Global Financial and Economic Crisis: Implications for Trade and Industrial Restructuring in South Asia

Prabir De
Fellow
Research and Information System for Developing Countries (RIS)
India Habitat Centre
Lodhi Road
New Delhi

&

Chiranjib Neogi
Associate Scientist
Economic Research Unit
Indian Statistical Institute (ISI)
203 B T Road
Calcutta

Abstract
This study investigates the impact of global crisis shocks on South Asia’s trade and industry. We use both panel data modeling (PDM) and Vector Autoregression (VAR) techniques to understand the dynamic effects of global crisis shocks on Indian industry and trade. The estimated results of panel data models show that changes in trade composition are positively associated with changes in manufacturing composition in India, controlling for other variables. However, there is no strong indication to conclude that Indian industry has been severely affected by the fall in demand in crisis-affected advanced economies such as US, EU and Japan, holding other things constant. Since there may be lag(s) between changes in composition in export and industry, the study then explores the dynamic effects of global crisis shocks on Indian industry and trade with the help of Vector Autoregression (VAR) techniques. The findings of the study indicate that the compositional change in industry has responded significantly to the export to USA, Japan and EU in the crisis period. Variance decomposition of compositional change in industry reveals that during the pre-crisis period almost 100 percent of the variation in compositional change in industry depended on its own variation, while in the crisis period about 20 percent of the variation in compositional change in industry has depended on the exports to EU, Japan and US. Therefore, the effect of shocks of India’s exports to advanced economies during the crisis period has been transmitted to Indian industrial sector. However, Indian industry has not responded significantly to the shocks of imports from the advanced economies, while the response to its own shocks is significant during both pre- and post- crisis periods. The study also indicates that India’s trade openness has responded mildly to the shock of export to the US. India’s trade with the US coupled with US GDP significantly contribute to the variability of India’s trade openness in the crisis period, accounting for 40 percent of the variation of the trade-GDP ratio of India, whereas the same of EU and Japan have either
no effect or very insignificant effect on India’s trade openness. This study suggests that Indian industry has not been significantly affected by the ongoing global crisis. Even though India continues to enjoy relatively large domestic demand, the compositional change (positive) in the manufacturing sector would become less if the crisis continues, resulting in a slowdown in growth and a rise in stagnancy.

**Key words:** Global crisis, Vector Autoregression (VAR), Panel Data Model (PDM), Trade, Industrial composition, Trade openness, India, South Asia

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