued that because of China's relatively strong economic performance, international capital would low into China to seek safe haven and China should be prepared for a new wave of hot money inflows. Others argued that because of the liquidity shortage, need for capital injection and deleveraging, unwinding of carry trades, and the flight to safety (i.e., US government securities), international investors would liquidate their holdings in emerging markets, and hence international capital would flow out of China and return to the US and other financial centres of developed countries. As it turned out, since early 2008, capital seemed to have been flowing out of China. For example, China's FDI inflow declined to some $20 billion in 2008 from $50 billion in the previous year.

Traditionally, there are two ways to measure the magnitude of cross- border speculative capital flows (hot money): one is to check the volume of the "errors and omissions" item in the balance of payments; the other is to calculate the so-called unexplained capital inflows (or outflows), which is equal to the change in foreign exchange reserves minus FDI and trade surplus. The statistics on errors and omissions in the balance of payments showed a negative figure of some $40 billion in the second half of 2008, compared with a positive figure of nearly $20 billion in the first half. According to the second measurement, in 2007 and the first half of 2008, there were hot money inflows, and in the second half of 2008, there were hot money outflows. [In fact, in 2007 and the first half of 2008 hot money greatly complicated the Chinese monetary authorities' efforts to contain asset bubbles and stabilize the Yuan exchange rate.] However, because of the strong recovery of the Chinese economy and perhaps also due to the improved risk appetite of international investors in general, hot money started to flow back into China since early 2009, increasing strongly since March of that year. In recent months, China's stock prices have rebounded with a vengeance and housing prices have broken the historic record set in 2007 when the asset bubble peaked. In August, hot money seems to have begun flowing out of China again, which may have impacted on the stock exchange crash in the same month. However, due to the lack of statistics, the direction of causality is difficult to judge. Most Chinese economists believe that the alternating between boom and bust in China's stock markets so far is mainly a domestic matter. They also believe that hot money will continue to flow into China but the scale and variation are difficult to estimate. The Chinese government is keeping a close eye on the cross-border capital flows and is ready to take action to maintain the stability of China's capital market. It seems that the most serious impact of the crisis on the financial front in China was the difficulty in obtaining trade finance, the adverse effect of which was most acutely felt in the processing trade industry.

[16] Yongding (2010), "The Impact of the Global Financial Crisis on the Chinese Economy and China's Policy Responses". Third World Network, Malaysia.

3) **REDUCTION IN GROWTH OF EXPORTS:** Compared with other areas, the far more serious impact of the global financial crisis on the Chinese economy has been on trade. China's fast growth came to a sudden halt in the third quarter of 2008. In the third quarter, China's annualized GDP growth dropped to 9 percent (6.8 percent in the fourth quarter) from 13 percent in 2007; the growth rate of industrial production fell to 8.2 percent, about half the rate in the same period of the previous year; and the growth rates of many important product sectors fell from the double digits into negative territory. The export growth rate fell from 20 percent in October 2008 to -2.2 percent the following month. Statistics show that the most important cause behind the fall in China's growth in the third quarter of 2008 was the sudden collapse of the export market, which was in turn caused by the sudden worsening of the US financial crisis after the Lehman Brothers collapse. Among Chinese industries, the most dramatic fall in production happened in the steel industry. Indeed, an analysis of the causes of the decline in steel production would shed light on the factors behind the slowdown in the Chinese economy in general .It can be seen that the drop in steel exports directly accounted for 54 percent of the total decrease in steel production in September 2008, and the fall in exports in turn was a direct result of the global economic downturn. Besides the direct impact, the indirect impact on steel production of the fall in demand experienced by steel-related exporting industries was also very great. On the whole, the decline in external demand can explain more than 60 percent of the fall in steel production.

POST CRISIS REBALANCING STRATEGIES

INDIA[17]

In order to tackle the negative fallout of the global financial crisis on Indian economy in terms of economic slowdown, the government responded by taking a number of measures. These measures can be broadly classified as follows:

MONETARY MEASURES: These measures aimed at reducing the cost of borrowing and improving market liquidity and cash flows so as to facilitate the flow of funds from the financial system to meet the needs of the productive sectors. The RBI took a number of monetary easing and liquidity enhancing measures including reduction in cash reserve ratio (CRR), statutory liquidity ratio (SLR) and key policy rates such as repo and reverse-repo. Between August 2008 and March 2009, RBI's successive policy announcements reduced reverse-repo and repo rates from 6 percent to 3.5 percent and 9 percent to 5 percent respectively. CRR was reduced from 9 percent to 5 percent and SLR was reduced from its statutorily maximum limit of 25 percent to 24 percent. This was supplemented by a wide variety of measures to support liquidity, including to distressed segments of the financial system such as non-banking financial companies (NBFCs) and mutual funds. All these measures, by injecting more money, helped in augmenting liquidity in the system to the extent of Rs. 3, 88.000 crore (RBI, 2009).

FISCAL MEASURES: These measures related to substantial fiscal expansion in the form of tax relief to boost demand and increase in expenditure on public projects such as public works and social safety nets to create employment and public assets. The net impact of these measures was an increase in fiscal deficit from 2.7 percent in 2007-08 to 6.2 percent of GDP in 2008-09. Thus, an overall fiscal stimulus of nearly 3.5 percent was created notwithstanding the fact that some expenditure was on account of the implementation of the Sixth Pay Commission award and the agriculture debt relief scheme (small farmers' debt waiver of Rs. 50,000 crore) announced in the Union Budget 2008-09. For implementing the fiscal stimulus, the government increased its spending on the plan, both for Central sector as well as on Central assistance to State and Union Territories, by nearly 1 percent of the GDP. There was an increase of nearly 2.5 percent of GDP on non-plan expenditure that included increased spending on fertilizers and food subsidies, agriculture debt waiver, defense, salaries and pensions and additional allocations for the National Rural Employment Guarantee Act. The government also stepped up its efforts to increase infrastructure investments in telecommunications, power generation, ports, airports, roads and railways. These three stimulus packages introduced by the government to help the industry tide over the impact of global financial crisis led to a sacrifice of Rs. 1.86 lakh crore in revenue.

TRADE-RELATED MEASURES: The government also undertook specific measures to address the impact of global slowdown on India's exports. These included:

- Extension of export credit for labour-intensive exports.
- Improving the pre- and post-shipment credit availability.
- Additional allocations for refund of terminal excise duty/CST and export incentive schemes.
- Removal of export duty and export ban on certain items.

Although the above measures could not substitute for the dramatic slump in foreign demand, yet they were helpful in facilitating the adjustment of companies and workers to the new reality and to survive the temporary setbacks.

INSTITUTIONAL MEASURES: The broad objective of these measures was recapitalization of banks as well as consolidation of financial sector institutions. The government contributed to recapitalization of Regional Rural Banks (RRBs). In order to restructure and consolidate these banks, 196 RRBs were merged into 85 RRBs. The government also recapitalized public sector banks (PSBs) over two years to maintain credit to risk-assets ratio (CRAR) of 12 percent. As a result of these efforts, the non-performing assets (NPAs) of PSBs declined from 7.8 percent on March 31, 2004 to 2.3 percent on March 31, 2008.

OTHER MEASURES: Besides the above short-term measures, the government also responded by resorting to some medium-term measures relating to domestic financial sector reforms and other reforms and reforms of international financial architecture. The domestic financial sector reforms and other reforms aimed at:

- Increasing access to finance
- Improving domestic resource mobilization
- Improving efficiency of the banking sector
- Avoiding financial repression.
- Strengthening property and contractual rights, judiciary and rule of law.

The government initiatives here included:

- Extension of interest subvention on pre- and post-shipment credit for specific sectors.
- Improving regulatory oversight of capital markets
- Putting in place a disinvestment plan for public sector enterprises (PSEs)

CHINA[18]

When the global slowdown became apparent, the Chinese government shifted its policy direction quickly and forcefully. In November 2008, the government started to implement a very large stimulus package. At the same time the PBOC also ushered in an expansionary monetary policy.

EXPANSIONARY FISCAL POLICY: In November 2008, the government introduced a 4 trillion Yuan ($580 billion) stimulus package for 2009 and 2010. In 2008, China's GDP was 29 trillion Yuan. The package thus amounted to 14 percent of GDP. Besides the increase in expenditures, the government also considered possible tax reductions, which included value-added tax (VAT) reform, purchase tax cut and raising the threshold of individual income taxes. According to the National Development and Reform Commission (NDRC), assuming that the fiscal multiplier in China is 2-3, the package can induce an increase in GDP of about one percentage point in both 2009 and 2010. On top of the central government's stimulus package, provincial governments were encouraged to raise money to launch their own complementary stimulus packages. The total amount of planned stimulus packages announced by local governments stood at 18 trillion Yuan.

The structure of the 4 trillion Yuan stimulus package is summarized in Figure 1. It is easy to see that most of the money has been and will be spent on infrastructure such as railways, highways and so on, followed by post-earthquake rebuilding.

The sources of financing of the stimulus package were designed as follows:

•The central government will finance one-quarter of the 4 trillion Yuan package in the form of direct grants and interest rate subsidies. In the case of central government-sponsored projects, the NDRC and Ministry of Finance may inject all of the registered capital.

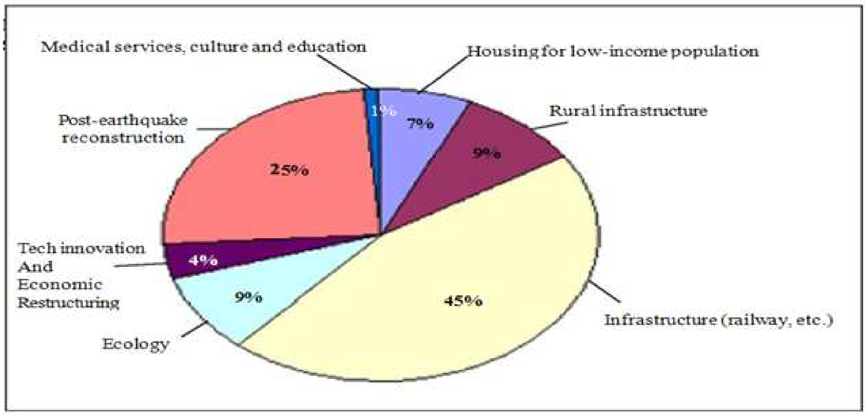
•Government bonds will be issued to cover the budget deficit.

[17] www.globalissues.org/article/768/global-financial-crisis

[18] www.bruegel.org/...Global.../AEEF4PublicationYuYongding.pdf

•The central government will issue bonds on behalf of local governments to fill the shortfall in financing local projects.
•Bank loans will be an important source of funds, especially for local governments.

Figure 1 The Structure of China's Stimulus Package



In March 2009, the National People's Congress approved the government's new budget for 2009. According to this budget, in 2009, the total government (central plus local) revenue would be 6.674 trillion Yuan, up 8.0 percent from 2008. Of this, the revenue of the central government should reach 3.586 trillion Yuan, an increase of 9.8 percent over 2008. Total government expenditure (central plus local) would be 7.624 trillion Yuan, up 22.1 percent; the expenditure of the central government would be 4.3865 trillion Yuan, an increase of 848.501 billion Yuan or 24 percent. 2 In 2009, the total government deficit would be 950 billion Yuan ($139 billion), the highest in six decades, compared with 111 billion Yuan in 2008. The central government's deficit will be at 800 billion Yuan, 570 billion Yuan more than the previous year. The State Council will allow local governments to issue 200 billion Yuan worth of government bonds through the Ministry of Finance. The expected budget deficit/GDP ratio is estimated to be about 3 percent, compared with a ratio of 0.4 percent in 2008. There is no detailed information available on how the budget for 2009 was amalgamated with the 4 trillion Yuan stimulus package. However, attention should be paid to some key figures provided by the Ministry of Finance in a related report on the central government's 2009 budget:

- 908 billion Yuan in public spending, an increase of 487.5 billion Yuan, or 54 percent, over 2008
- 123.08 billion Yuan for direct subsidies to agricultural production and trade, an increase of 19.4 percent over 2008
- 220.833 billion Yuan for subsistence allowances for both urban and rural families.
- 103.341 billion Yuan for subsidizing rural residents' purchase of home appliances and vehicles and increased reserves of important materials such as grain, petroleum, non-ferrous metals and specialty steel products.
- 716.14 billion Yuan, an increase of 120.59 billion Yuan or 20.2 percent, to assist agriculture, rural areas and farmers
- 728.463 billion Yuan for items directly related to the people's wellbeing such as education, medical and healthcare, the social safety net and so on, an increase of 29.4 percent over 2008.
- 146.103 billion Yuan for science and technology, an increase of 25.6 percent over 2008.3
- 500 billion Yuan in tax and fee reductions, which partially will be the result of VAT restructuring, increase in tax rebates and exemptions. On the whole the government plans to withdraw or suspend 100 administrative charges by 2009.

According to the Ministry of Finance, as of 31 May 2009, China had allocated 562 billion Yuan ($82.3 billion) for public works projects, completing 61.9 percent of its central budget for 2009. More than half of the allocated funds went to rural development and prominent infrastructure construction:

- 163.5 billion Yuan went towards infrastructure projects such as railways, highways, airports and harbour construction.
- 138.1 billion Yuan was spent on projects to enhance rural infrastructure and improve living standards in the countryside through the construction of irrigation facilities, power grids and paved roads.

Other spending included:

- 84.8 billion Yuan for reconstruction in areas hit by the 12^{th} May 2008 earthquake
- 44.2 billion Yuan for education, medical care and cultural development
- 42.7 billion Yuan for low-income housing projects
- 41.2 billion Yuan for industrial upgrades
- 27.8 billion Yuan for environmental protection and energy saving
- 19.7 billion Yuan for public service facility buildings

It can be seen that the most important component in the stimulus package is investment in infrastructure. Fixed asset investment has long been the most important driving force behind China's economic growth, and has been growing faster than GDP since the turn of the century. Due to the dual role of fixed asset investment in creating demand in the short run and supply in the long run, an increasing investment rate will create immediate excess demand for a while, and then the economy will shift from a phase of overheating to overcapacity. Since 2001, China's investment rate has been increasing steadily. Investment hit an annual growth rate of 32.9 percent on a year-on- year basis in the first five months of 2009. As a result, China's investment rate may have surpassed 50 percent of GDP.

EXPANSIONARY MONETARY POLICY: Up to May 2009, the increase in bank credits was 5.77 trillion Yuan, higher than the official target of 5 trillion Yuan for the entire year of 2009. In contrast, the annual increases in bank credits in 2006 and 2007 were 3.18 trillion Yuan and 3.63 trillion Yuan respectively. The increase in bank credits in the first quarter of 2009 was surprisingly high, and the same was true of the growth rate of broad money M2. The gap between the growth rate of M2 and nominal GDP has broken the historical record (Table 1).

Table 1 Credit and Monetary Expansion

Billion Yuan, %	May	April	March	February	January
Growth of M1	18.7	17.5	17.0	10.9	6.7
Growth of M2	25.7	26.0	25.5	20.5	18.8
Credit	664.5	591.8	1890	1070	1620
Growth of credits	30.6	29.7	29.8	24.2	21.3

(*Source: People's Bank of China*)

The most important cause of the rapid increase in credits and money supply is the PBOC's expansionary monetary policy. Previously, corresponding to the rapid increase in liquidity caused by PBOC intervention in the exchange market, which was aimed at offsetting the appreciation pressure on the Yuan created by a persistent trade surplus, the PBOC sold large amounts of central bank bills to mop up the excess liquidity. Since the fourth quarter of 2008, the PBOC has almost stopped selling more bills. As a result, the liquidity has inundated the inter- bank money market and once even made the interest rates in the inter-bank market lower than the interest on deposits with commercial banks with the same terms of maturity. This was described in China's banking circles as "flour being more expensive than bread".

CORPORATE GOVERNANCE PRACTICES AND POLICY RESPONSE TO OVERCOME WEAKNESSES[19]

The collapse of the sub-prime mortgage market is the most apparent cause of the global financial crisis but it needs to be recognized that the sub-prime crisis was building for years before showing any signs and attention intensified in the year 2007, only when there was a dramatic rise in the mortgage delinquencies and foreclosures in the United States, with major adverse consequences for banks and financial markets around the globe. Other major factor that played a contributing role in precipitating and exacerbating the crisis is the failure of the corporate governance practices of the financial institutions such as lax board oversight, misaligned compensation structure that encouraged aggressive risk taking, abuse of the process of securitization, dishonesty among the mortgage lenders, greedy hedge funds and rating agencies, and mistakes of the U.S. government in over- promoting homeownership, fraud in mortgage lending, overleveraged banks and financial institutions, shadow banking system and off balance sheet transactions. The recent turmoil suggests a need to re-examine the corporate governance practices in these key areas and learn the right lessons from the crisis in order to introduce appropriate reforms, which not only reduce the probability of occurrence of such events in future but also minimizes the impact of such events, if at all they occur.

The following are the major areas of reforms in corporate governance practices after noticing the collapse of major investment banks:

1. Splitting the offices of CEO and Chairman
2. Efficient risk management i.e. having a Chief Risk Officer responsible for risk management
3. Close supervision of rating agencies
4. Encouraging competent directors
5. Abolish practice of nominating independent directors
6. Exempt independent directors from vicarious liability and provide insurance cover to them
7. Review the definition of independent director given in clause 49 of listing agreement
8. Initiate superior Board practices
9. Improve remuneration policy
10. Have ethics code in listed companies
11. Legislative sanction to insider trading laws
12. Rotation of external auditors in non-financial institutions
13. Introduce new audit standards and joint audit
14. Make audit committee strictly independent
15. Prohibit political funding
16. Install whistleblower system
17. Introduce class action suit & compensation
18. Have in place permanent PPP system, and
19. Enhance criminal and civil penalties.

CONCLUSION

The financial crisis of the US is has being viewed as the biggest challenge to the international financial system since the Great Depression. What started as turbulence in segments of the U.S. subprime mortgage market has become a global financial crisis due to the integration and interconnectedness of the US economy with the rest of the world and increasing globalization. Many wonder how such a small sub-prime market could cause so much of trouble around the globe, especially in countries, which were not even involved in sub-prime lending. The contagion of crisis has spread through all channels i.e. financial channel, real channel and the confidence channel. In case of India and China, the robust growth rates in the country over the last few years, cautious policies, prudent regulation and effective supervision helped the economy in being relatively less affected by the global financial market turmoil. It is important for the corporate sector to learn right lessons from the crisis so as to avoid such happenings in future. There is need to reform corporate governance by taking harsh policy measures.

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