

A Comparative Assessment of How Trade Liberalization and the Economic Crisis have impacted India and South Africa¹

It is widely accepted that though the financial and economic crisis broke out in the United States and mainly engulfed the developed industrial countries in 2008, its impact was significant across the globe. This was not surprising because the last three decades have been ones in which almost all countries have seen an increase in their degree of integration with the rest of the world economy, resulting from the liberalisation of trade in goods and services and reduced restrictions on the cross-border flow of capital. However, the generalised effect of the crisis neither meant that the extent and nature of the impact was the same across countries, nor that the recovery from the crisis induced recession was simultaneous or similarly robust. This note is concerned with comparing the impact of the crisis on two large countries located in very different contexts, namely India and South Africa.

When the crisis broke out, both India and South Africa were among the main countries that appeared to be less vulnerable due to the minimal exposure of their banking and financial systems to toxic assets that had lost value as a result of the financial implosion. Moreover, the central banks and the governments in these countries had, as part of efforts at financial restructuring and reform, recapitalised their banks and cleaned up their balance sheets through measures to reduce the volume of non-performing assets. Therefore, there was a perception that the crisis was more a problem for developed countries than for emerging economies like South Africa and India.

However, even if direct exposure to toxic assets was not a problem, it was to be expected that in the more globalised context of the new millennium, no country can consider itself as being insulated from a crisis. Some impact was inevitable, independent of the epicentre of the crisis, particularly if that epicentre happens to be the principal markets and principal financial centres of the world. Not surprisingly, it soon became clear, in the case of both these countries, that they were not immune to the effects of the crisis. An obvious way in which those effects were felt was through the deceleration in trade growth resulting from the global economic slowdown. The impact of course differed between the two countries. While both countries were significantly integrated with the world system, South Africa's "dependence" on external markets was substantially more than India's. According to the World Bank's *World Development Indicators* database, the exports of goods and services in 2008 amounted to a little more than 35 per cent in South Africa, while it stood at slightly less than 23 per cent in the case of India. This obvious form of transmission of the effects of the crisis indicates that it was of greater relevance for South Africa than for India.

A second way in which both countries were affected was through the outflow of capital. As a result of three decades of financial liberalisation

¹ This comparative analysis is based on two detailed background papers prepared by: Chandrasekhar, C.P. (2010). Trade Integration and Labour Market Trends in India, ICTSD Programme on Competitiveness and Sustainable Development, Issue Paper No. 16 ; Borat, Haroon and van der Westhuizen, Carlene and Goga, Sumayya, The Determinants of the Labour Demand Shifts in South Africa: The Role of International Trade, Technology and Structural Change, ICTSD Programme on Competitiveness and Development, Issue Paper No. 17, (2010).



and long stints of positive and even creditable GDP growth, both nations had become targets of significant flows of foreign direct and portfolio investments. In the context of the crisis, not only did new additional flows dry up but foreign investors, needing to cover losses and meet commitments at home, chose to book profits in emerging markets and repatriate capital. The impact is quite visible in both cases. In India, net flows of portfolio equity capital turned from a positive \$35 billion in 2007 to a negative \$15 billion in 2008. South Africa was less affected by this kind of turnaround since it had not experienced as much of a surge in inflows as India had. Net portfolio equity inflows in its case fell from a positive \$8.7 billion to a negative \$4.7 billion between 2007 and 2008. In the case of portfolio bonds, inflows into India fell from \$9.2 billion to \$1.8 billion over these two years, and into South Africa from \$4.6 billion to a negative 0.7 billion.

Besides the direct impact this had on stock and debt markets, the result of the sudden reversal of capital flows was a liquidity crunch. With growth in most emerging markets dependent on easy liquidity conditions and the credit financed expansion in housing and consumption demand that those conditions entail, a crunch of this kind can squeeze domestic final demand and aggravate the effects of an export slowdown.

Not surprisingly, both countries experienced a slowdown in growth starting around the third quarter of 2008. In October of 2008, South Africa experienced its first recession in almost seventeen years which significantly changed the course of not only the growth path of the economy, since South Africa's economy had grown at an average of almost five percent annually between 2001 and 2007. Additionally, India which had experienced acceleration in its growth rates from the 6 per cent rate of the 1990s to close to a 9 per cent average over the five year period ending in 2007-08, recorded a decline in GDP growth to 6.7 per cent during 2008-09. Moreover, as detailed below, the impact on employment of the crisis was particularly adverse in both countries.

The impact on GDP growth seems to have been more dramatic in the case of South Africa, possibly because of its greater dependence on world markets. South Africa's GDP growth fell from 5.1 per cent to 3.1 per cent between 2007 and 2008. As a result, the South African economy contracted by 1.8 per cent in 2009. In India's case the comparable figures were 9.2 per cent in 2007-08, 6.7 per cent in 2008-09 and an estimated 7.3 per cent in 2009-10. While this does signify a deceleration in growth it hardly constitutes a growth crisis.

What is noteworthy in both these cases is the rapidity with which the economic decline bottomed out and the robustness of the subsequent recovery, although growth is not back to the levels touched in the immediately

preceding boom. This combination of a limited impact of the crisis and a quick and robust recovery is, in the case of both countries, the result an aggregation of fortuitous factors and policy responses. The incidental factor for South Africa was the huge expenditure incurred to host the football World Cup, which turned out to be a major stimulus to the economy and a stabilising factor in the context of the crisis. In India, the fortuitous factor was that the crisis coincided with the year in which the government had to pay out large arrears and incur a substantially higher salary bill, due to its commitment to implement the recommendations of the Sixth Pay Commission for civil servants required to be set up once every ten years.

The policy factor was the fiscal stimulus adopted by the governments of South Africa and India in response to the crisis. While it is difficult to clearly separate the relative size of the fortuitous and policy-driven components of the stimulus, it is clear for both countries that the fortuitous factor dominated. Further, in the case of both nations, various tax concessions and enhanced credit provisions (rather than just expanded government expenditure) played a significant part in the policy driven stimulus. However, in India's case, for example, schemes such as the National Rural Employment Guarantee Scheme, which guarantees at least 100 days of employment per rural household per year, in fact, directly addressed the unemployment that would have resulted from the downturn.

Employment during the crisis and after

This raises the question which is the immediate concern of this paper. What were the effects of the crisis and the stimulus package (fortuitous or policy driven) on employment in the two countries? One difficulty in making a comparative assessment of the impact of the crisis on employment in the two countries is that, while South Africa has a quarterly survey of the employment/unemployment situation, India, as of yet, does not. In India's case, surveys conducted on a quinquennial basis provide the data for assessments of labour market trends, though some (non-comparable) data is available annually. The last quinquennial survey was in 2004-05 and the next one is currently underway. On the other hand the data for individual years is available only up until 2007-08, which predates the crisis. Hence, an assessment of the employment impact in India must rely on less robust, "quick" surveys undertaken by the Labour Bureau of the government in the aftermath of the crisis.

The crisis and employment in South Africa

In the last quarter of 2008, South Africa reported its first significant decline in seasonally adjusted, annualised quarterly gross domestic product growth rate of -0.73 per

cent, thus ending 17 years of positive economic growth for the economy. As expected, the contraction in GDP was coupled with an equally unimpressive employment performance. Hence, employment growth became negative in quarter one of 2009, with a growth rate of -1.5 per cent. The decline continued for at least three consecutive periods at an increasing rate, ending with a sharp decrease of 3.64 per cent in the third quarter of the same year.

The annualised figures suggest that in the pre-crisis period, GDP grew on average at 4.54 per cent annually between 2001 and 2007, while employment grew by 3.24 per cent. GDP growth dropped to -2.54 per cent over the period of 2008 to 2009, while employment declined at -5.64 percent in the post-crisis period. The simple output elasticity of total employment for the pre-crisis period is 0.73, indicating that for every one percent growth in GDP, total employment increased by 0.73 per cent. In periods of recession though, as in the post-crisis period here, the simple output elasticity of total employment is interpreted as for every one per cent decrease in GDP, total employment decreased by 2.22 per cent.

There is a clear difference between employment and total value added movements across different sectors. In particular, the manufacturing industry witnessed the most severe decline in output relative to all industries in the post-crisis period at -12.42 per cent. Similarly, the primary sector also shrank at an average of 6.13 per cent and lost 129 000 jobs in total since the recession struck. However, the construction industry experienced a noticeable counter-cyclical trend, expanding at 7.9 per cent in total value added, possibly influenced by the public infrastructure expansion programme and preparations for the World Cup.

The data also shows that Agriculture experienced a severe contraction in output as total value-added declined by close to six per cent after the second quarter of 2008. Employment in agriculture fell by close to 15 per cent. The large job losses in wholesale and retail trade, where employment declined by ten per cent and output by three per cent, reflect on the collapse in domestic demand as the crisis struck. These sectoral results also implied that the impact of the crisis on informal sector employment was particularly adverse.

In terms of numbers, the effect of the weakened economy resulted, in the first instance, in almost 800 000 workers losing their jobs over the period of October 2008 to October 2009. While there was strong, positive employment growth during the pre-crisis period, there was an unprecedented collapse in employment with the onset of the recession. The evidence also showed that informal sector workers represented 28.15 per cent of the total fall in employment during the post-crisis period, and that employment shifts for the informal sector were

significantly higher when compared with changes in total employment. Informal sector employment declined by almost ten per cent, while total employment declined by 5.64 per cent between the third quarter of 2008 and the third quarter of 2009. In sum, the results suggest that it is in general, those participants deemed most dispensable by employers who have been most deleteriously affected by this downturn in the domestic economy, as well as those in less stable, less secure informal sector jobs.

The crisis and employment in India

As noted earlier, assessing the employment effects of the crisis in India is difficult because of the absence of extensive survey data on employment. However, in response to the crisis the government commissioned a series of quarterly reports on employment by the Labour Bureau, which were described as “quick, thin surveys” (available at www.labourbureau.nic.in), the first of these being related to the last quarter of 2008. The surveys showed that by early 2009 the adverse employment effects in India resulting from the merchandise export decline were evident. The first of the surveys that covered 2581 units in eight sectors by the Labour Bureau, Shimla, estimated that total employment in the sectors covered declined from 16.2 million during September 2008 to 15.7 million during December 2008, implying a job loss of about half a million. An update on that survey, which covered around 25 per cent of the original limited sample in six sectors, estimated that in January 2009 the rate of decline in employment was higher than the average monthly rate of decline during the previous quarter and that job losses in the non-export sectors were now more severe than before. Even though these estimates are by no means reliable or definitive, they are indicative of the trends under way. While decreases in employment levels were predictably higher in the export-oriented sectors, it is noteworthy that these surveys found job losses increasing in activities that cater dominantly to the domestic market as well.

In addition to quantity adjustment in the labour market, workers' incomes were also hit, with reports of falling real - and sometimes even nominal - wages of workers in industry and services as well as reduced incomes of self-employed workers, who constituted more than half of the work force by 2005. Agriculturalists, especially those producing export crops, whose prices had collapsed, faced growing difficulties on top of their existing financial problems reflecting rising input costs and large debt burdens. Meanwhile, liquidity trap conditions were evident as “secure” borrowers were unwilling to invest because of greater uncertainty. Small scale producers in all sectors were squeezed by the pincer movement of falling demand and credit crunch as even informal sources of credit dried up. Since these producers account for the bulk of employment in manufacturing and services and typically hire workers on informal casual contracts, their

economic difficulties translate directly into reduced employment. Surveys of home-based workers reported rapidly declining orders and falling piece rate wages, even in nominal terms, for work that formed a part of wider production chains for both domestic and export markets. As in the case of South Africa, the impact of the crisis on informal sector employment appears to be substantial in India, though there is a lack of convincing evidence to demonstrate this.

The striking feature in the Indian case is the quick reversal of employment decline. The second quarterly survey found that as compared to the October-December 2008 quarter, during which about half a million workers had lost their jobs, employment in selected sectors had increased by a quarter of a million during the January-March 2009 period. After some sign of loss of dynamism in the third survey, this early reversal of employment decline was sustained and improved upon as a result of the stimuli discussed above. By the time of the quick quarterly survey relating to January to March 2010, overall employment in the eight selected sectors covered in the quarterly surveys had increased by 1.07 million between March 2009 and March 2010. What is surprising is that out of the total increase of 1.07 million in the employment of all sectors covered, an increase of 0.8 million is in the export units. The main contributors here are India's flagship IT services and Business Process Outsourcing sectors, which were export sectors where employment increased by 0.54 million during this period. Clearly, the bail out of the global financial sector played a role in reviving demand for these services in which India has an export advantage. Therefore, it is likely that the recovery in employment in the South African case may not have been as sharp as in India.

Some implications

There are many implications of the above analysis. To start with, it is clear that India and South Africa were impacted by the global crisis not because of their exposure and entanglements with the markets, institutions, and instruments that were at the centre

of that crisis, but because of their integration through trade and capital flows with the global economy. Given the importance of the domestic market in these economies, this meant that while the impact was significant, it was not debilitating. Second, the impact was felt not just on output but on employment, especially employment for the more vulnerable sectors dependent on the informal economy. Third, given the depth and duration of the crisis in the developed economies, the impact of the crisis on India and South Africa would have been far more severe if they had waited for a global revival and turn around to extricate themselves from the crisis. Fourth, both countries limited the impact of the crisis on their economies with what amounted to be a counter cyclical response, in the form of a fiscal and economic stimulus reflected in both enhanced government expenditures and in tax concessions, compensatory support and credit provision for domestic producers. Fifth, given the fiscal policy inclinations of the respective governments, the enhanced expenditures would not have been as large as they were but for the fortuitous coincidence of expenditure increases necessitated by the Sixth Pay Commission's recommendations in India and the World Cup in South Africa. Finally, the benefits of the global response to the crisis sat on top of this domestic effort, with export benefits, which were substantial as in the case of the BPO sector in India.

The net result of all this is that, while initially affected, India and South Africa, have weathered the storm. But this experience indicates that both countries must contemplate ways of calibrating their integration with the global system and relying more on an expanded domestic market to sustain growth, so as to render that growth more stable. Moreover, it is time that they think of enhancing the long term relationship between output increases and employment increases as well as of putting in place appropriate social protection measures so that future crises, if and when they occur, would be even less of a danger to the vulnerable among their populations.

About the International Centre for Trade and Sustainable Development

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