

“The Impact of the Global Financial Crisis on the Economic Development, Trade, and Employment in Emerging Market Economies”

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Abstract

This research will focus primarily on the current financial crisis and its impact on economic growth, trade, and employment in emerging market economies (EMEs), particularly China and India. The emerging market economies are categorized as transitional, meaning they are changing from a closed market economy to an open market economy. This contrasts with the mature market economies, or established market economies. Neoliberal economic policies are thought to boost economic performance and improve the efficiency and transparency of the capital market in any economy where they are adopted.

The so-called "neoliberal economic policies" proponents have long argued that these measures are successful, and as proof they cite the fact that the Indian economy is growing quickly, the stock market is booming, and foreign reserves are at a comfortable level. The 'free trade' policy is responsible for making a variety of previously unimaginable goods accessible, which is evidence of the beneficial benefits of globalization. The idea of the market's "invisible hand" makes the assumption that it operates autonomously. The author has examined how the financial crisis has impacted the economic growth and various sectors of the economies of China and India using the most recent information and research that is available.

Keywords: Financial crisis, emerging market economies, India, China, neo-liberalism, FDI, growth rates and economic crisis.

Introduction

The continuing financial crisis, which began in August 2007 and has now moved to developing countries, was initially felt in the United States and other Western European nations. This article attempts to assess the impact of the current global financial crisis on China and India, two emerging economies. Since the populations of these two countries make for more than one-third of the world's population, researchers think that a thorough analysis of this subject is required. Additionally, both economies have experienced rapid economic growth ever since the adoption of neoliberal economic reforms, also known as "market-friendly" policies. As a result, the International Monetary Fund (IMF) and the World Bank have cited them as successful examples in the fight against unemployment and poverty (Winters and Yusef 2007; Dyer 2009a; Bradsher 2009).

Because of the effects of "decoupling," as well as because these economies have implemented market reforms that have increased their efficiency and competitiveness so that they can withstand such challenges, mainstream economists and international financial institutions predicted that the financial crisis in the United States would have a minimal or no impact on the emerging economies of China and India (The Economist 2008a; Wolf 2008; Boothe 2008; Bradsher 2009). However, both of these economies have been significantly impacted by the crisis, with China suffering. This article's goal is to look at the external factors that have been causing the current slowdown in growth in emerging economies.

According to Siddiqui (2008)b, "financial crisis" is a general phrase that may be used to describe a wide range of various situations. The real estate market, the banking industry, and, of course, recession are just a few of these instances. The world economic crisis initially hit the American subprime mortgage market in August 2007, and it swiftly spread to other markets in the United States and other European countries. A serious financial crisis including the bankruptcy of financial institutions like banks and insurance firms occurred in several industrialized countries quickly (The Economist 2008b and 2008c; Felton and Reinhart 2008). The major focus of the research will be on the current financial crisis and its impact on GDP, global trade, and employment in emerging market economies (EMEs), notably China and India. (The Economist 2009a; Wade 2009) China and India, for instance, have lately seen a sharp decline in the demand for exports, foreign institutional investments, and real estate prices.

The current financial crisis is having a severe impact on the economies of the emerging

markets, and this has been increasingly generally acknowledged in recent years. Such as "China's breakneck growth has stalled," according to "The Economist." The rest of East Asia, which had believed that it was somehow "decoupled" from the West's economic woes, has now learned that it has been hit as hard as everywhere else in the world, and in some cases worse.... In terms of both volume and velocity, the scope of this economic downturn is far greater than that of the financial crisis that took place in 1997–1998. When seasonal effects are taken into account, we can observe that China's gross domestic product, which increased by 13% in 2007, hardly increased at all in the last quarter of 2008. The estimated 10% annualized decline in Japan's gross domestic product for the same quarter. The Economist (2009b:10) states that South Korea is at 21% and Singapore is at 17%. It was emphasized that the impact would be felt primarily as a financial loss as a result of trade. The volume of trade and financial flows between the two countries may be used to gauge how "open" the economies of China and India are. The Economist (2009a) reports that less than 15% of India's GDP is accounted for by exports of goods, hence it was assumed that the impact on trade routes would be moderate. The 'free trade' policy is responsible for making a variety of previously unimaginable goods accessible, which is evidence of the beneficial benefits of globalization. The idea of the market's "invisible hand" makes the assumption that it operates autonomously. Contrarily, capitalism developed in western Europe throughout the 19th century via a process that included an active state to promote market forces. This was described as a "great transformation" process by Karl Polanyi in 1944, which was fueled by the "double movement" of the market and the state. During this time, the government had a significant role in setting the market's rules. As a result, the state clearly promoted the market's interests while simultaneously regulating it.

Emerging Market Economies

If a country's yearly income per capita is at least \$9,265 but less than that amount, it is regarded as having an emerging economy. The inclusion of both big and small countries is determined by this criterion. These economies are often in the process of transitioning from a closed economy to an open economy in order to integrate into the world economy. A low-to-middle per capita income economy is referred to as an emerging market economy (EME), a term originally used in 1981 by Antoine W. Van Agtmael of the World Bank's International Finance Corporation. These countries are home to around 20% of the world's economies and about 80% of the world's people. China is thus grouped with much smaller economies that have a lot fewer resources, despite the fact that it is one of the world's economic powerhouses (Arrighi 2007; Siddiqui 2009b; Dyer 2009a; Sachs 2009). Tunisia is a prime illustration of one such nation. Because both China and Tunisia have implemented growth and economic reform initiatives, as well as opened up their respective markets, both countries are included in this category.

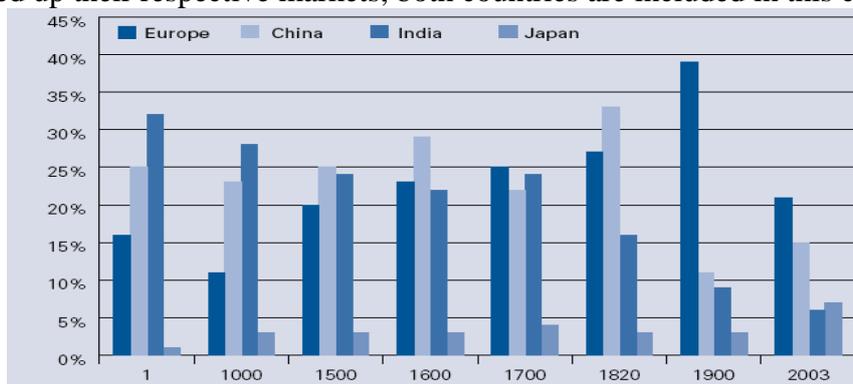
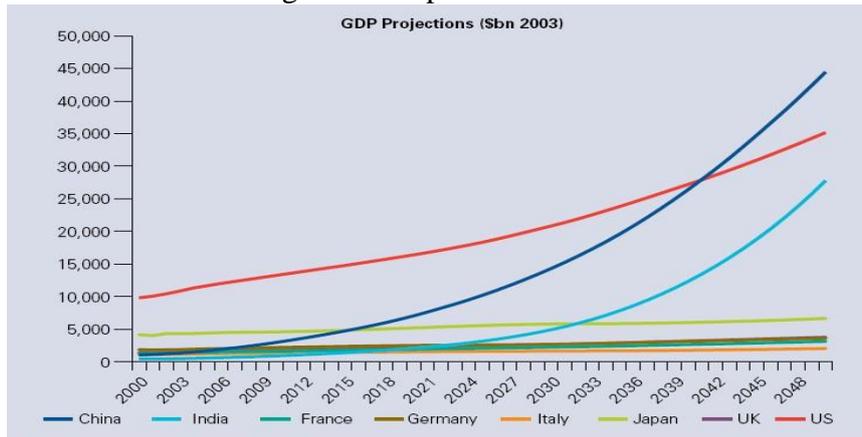


Figure 1. China and India's Gross Domestic Product Growth

However, examining the gross domestic product over a longer period of time and comparing it with the GDP of other countries, such as Europe and Japan, would be intriguing. The famous British economic historian Professor Maddison (2007) estimated the global GDP for a number of countries, which is divided into the categories indicated below, with regard to the subject of the historical proportion of world GDP growth. Figure 2 shows that during the last two millennia, China and India have contributed about half of the world's GDP together. Both countries, however, underwent a long-lasting era of relative decline starting in the 1800s. The

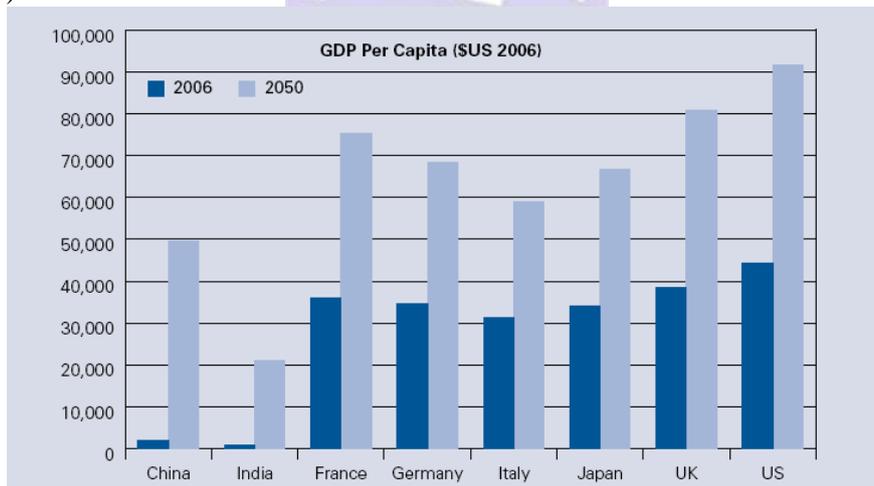
growth of European domination, the colonization of Asia, and the subjugation of its economies all occurred at the same time during this time period.



Source: Goldman Sachs, *Dreaming with the BRICS* (2003)

Figure 2: Historical Share of World GDP

China and India have experienced rapid economic growth in recent years, and the impact of this growth on the world economy has been significant in a number of ways, including the fact that not only have exports from these two countries increased, but also imports from these two countries have increased significantly, opening up new markets for western technology and capital investments. The UK only accounts for 3.3% of global GDP when evaluated using PPP, whereas China and India presently account for 10.8% and 4.6% of world GDP, respectively. More significantly, their rapid growth is quickly dictating world demand and accounts for almost 30% of the increase in global GDP since the year 2000. Both countries adopted "pro-market" policies in an effort to broaden their receptivity to foreign trade and investment. While India's trade with the rest of the world began to significantly expand in the early 1990s, China's trade with the rest of the world started to increase rapidly in the late 1970s. (BERR, 2009) China and India India and China China and India combined were responsible for almost 10% of the growth in world trade throughout the 1990s. Every ten years, China's share in world trade has almost doubled. India's share in world trade remained constant throughout the 1980s and 1990s, but it has started to grow more quickly over the last ten years (China and India, BERR, 2009).



Source: Goldman Sachs, *BRICs and Beyond* (2007)

Figure 3: Projected per Capita GDP Growth

Figure 3 illustrates how Goldman Sachs' (2003) projections were based on the too pessimistic assumption that the current period of robust economic growth would continue. Both China and India are expected to retain their present high rates of economic growth in the next decades. China is on course to overtake the United States as the world's largest economy by the year 2041, according to projections published by Goldman Sachs in 2003. China is also anticipated to become the world's second largest economy by the year 2016. By the year 2032, India will have surpassed Japan in terms of GDP. Despite the fact that these countries will grow

economically, their per capita incomes will remain be low compared to those of the developed economies.

Decoupling Theory

International financial institutions predicted that the global financial crisis would have a little impact on the economies of China and India at its inception in 2007. The "decoupling" of the economies of Asia and the West has been mentioned by mainstream economists in accord with these points of view. According to Nocera (2008) and Rodrik (2006), China and India have already shown to be viable alternatives for the global economy. On the other hand, recent statistics show that China has been significantly hit by the global economic crisis, as demonstrated by a decline in its exports and a noticeably higher number of manufacturing jobs lost (IMF 2009; Krugman 2009). China is not one of the potential alternative growth markets. Additionally, when the crisis in the United States became apparent, the Indian government, for instance, quickly reassured both domestic and foreign investors that their financial system was safely isolated from that of western economies and that the impressive growth that many had witnessed was most likely not going to be impacted. This happened as soon as the crisis was made apparent in the US. The International Monetary Fund (IMF) and the renowned business publication *The Economist* both supported the "decoupling theory," which served as the foundation for this (*The Economist* 2008a). This theory held that local factors primarily determined growth in Asia and that these factors were independent of Western tendencies. This theory further proposed that these factors were unrelated to one another. China and India would continue to be the growth engines in Asia, and they would also act as a shock absorber for the western economies, maybe even helping them to emerge from recession (Nocera, 2008). This would be because Asia's growth engines wouldn't just keep running.

At first, it was thought that the present global financial crisis would not significantly impact China and India. To begin with, it was assumed that the U.S. economy's downturn was only linked to the housing sector and would thus have a less significant impact on the economy as a whole. Second, it was said that trade between emerging markets had become more important than it had been in the past, while trade between emerging economies and the United States had become less important. Thirdly, emerging economies were net savers rather than borrowers in the world economy, and fourth, these economies had experienced neo-liberal economic reforms during the past several decades, which had made them more competitive and efficient. It would seem that an economy facing a global economic crisis is impacted by a higher degree of financial integration in three different ways. These consequences include a decline in stock prices, a reduction in local liquidity, and a limitation on access to foreign finance for businesses. It will be increasingly difficult to get commercial loans from other countries. The economy will be impacted by both foreign institutional investment (FII) and foreign direct investment (FDI). These inflows may be partly responsible for the growth of the nation's foreign exchange reserves. For instance, foreign institutional investor (FII) inflows into India decreased from \$15.5 billion to 6.6 billion over the same time period in 2007-2008 to 2008-2009.

(Jacques 2009; Winters and Yusef 2007; Wolf 2008) It has been proposed that China would use its two trillion dollars' worth of foreign reserves to salvage the collapsing American financial system. However, these anticipations are wholly imaginary. In the not-too-distant future, I find it difficult to imagine that China will overtake the United States as the main driver of growth for the world economy. This is primarily because exports have been China's main growth engine, which has in turn attracted several other East Asian countries to it in a manufacturing chain. For instance, more than half of China's total exports are sent to the United States, the European Union, and Japan combined. It is certain that the recession's worsening effects would have an impact on China's exports and overall economic activity. The Chinese government is striving to boost domestic demand in the nation. However, it won't result in world-wide demand levels that even remotely approach alleviating the shortfall brought on by the Western recession. Additionally, China's share of global imports is still insufficient for it to serve as an economic growth engine comparable to that of the US economy.

Falling Growth and Employment

The IMF's 2007 and 2009 projections for growth in the whole Asian region, as well as The

Economist's 2009a and 2009b reports, have all been significantly revised to the upside. The International Monetary Fund (IMF) anticipated that Asia's emerging economies, which grew collectively at rates of 10.6% in 2007 and 7.8% in 2008, would only grow at a pace of 5.5% in 2009 (IMF 2009). The Chinese government estimates that more than 20 million rural migrant workers have lost their jobs as a direct result of the decline in industrial productivity. The decline in growth rates has a detrimental impact on the demand for electricity and raw resources. For instance, after expanding by 15% per year on average since 2003, China's electricity production decreased by 6% in 2008. This shows that the Chinese economy has not been growing at the 9% rate that the IMF said it would in 2008. Even 5% growth wouldn't be enough to keep unemployment at its present rate (Wade 2009).

The amount of net capital flows to emerging markets will decrease to around 165 billion US dollars in 2009 from 929 billion US dollars in 2007, according to the International Monetary Fund (2009). Beattie (2009) asserts that it is anticipated that commercial bank lending would turn around. The most recent IMF forecast for 2009–10 indicates that the pace of global growth would sharply decline to negative rates, as shown in Chart 1 below. This would also suggest that there would be a decline in the demand for goods made in emerging markets, which would result in a decrease in the demand for exports. In emerging economies like China and India, it would have a detrimental impact on employment and income levels as a result.

As a whole, the economies of Asia, which had become dependent on the export of manufactured goods to the markets in the West, are seeing a sharp decline in the production of goods intended for export as well as an increase in the rate of unemployment. Taiwan's export decline, for instance, was 40% in December 2008 when compared to the same month previous year. Not only are the export industries in Indonesia, the fourth most populous nation in the world, cutting back on production, but tens of thousands of migrant workers are also coming home after losing their jobs in nearby countries like Singapore and Malaysia, which is contributing to the country's rising unemployment rate (Bradsher 2009a and also 2009b).

Crisis of Neo-liberalism

Anglo-American capitalism, sometimes referred to as the neo-liberal or free market concept, has dominated economic theory in western countries for the majority of the last 25 years. This theory is based on the dominance of global finance, which has been demonstrated to influence western governments' views in favor of policy regimes that benefit the financial sector (Harvey 2006; Glyn 2006). The liberalization of trade, the economy as a whole, and financial markets are the three main principles of neoliberalism, together with the enforcement of "sound finance" via the reduction or elimination of significant budget deficits. Harvey (2006) asserts that the current financial crisis has irreversibly harmed the neoliberal conceptual framework's credibility.

Latin America has sold more goods by value than any other region since the 1980s, and this occurs in developing countries under the pretense of privatization. It was a political decision to withdraw the state from business as highly indebted governments implemented the structural adjustments needed by the IMF in order to receive fresh loans (Glyn 2006). The decision to exclude the state from business was political since external influence had a significant impact. When individuals speak about globalization, they are referring to the implementation of policies like privatization, deregulation, and liberalization as well as the laissez-faire philosophy.

The liberalization of trade is a key element of neoliberalism. The question that has to be addressed is why Britain had such a keen interest in the adoption of "free trade" policies. Regarding the liberalization of foreign direct investment and trade Friedrich List (1833), writing in the early 19th century, makes the case that the theory is essentially defective and rife with errors. According to his understanding, this represents the interests of industrialized countries, which are those that have made a name for themselves as global manufacturing leaders. The reasons why British industrial capital needed such things at such a young age, such as a strong drive to export and push towards foreign markets, were well explained by Karl Marx in 1961. He emphasized that the small size of the British domestic market, the steam engine's associated economies of scale, and increases in productivity resulting from better

organizational practices in use in new factories were all factors in the rise in productivity. When capital had accumulated to the point that exporting capital together with goods was essential, the process started. The importance of this part of external economic growth soon increased, helping them establish themselves as structural elements of the world economy.

John Maynard Keynes already created capitalist market economies, if they are allowed to. It could be useful to take a second, more thorough look at government policy in Britain's early industrialization. The industrial revolution that occurred in England in the second half of the 18th and the first half of the 19th centuries is described by Polanyi (1944). Although the economy was entirely commercial, it was not yet fully market-organized when this transformation occurred. Markets were locations where people bought and sold goods. These were interpersonal interactions that were organized around the price, value, and quantity of the goods and services being traded. Britain's quick commercialization during this time period was facilitated by cottage industries, paid farm labor, and brisk city trade. The bulk of the populace was able to make money as a result and trade it for the goods that were being offered. The administration and regulation of markets by governments and other groups, however, was widespread and usual at the time, as Polanyi also noted. In addition, the relationship between business and industry changed as a result of a rapidly expanding industrial system. The philosophy known as "laissez faire" is described by Polanyi as having "[b]orn as a mere penchant for non-bureaucratic methods...[and] evolved into a veritable faith in man's secular salvation through a self-regulating market" (Polanyi 1944:135). This happened despite the fact that the concept endangered the current social structure. The enclosures in the 1790s, the reform of the poor law in 1834, the Bank Charter Act in 1844, and the abolition of the Corn Laws in 1846 are only a few of the examples of government participation in British history that he highlights (Polanyi 1944).

Instead of sales in the local market, exports have received a lot of attention in recent years. In so-called "emerging markets," where the so-called successful sectors are another factor causing economic dualism, this tendency is likely to have acquired even greater traction. Due to the burden of foreign debt and increasing pressure from the International Monetary Fund (IMF) to increase exports in order to pay off the debts, this has happened. Additionally, it is related to the fact that there is insufficient domestic demand, which is the source of the skewed pattern that is emerging. As an example, despite the fact that children are dying in what is regarded as one of the world's "bread baskets," agro-food companies are booming in Brazil. Professor Bush (2007) asserts that "Although trade, debt relief, and development initiatives are important, they do not alter the structure of the market economy and the poverty that is created by the process of trade, liberalization, and market reform" in his analysis of the impact of two decades of neoliberal policy in sub-Saharan African countries.

Conclusion

Our research has led us to the conclusion that the slowdown in growth rates that is happening in developed countries as a direct result of the present financial crisis would have a significant and detrimental impact on emerging economies like China and India. For instance, India's industrial output had a significant decline in March 2009, falling to a growth rate of -2.3%. In this context, the manufacturing sector, which makes up around 80% of the Index of Industrial Production (IIP) weight, had a decline of minus 3.3%. The global economic prospects (GEP) study indicates that India's current growth rate for this year is 5.5%, and it predicts that it would decline to 4% the next year, contrary to claims made by the government on the country's GDP growth rates. The employment situation would be further devastated by this, and India's poverty level will rise as a result of the abrupt decline in growth. According to the GEP, more than a quarter of Indians who are considered to be "living in extreme poverty" subsist on less than US\$1.25 per day, putting India just slightly ahead of Sub-Saharan Africa in terms of population below the poverty line. This will have a severe impact on employment even further. Additionally, the level of poverty in India will rise as a result of this abrupt decline in growth. On a national as well as a global level, there has been a lot of expectation since the start of this decade due to a significant increase in growth rates in the economies of China and India. Any decline in growth rates would not only result in an increase in unemployment, but it will also

create combustible conditions, such as a growing divide between urban and rural areas and across regions. High expectations are the result of 25 years of rapid economic growth in China's case and 17 years of rapid economic growth in India's case. The growth of the economy may be responsible for the quickening of social change and the escalation of internal conflicts between people and areas. The economy will slow down, and social unrest will increase as a result. (Jacques 2009; Winters and Yusef 2007; Wolf 2008) It has been proposed that China would use its two trillion dollars' worth of foreign reserves to salvage the collapsing American financial system. However, these anticipations are wholly imaginary. In the not-too-distant future, I find it difficult to imagine that China will overtake the United States as the main driver of growth for the world economy. This is primarily because exports have been China's main growth engine, which has in turn attracted several other East Asian countries to it in a manufacturing chain. For instance, more than half of China's exports go to the United States, the European Union, and Japan combined. There is little doubt that the recession's impact on China's exports and economic activity will deteriorate as it persists.

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