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SUB-PRIME CRISIS: CONCEPT AND ORIGIN

DR. RAJESH PAL
ASST. PROFESSOR
DEPARTMENT OF ECONOMICS
M. G. KASHI VIDYAPEETH
VARANASI

ABSTRACT

The present sub-prime crisis was the unplanned consequences of two phenomena. First, this was a crisis made mainly by the US Federal Reserve Board during the period of easy money and financial deregulation from the mid 1990s until today. Second, US over-consumption and over-borrowing led to unprecedented housing and consumer credit bubbles in the US and other countries, notably those that shared American's policy orientation. With the financial deregulation, banks take hundreds of housing loans that they have made, bundle them up, cut them up into separate pieces, mixing loans of different quality. The bank converts a set of such loans into saleable financial assets such as bond through a process known as securitization. What happened was the value of houses came crashing down because many borrowers were defaulting on involvements and lots of houses were being sold off to repay debts— the security one holds become practically worthless. This was the climate under which banks found it difficult to raise loans from other banks using securitized loan assets as collateral. A number of such loans turned sour and hence become sub-prime when the housing markets begin to collapse. To overcome the global financial crisis, America as well as Britain have opted policy of Nationalization—the direct government control. America in particular, celebrated laissez-faire capitalism and has been deeply skeptical of government interventions. Now America is talking about nationalization, it seems that laissez-faire policy is over.The paper aims to explain the concept, origin and measure to over the sub-prime crisis.

KEYWORDS
laissez-faire policy, securitization, sub-prime crisis.

INTRODUCTION

The present sub-prime crisis is the first big crisis of the age of globalization. Financial meltdown has indeed shaken the world as never before. In fact the present meltdown is not a simple financial crisis. It is the global capitalist crisis. Capitalist economy has to analyzed as a system of production and as a system of markets. These do not exist independently of one another. In the real world they always exist together, so that the tendencies of production find expression only through the workings of the market. The production cycle is ruled by exchange value which appears on the market in the form of money. Money therefore has a contradictory role in a market economy—it is both a medium of exchange and a store of value. On the market all that can be observed are commodities (C) with a definite price being exchanged for money (M), money then being exchanged for other commodities - a perpetual process of C ➔ M ➔ C. At this level the only thing that seems important about commodities is their price—their value in terms of money. Money must also flow and circulate hence it is called currency coming from the root word current. Money must constantly flow. If it does not, it leads to stagnation. It capitalism could not create sufficient markets, sufficient demand, in which to sell its ever-increasing output, then production would be interrupted and the economy would stagnate. Before going to know how this present crisis came into being. Let us have some conceptual framework of crisis.

CONCEPTUAL FRAMEWORK OF CRISIS

Crisis is a complex phenomenon, and the term itself has many meanings. It was first used in medical science to denote the point in the progress of a disease at which an important development in change takes place which is decisive for recovery on death. It has since been used metaphorically to refer to similar turning points in the development of society. Marx used the term in the main to refer to economic and commercial crisis which were interruptions to production and process of capital accumulation, and took the form of (i) goods piling up because they could not be sold profitably, (ii) Widespread bankruptcies, (iii) financial panics, (iv) cut backs in production, and (v) mounting unemployment. But he also spoke of the periodic economic crisis that crowned the trade cycle, through which the capitalist economy developed[1]. Marx always insisted that capitalism was a contradictory mode of production and that to explain it required twofold analysis—in terms of value and in terms of money. The former was the sphere of production and social relations, the latter the sphere of the market and price. Only by grasping both together could be actual nature of capitalism, its origins, development and ultimate limits, be understood.

Baran and Sweezy's conception of monopoly capitalism is built on two supports—an under consumption theory of crisis and the concept of the 'economic surplus'. The first was developed by Sweezy in his book". *The theory of capitalist development*. In his words: 'The specific form of capitalist crisis is an interruption of the circulation process induced by a decline in the rate of profit below its usual level" In discussing the causes of crisis, Sweezy argued strongly that there were two distinct theories of crisis in Marx. The first was the long term tendency of the rate of profit to fall in the course of capital accumulation, due to the increasing proportion of machinery to labour in value terms (the rising organic composition of capital). The organic composition of capital expresses the relationship between living labour and the means of production in the process of production in terms of value (exchange value) and of use. The rate of exploitation could not be raised fast enough to offset the cost of investment in plant and machinery. The second theory of crisis in Marx, according to Sweezy, saw crisis arising from problems of realization that is from problems of market. It may be that there arises a disproportion between different sectors of the economy, the capital good sector on the one hand and the consumer goods sector on the other. Output and capacity in one was ahead of output and capacity in the other, because economic production as a whole is unplanned and chaotic.[2]

Crisis which also arises from the anarchic and unplanned character of capitalism and from other sources will come and go. The capatialists want to limit wages and to dismiss workers. The purchasing power of the mass of the population grows rather slowly under capitalism. There is thus a constant contradiction between the rapid growth of producing power and the much slower growth in consuming power in society.[3] To ensure that society's consuming power matches its producing power, capitalists came with innovative ideas like plastic money i.e. credit card etc. This periodically results in crisis. Periodic crisis remain therefore an integral part of capitalism. So business cycles consisting of phases of boom, recession, depression, recovery and boom again constitute an inevitable feature of capitalism as a system. To ultra monetarists all slumps and booms, crisis and recessions were due primarily to change in the money supply, and that therefore, government and central banks were responsible for them. Steady growth without inflation would be achieved, if government knows how to manage monetary supply properly without interfering in the working of the free enterprise economy.[4]

In a capitalist economy, demand is a constraint problem. Under capitalism there is always tension between rising productive power and slowly growing consuming power. The inability of capitalism to ensure adequate growth of consuming power—'Demand' in line with the rapid growth of productive forces is the basis for the periodic recurrence of demand crisis under capitalism.[5]

Everyone agrees that the capitalist world is gripped by crises. But what are its causes and what are the most likely outcomes. It is the realization that progress within the framework of capitalism may no longer be possible that is slowly changing the context of politics throughout the capitalist world.

ORIGIN OF CRISIS

Today we know that sub-prime lending was only a small fraction of the problem. Even bad home loans in general were only part of what went wrong. We are living in a world of troubled borrowers, ranging from shopping mall developers to European "miracle" economies. And new kind of debt trouble just keep emerging. How did this global crisis happen? Why is it so spread ? Paul Krugman suggests the answer can be found in a speech of Ben Bernanke, the Federal Reserve Chairman, gave four years ago. The speech, titled "The Global Saving Glut and the U.S. Current Account Deficit" offered a novel explanation for the rapid rise of the U.S. trade deficit in the early 21st century. The causes, argued Bernanke, not lay in America but in Asia.[6]

In the mid 1990s, he pointed out the emerging economies of Asia had been major importers of capital, borrowing abroad to finance their development. Asia recovered smartly in 1999-2000 over its financial crisis of 1997-98 then anybody thought possible because-out of the blue-the U.S. emerged as last resort. This enabled third world countries to build up stupendous forex reserves of $ 4 trillion. But after the Asian financial crisis of 1997-98, these countries began protecting themselves by amassing huge war chests of foreign assets, in effect exporting capital to the rest of the world. The result was a world awash in cheap money, looking for somewhere to go. Most of that money went to United States hence giant trade deficit because trade deficit is the flip side of capital inflows.

Ben Bernanke ought to know that the situation in the western financial markets is attributed to the change in the social structure of its society. Social system has much impact on the economic phenomenon of the country. Social institution, habit and attitudes are influencing the productive activities and expenditure patterns substantially[7]. Savings and investments patterns are considerably influenced by cultural and social considerations, Japan, building perhaps more on a local culture than on an international social philosophy, has built a capitalist developmental state which is contrasted with the USA regulatory state. However Japan's success is explained more by its high savings rate and its successful industrial relations system than by its industrial policy.[8]

Underlying the American economic failure is the US interest in maintaining an extravagant consumerist life style for its population at the expense of the savings of the rest of the world. It was the unplanned consequences of two phenomena. First, this was a crisis made mainly by the US Federal Reserve Board during the period of easy money and financial deregulation from the mid 1990s until today. American bankers, empowered by a quarter century deregulatory zeal facilitated a consumption spree aided by low interest rates and low prices of Asian manufactures. Consumers and capitalists raise their expenditure and therefore their demand for cash. Initially, this is financed from existing cash balances from an expansion of credit, from running down bank deposits, and the like. This reduces the amount of liquidity in the system. Second, Asian governments reinforced this trend by keeping their currencies undervalued and export cheap, and by investing their forex reserves in US gilts, keeping US interest rates low. US over-consumption and over-borrowing led to unprecedented housing and consumer credit bubbles in the US and other countries, notably those that shared American's policy orientation. Greenspan stoked two bubbles, the bubbles of 1998-2001 and the subsequent housing bubbles. In both cases, increase in asset values led US households to think that they had become vastly wealthier, tempting them into massive increase in their borrowing and spending. The rise in consumption based on this wealth in turn raised house prices further, convincing households and lenders to ratchet up the bubble another notch. This has all come crashing down because several highly leveraged institutions such as Bear Stearns and Lehman Brothers, have gone bankrupt. Investment banks i.e. Morgan Stanley and Goldman Sachs have converted themselves into ordinary banks. Two decades of the dominances of the global financial sector by a handful of American investment banks is over.[9] In a book entitled, "*The sub-prime solution*" written by Robert J Shiller states that the housing market was indeed a bubble fed by irrational exuberance that bore no relation to reality. Thus his diagnosis of the crisis is basically that it was a result of bad judgements and unjustified risks undertaken by people acting irrationally. George Cooper takes the analysis is a step further in his book entitled. "*The Origin of Financial Crisis*". Cooper's starting point is the falsity of Efficient Market Hypothesis (EMH). EMH hypothesis holds that markets are self-correcting mechanism that left to themselves converge to the most efficient equilibrium. Unfortunately market fails to reach to a stable equilibrium, instead this produces credit bubbles that burst and led to crisis. Thus Keynes has always advocated for interference by the government in the market to prevent major crisis, which is result of Financial Instability Hypothesis (FIH) of Herman Minsky, the foremost devotee of John Maynard Keynes in the U.S. The FIH maintains that market economies are inherently unstable, generating crisis internally even in the absence of external shocks. This is specially true of markets in assets such as land or finance. The U.S. Federal Reserve was created for just this purpose after the financial instability of the early twentieth century. In search of profits, multinational corporations have moved towards cheap labour countries using the opportunities presented by globalization. This has resulted in stagnation of wages in the developed western countries. In order to keep lid on the resulting political discontent at home, western governments have deliberately allowed the creation of housing bubbles and credit schemes leading to an exponential growth of debt. When Turner blames globalization he means capitalist globalization. Indeed when seen in this light, the housing bubbles, the debt crisis and deregulation troubles are not a mistake but rather and essential features of the system. Two features of the modern economic system stand out: the stagnation of wages and increasing financialsation of capital in response to the decreasing rates of profit in traditional avenues for investment. This development to a monopoly-finance stage of capitalism meant that assets bubbles and spiraling debt was just a means of putting of the point at which the problem of the system would explode[10]. Had there been tighter regulation and caps on a debt, a crisis would have just occurred earlier! Indeed Turner was one of the few people (other than by now famous, Professor Nouriel Roubini, who specializes in predicting gloom had predicted the crisis in advance. Commercial banks also lost heavily in these dealings, wiping, out much by their capital. And finally, the failure of Lehman Brothers and near failure of the insurance giant AIG, incited financial panic, in which over healthy firms are unable to obtain short term bank loans or sells short term commercial paper.

One way to look at the international situation right now is that we are suffering from a global paradox of thrift : around the world, desired saving exceeds the amount businesses are willing to invest. And the result is a global slump that leaves everyone worse off. So that's how we got into the mess. And we are still looking for the way out[11].

The US and several European economies are trapped in situation that most students of economics get to study only in classroom. It is called the liquidity trap—a situation in which the nominal interest rate is zero or close to zero and cannot be lowered further to stimulate the economy. Crisis today in the world capitalist economy is not merely of liquidity. It is the crisis of solvency. Because banks were lending massively without due diligence to assess whether the borrower can repay or not – this is what is called sub-prime lending. But why did sub-prime lending take place on large scale? There are two reasons for this—(i) banks felt the pressure to expand lending in order to make adequate returns, and (ii) banks were competing with financial institutions like investment banks and speculator dealing in a range of financial assets-were making huge profits. This cannot be handled merely by infusing money to some banks. Moreover, one must know that it is not merely banking financial, insurance and stock markets which are in crisis. There is a crisis in the real economy in the sense that the industrial output in the advanced capitalist countries is falling. Unemployment is rising. It is higher than it has ever been in the Second World War. And the only comparison could be with the Great Depression of the 1930s, when unemployment rates reached 25 per cent of the labour force[12].

A financial crisis in any one country 30-40 years ago would have not impacted so quickly on other countries. Today because of the process of integration what is called globalization, it has spread to other countries. Remember globalization is integral to capitalism it is not a separate thing. Capitalism means making profit. Capitalism does not say that profit must be made only by ethical means. The essence of capitalism is pursuit of profit. So from its birth, capitalism has been an expanding globalizing mode of production. As Marx put it, 'Capital is nothing but self-expansion of value. Since 1980s onwards, in particular the integration of financial markets on global scale, because of that integration, if America sneezes, we do not just catch a cold, we get a fever. That is the degree of integration today in the world of financial sector. And this is in fact a key factor underlying the present crisis.[13] In the particular case of the current crisis, let us try to understand this in a simple manner. With the financial deregulation, commercial banking has shifted from the old commercial banking model which is also called museum model to new model what is known as a parking lot model now. Under new model, the loan agreement between the borrower and the bank is not the end of matter. Banks take hundreds of housing loans that they have made, bundle them up, cut them up into separate pieces, mixing loans of different quality. The bank converts a set of such loans into a saleable financial assets such as bond through a process known as securitization. The people who buy these bonds do so when the housing market was expanding and the value of the housing assets are going up and they expect to resell these bonds at a higher price. What happened was the value of houses came crashing down because many borrowers were defaulting on involvements and lots of houses were being sold off to repay debts— the security one holds become practically worthless. Banks thought that by selling the loans to others, they were escaping the risk. Those who bought the securities and sold them thought they had escaped that risk because somebody has bought the bond. But the risk has not left the system; instead they have spread all through the system. Not only that the same players who played this game of packaging loans and selling them to investment bankers like

Goldman Sachs and Merril Lynch and so on would then go to the stock market to find that the shares of these companies are rising, and they will buy the shares of these companies, thus re-importing risk!. They thought they were escaping the risk by selling the bonds, but they were going and buying the shares of companies holding these very bonds. Thus, while everybody thought they were transferring risk they were collectively fooling themselves. Everything was going well as long as housing market was expanding and the underlying assets prices were rising. The moment market begins to fall, the house prices begins to fall because of rapid increases in foreclosures and more and more housing become under sale, the whole system begins to collapse. This was the climate under which banks found it difficult to raise loans from other banks using securitized loan assets as collateral. A number of such loans turned sour and hence become sub-prime when the housing markets begin to collapse. This is one of the key mechanisms underlying the crisis.

To overcome the global financial crisis, America as well as Britain have opted policy of Nationalization—the direct government control or ownership of economic activity. Just when things looked unfixable- Britain came up with a plan of nationalization of troubled lender Bradford and Bingley, the latest European victim of the fast moving global financial crisis. It is ironic that the Republic administration in America, for whom government intervention is anathema, has decided to adopt the interventionist recipe dished out by Brown. Brown is credited with framing a model of bailout plan for Britain's banking system, which involves injecting £50 billion of taxpayers' money into banks and underwriting inter-bank loans. But beneath the discourse over the specific of the rescue efforts lies another debate. It is in fact a mere fundamental one. It is got to do with the role of the state in a free market. Adam Smith, the father of economics saw the market as a means of enlisting co-operation among strangers. "Give me what I want and I will give you what you want is the preposition that lies at the base of every market transaction. Competition is inherent in the market system, for example the coming together of the two rival airlines, Jet and Kingfisher is possible only due to the current global financial crisis. Earlier such undertaking was products of greed but today these treaties are survival tools.

Smith argued that government's restrictions on the market can prevent mutually beneficial trades and reduce the welfare of potential traders. It has been argued that in the age of globalization, the state pre-eminence has been under minded that it is no longer a significant economic actor, subsumed as it were, by international organization and other non-government economic players. America in particular, celebrated laissez-faire capitalism and has been deeply skeptical of government interventions. Now America is talking about nationalization, it seems that laissez-faire policy is over.

The present situation is very critical movement in American economy. Big banks, financial institutions and lenders who admittedly lent money recklessly during the housing boom need to be saved with capital infusion because their situation has scared others into withholding credit, which drives the American economy. The current crisis demands quick action. The most important actor by far is the US Fed. This is because the US domestic currency is acceptable everywhere, and is currently viewed as a safe heaven. The Fed can print currency or announce international dollar swaps without congressional or presidential approval. This freedom and powers has enabled Fed Chairman Bernanke to take several initiatives of unprecedented boldness. Allan Greenspan, the erstwhile Fed boss was even quoted saying to a media house, "It may be necessary to temporarily nationalize some banks in order to facilitate a swift and orderly restructuring". But unfortunately the man who matters, Fed boss in charge Ben Bernanke, does not seem to be very fond of the idea. He just squashed the option in the Senate Banking Committee meeting saying, "We don't need majority ownership to work with the banks. We have very strong supervisory oversight. We can work with them to do whatever is necessary to restructure, to take whatever steps are needed to become profitable again, to get rid of bad assets. We don't have to take them over to do that". Congressional approval was indeed needed for $700 billion rescue package. How much should government involve itself in the market place? This question touches on one of the most important economic issue: the division of responsibility between the public and private sectors. In general, economic principles would suggest that government undertake only functions that it can perform more efficiently than the market. Competition is inherent in the market where buyers receive the entire product's benefits, a producers pay all the cost of production. If such optimum conditions are not achieved, the market fails. Under current global financial meltdown, Government must come with a bailout plan, not for any private industry, but for the welfare of the people. This argued of a larger systematic risk can hardly be applicable to airlines. It is therefore, best to leave it to market forces to deal with the situation and ensure the survival of the most efficient, the theme of globalization. Government function is to control and regulate private sector industry, provide education, maintain law and order, welfare of people etc. If private sectors are ready to share the functions of government, then government must go for bailout of the private sector industries in the time of crisis.

Given the current global climate, bailout plan for private sector airline industry i.e. Kingfisher and Jet Airways would raise some policy issues. And if a package was prepared for the aviation sector, demands by other segment could not be ignored. At a time, when the government is trying to entertain state run enterprises to become more competitive, a bailout for the private sector would be a bad policy. In a democratic welfare society under the shadow of new global economic order, government must come out with policy for those who lost their jobs for no fault of theirs, but mismanagement of private companies who over extended themselves in their rush to expand must not propped up with tax payer's money. Lay-off of employees by the corporations generates external cost to the economy. When exchange between buyers and sellers affect people who are not directly involved in the trades, they are said to have external effects, or to generates externalities are the positive or negative effects that market exchanges may have on people who are not in the market. They are third party effects. When such effects are pleasurable they are called external benefits. When they are unpleasant or impose a cost on people other than the buyers or sellers, they are called external cost. The reductive nature of the corporation allows it to multiply endlessly without any sense of the consequence of its actions. The corporation cannot say no, unless the law explicitly requires it to say no. Indeed, if corporations fully recognized the adverse effects of their self-interest, external cost would not exist. "It is not from the benevolence of the butches, the brewer, or the broker, that we expect our dinner from their regard to their own interest. We address ourselves, not to their humanity but to their self love, and never talk to them of our own necessities but of their advantages". When this passage from Adam Smith's "An Enquiry into the nature and causes of the Wealth of Nations (1776) is taken out of context, as it so often is, it may convey a narrow and cynical view of human behaviour. Smith say, self-interest is an incentive – a reason to cooperate and coordinates one's activities with others.

A shortage of money generally stop that boom, then it follows that a plentiful supply of money should initiate the recovery from a depression. The injection of money into circulation by several governments in the west during great depression 1929-33 didn't help to start recovery in the economy. According to Saving-Investment theory, the basic factor in initiating recovery from depression is an increase in investment rather than increase in supply of money. An investment is governed more by the marginal efficiency of capital (MEC) i.e., expect profitability. An increase in the quantity of money may no doubt cause the rate of interest to fall, but his by itself, is not enough to bring about an improvement in MEC. If MEC fails to improve, an increase in investment may not take place, despite the increase in the supply of money. In fact there is no relationship between the quantity of money and the aggregate demand. This has been proved in the recent global financial turmoil. Reduction in repo rate and cash reserve ratio from 9 per cent to 5.5 per cent by RBI within fourteen days and injection of Rs. 1,65,0000 crore liquidity into the banking system to increase aggregate demand, met with little or no success in their efforts. An important indicator of demand is consumer spending. What the country needs is a 'New Deal' similar to the one that President Franklin Roosevelt employed 75 years ago to bring the economy from the ruins of the 1929 depression that causes in most western economies. In 1933 the Franklin Roosevelt restored the confidence of the people, to give them a sense that somebody was in charge. Today's political leaders, so far have failed utterly and catastrophically to project any sense of authority, to give the world any reason to believe that this country is being governed.

INDIAN ECONOMY UNDER GLOBAL TURMOIL

The global economic slow down started with the US, spread to Europe, and has now become a full-blown pandemic. It is no longer a crisis restricted to Wall Street, its representation now reverberate across the world. India is not insulated against the global turmoil. The biggest problem the country faces is uncertainty in demand projection, and lack of funding for long term capital expenditure. The financial meltdown has exposed a lot of excesses and speculation that was being built into the economic system. It India too, we had imported many of these excess into our system. Though India derives less than 14 per cent of its GDP from export, yet India was a big beneficiary of the very high global risk appetite over the past five years and is dependent on capital to fund its current account deficit. The bulk of this capital comes from financial markets and not from foreign direct investment (FDI), unlike in other large emerging markets. This makes India a relatively high beta equity market despite the low share of exports in GDP. And, the pure financial impact of funds being withdrawn obviously hurt the ability of the large Indian companies to finance themselves in the global market. Today many companies have become globally recognized, and have geographically and vertically distributed revenues. More than 400 large companies in India operate global treasuries, which implied that with a day's lag the

difficulties of London money market were visible in the Indian money market. The speed and spread of the liquidity crunch in India indicates that corporate finance is far more globalised than it was thought to be. Here is an explanation of how this sub-prime crisis comes home. A recent paper co-authored by Jahangir Aziz Ila Patnaik and Ajay Shah tries to explain the complex linkages between the seemingly unrelated events. Their hypothesis in brief: in trying to manage the exchange, growth and inflation, the central bank had kept the system chronically tight on liquidity. Several Indian companies that had been using the London money market fell short of dollar liquidity in mid September. So they borrowed on the money market and took the dollar out. At the same time, corporations were liquidating their holdings in mutual funds. Mutual funds, too, then started making claims on the money market, leading to a colossal shortage of liquidity. This was accentuated by factors such as advance tax payments and sale of dollars by RBI to prop up the rupee[14]. Is there a way to manage this extraordinary crisis? Jahangir Aziz, Ila Patnaik and Azaj Shah point to a four prolonged strategy – increase rupee liquidity, increase dollar liquidity, refrain from artificial exchange rate stability, and remove currency mismatches. Author Ajay Shah believes that RBI has moved quite a bit on providing rupee liquidity but the weakest links in the coming days will be dollar liquidity and currency mismatches. However, as M.M. Miyajwala, CFO, voltas, says : "In this scenario, normal measures by the RBI alone will not help. The lending rates are not coming down despite the central bank has cut the key rates. RBI's repo rate cut will not have any effect as the interest rates on government bonds are firming up. This means, even if RBI reduces the policy rates, taking advantage of inflation touching zero, it will not bring down the interest rates in the present condition. ICICI's former M.D. K.V. Kamath also said that firming up of the interest rate on government bond is not allowing lending rates to come down. Because of the rise in the bond rates, cost of fund is not reducing prompting banks to hold interest rates at higher levels. As the government's spending as part of the stimulus package would be financed from the borrowed money, this will affect the availability of funds to the private sector and create upward pressure on interest rates. Bankers are arguing the RBI should buy bonds from the market. As the inflation has fallen to 0.27 per cent during the week ending March 14, 2009 the government can inject liquidity without worrying about inflation. This would only help in bringing down the interest rates. Falling in interest rates will revive the demand and so the economic activities. Alongwith monitoring policy government must come out with fiscal policy. The top regulators said there was no reason to believe that India's regulatory system had cushioned the economy from the global meltdown seen in more developed markets. Rather, it was the absence of innovative and exotic products in India that saved the financial system. The answer is not merely restricted to their conservative nature and largely state financed penetration muscle. Indian banks are comparatively saved because of the following reasons:

1. An AFP study categorically states, "private sector banks narrowly reduced their prime lending rate with the range of 50-75 basis points against a relatively higher reduction by PSBs in the range of 75-125 basis point" SBI for instance has taken the lead to bring down home loan rates to 8 per cent and auto loans to 10 per cent.
2. The additional benefit gained early by Public Sector Banks (PSBs) is in their huge mobilsation of term deposits. Also matter of fact, SBI mobilized Rs. 400 billion in terms deposits through its special deposit mobilization scheme offering an interest rate of 10.5 per cent 11 per cent for senior citizen.
3. In addition to the robust growth in loans and treasury income, state run banks have also benefited from government benevolence— all Public Sector Units (PSUs) park 60 per cent of their surplus funds with PSB[15].
4. Majority of the banks are not facing any capital shortage at present and those PSBs that need capital infusion have already been promised the same by the government. Though some of them have reported a reduction in the total capital to risk weighted assets ratio (CRAR) or commonly known as capital adequacy ratio (CAR-the ratio of a banks capital to its assets) by around 30 to 80 basis points, primarily on account of operational risk, there are many who have reported a capital relief. According to the recent record report on "Trends and Progress of Banking in India 2007-08" by the RBI," the overall capital adequacy of all scheduled commercial banks (SCBs) was at 13 per cent as on March 31, 2008 well above the Basel II norm of 8 per cent and the stipulated norm of 9 per cent for banks in India.

But, overall out of 41 banks that migrated to Basel II accord last March 2008, 40 banks had CAR of more than 10 per cent and bank had close 10 per cent even at the time of transition. So considering this, no doubt the Indian banks are faring well as of now, but then going deeper into the Basel II matrix, one can easily figure out that matrix is not just about CAR. The Basel II has three "Pillars". While Pillar one relates to minimum capital requirements, pillar two is the supervisory review of capital adequacy, and Pillar three is all about market discipline. It is Pillar two that makes the Basel II Accord more comprehensive as it aims at eying the overall risk of an institution. It is said by many critics that "fundamental to the successful implementation of the Basel II norm is an inconvenient but necessary marriage of two of unmatched horoscopes-qualitative tools and quantitative standards, "the task of implementing the accord surely appears to be a tough one for the Indian banks. In fact this was the main reason for the delay in implementing Basel II Accord in the country (originally set for March 31, 2007)[15]

MEASURES

Whenever the present crisis is discussed, comparisons with the 1930s are made, but since the form of the present crisis is quite unlike that of 1929-30, its political outcomes are likely to be very different. Writing on the Great Depression in the 1930s, Lord Robbins saw four essential condition for recovery—business confidence had to be resorted by stabilizing currencies and foreign exchanges; all barriers to international trade had to be removed; all 'inflexible' elements in the economy, particularly wage rates which did not fall far enough, had to be eliminated; and to make recovery complete, governments should refrain from all interference in the economy. In fact, recovery took a quite different form; not a restoration of what had existed, but a development of the economic structure, in particular a great extension in the role of the state.

If the economy is drifting towards world recession, can it really be that the only escape from such depression is the restoration of high profits at the expense of the mass of real incomes? If the problem is obtaining funds for investment and expansion, why should the state not provide them and assume a commanding position in the economy, instead of using its resources to prop up ailing private companies[17].

EUROPEAN COMMISSION MEASURES

The European Commission has brought forward measures to strengthen capital requirements for banks, improve deposit guarantee and reinforce regulation of credit rating agencies. The Group of 20 summit in London will be a key moment to achieve results that will help end the present financial and economic crisis and prevent future ones. The G-20 has decided to work hard for agreement on four key issues:

1. A large, coordinated and sustainable economic stimulus, to limit the effects of the crisis on our citizens and he reignite the real economy.
2. Requires a comprehensive reform of international financial institutions. This includes restoring of trust and confidence in the financial system-not for the sake of the banks, but for the sake of entrepreneurs and workers in the real economy who need credit. Measures should be adopted to get banks lending again. This means ending the uncertainty over the scale of banks losses by removing so-called "impaired assets" from their balance sheets.
3. A strong message against all forms of protectionism and for opening up trade by moving ahead with the Doha talks, and
4. Reinforcing commitments to developing countries and to making the IMF more representative. Developing countries need extra help. They must not pay the price of a crisis created in developed one. A global instrument for trade finance is one step the EU is proposing.

Some people blame globalization. They advocate "de-globalisation" as the way out of this crisis. De-globalisation is not the way to overcome crisis instead we need to establish a global set of rules that allow us to master globalization. These rules must be based on values and ethical principles. They must combine freedom, responsibility and solidarity. They must make sure that markets reward hard work and initiative, not mere speculation. Protectionism and economic nationalism are false friends which fuel poverty and conflict: we saw that in 1930. The way out of the crisis is "reshaping globalization" corporate industry has to focus on four essential elements, cleaning the balance sheet, improving competitiveness, focusing on core business, and strengthening management.

Becoming global is a learning game. A transformational merger is a frequently employed strategy to become a global firm. Hindalco did exactly that with its 2007 acquisition of Novelist, a world leader in aluminium rolling and can recycling. Several other Indian firms, such as Arcelor Mittal, Tata tea and United Breweries, have also used acquisitions as a path to globalization.

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