Editorial: Contemporary Issues in Global Economy and Policy Analysis

Sushanta Mallick
Srijit Mishra, Indira Gandhi Institute of Development Research

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CONTEMPORARY ISSUES IN GLOBAL ECONOMY AND POLICY ANALYSIS

Guest Editors:

Dr. Sushanta Mallick
School of Business and Management, Queen Mary, University of London, Mile End Road, London E1 4NS, UK
E-mail: s.k.mallick@qmul.ac.uk
Website: http://webspace.qmul.ac.uk/skmallick/

Dr. Srijit Mishra
Indira Gandhi Institute of Development Research (IGIDR), General Arun Kumar Vaidya Marg, Goregaon (E), Mumbai 400 065, India
E-mail: srijit@igidr.ac.in
Website: http://works.bepress.com/srijit_mishra

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1 Introduction

This special issue of International Journal of Trade and Global Markets (IJTGM) includes six papers about contemporary policy issues in emerging markets, selected through a peer-review process from 35 papers presented at the international conference on quantitative approaches to public policy in honour of Professor T. Krishna Kumar.¹

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The motivation for this special issue stems from Professor Krishna Kumar’s contribution in the area of econometric policy modelling, and how they have shaped his professional career, while focusing on emerging fiscal and financial issues in the global economy so as to aid us in suitable economic policy designs. In the light of the recent financial crisis, assessing how stability and growth in the emerging markets are affected by greater capital mobility is critical for the appropriate economic policy design for these countries.

In times of worldwide crisis, there is an urgent call for innovative solutions that should move forward the growth process and assist countries in overcoming the crisis in the immediate short-run and later accelerating the recovery and growth. There is a need for thorough understanding of major current problems before putting forward the solutions in these challenging times, which require non-standard solutions. The key issues discussed here include the role of fiscal policy and debt sustainability, financial regulation, trade financing and macroeconomic policy, in general, thus contributing to our understanding of the effects of different policies to minimise instability and enhance growth in emerging markets.

The first paper focuses on the economic impact of deficits and debt in emerging markets. Ashima Goyal in her paper adopts a Small Open Emerging Market Economy Model (SOEMEM) to investigate how rising fiscal deficits in the context of high debt ratios can trigger a sudden stop or even reversal of capital flows in an emerging market. These features were found together in early currency crises. Countries in these episodes had low private savings rates and low population densities. But, higher private savings can compensate for government dis-saving and reduce pressure on balance of payments. Second, in emerging markets with high population density, sustainable debts and deficits may be higher in a catch-up phase. Analysis of the evolution of government debt shows how debt ratios fall with growth rates. An optimising SOEMEM with dualistic labour markets and two types of consumers shows that debt ratios would tend to be higher in high growth phases in such emerging markets, and the conditions under which fiscal and monetary coordination can occur. The paper concludes with some application to and assessment of Indian debt and deficit ratios.

In the second paper, T.V.S. Ramamohan Rao investigates the financial regulatory system relating to the effects of recent financial meltdown. Securitisation, as a structured financial instrument, can give rise to excessive risk taking by the originator. It was expected that credit-rating agencies will assist the Special Purpose Vehicles (SPVs) and investors by revealing the risk. However, given that they pursue their own objectives of increasing business volume and revenue, credit-rating agencies will not concentrate on investor risks though they claim to do so. This paper defines regulatory practices against this backdrop. Two types of instruments have been considered, viz., an aggressive regulation that monitors and regulates the credit-rating agencies and another less aggressive regulation or selective regulation that is pressed into service only when miscalculation is suspected. The other dichotomy is to utilise ex ante or ex post regulatory measures. It is also obvious that regulatory measures can be directed to the originator, SPV or the credit-rating agency. A comparative evaluation has been made to arrive at an efficient design of regulatory mechanisms and to derive the implied credit ratings. In particular, the author shows that an efficient regulatory practice should require a deposit, proportional to the amount of receivables being securitised, from the originator.

The next paper is on firm-level financing by Elena Goldman and P.V. Viswanath, examining the extent to which Indian exporting firms are debt or equity financed. If external demand has a low correlation with domestic demand, export-intensive firms
can have greater cash flow stability than firms that only sell domestically, allowing them to have greater financial leverage. The paper tests this hypothesis by looking at a sample of Indian firms and finds that exporters do use debt financing to a greater extent. Since most debt financing is external, this also means that exporting firms are able to use more external finance. Thus, increased access to export markets has allowed Indian firms to exploit debt financing more and thus to reduce the cost of capital.

The fourth paper by Vinish Kathuria, S.N. Rajesh Raj and Kunal Sen provides a quantitative treatment on the issue of state–business relation and firm performance using data from India. It is commonly argued that a reform regime of providing better investment climate – i.e., lower distortions in the institutional, policy and regulatory environment in which firms operate – lead to discernible improvements in firm performance. In this paper, the authors argue that effective state–business relations determine better investment climate outcomes and thereby overall firm performance. The paper examines the positive effect of good state–business relations on Total Factor Productivity (TFP) and finds support for this hypothesis for firms in the formal sector in India for the years 2000–2001 and 2004–2005.

The fifth paper by K.N. Murty and A. Soumya develops a macroeconometric model to investigate the effect of public investment in infrastructure on the Indian economy. The model simulations suggest that stepping-up public investment in infrastructure has a beneficial effect of stimulating aggregate investment and jump-starting growth, particularly when an economy is faced with an economic downturn. Public investment through commercial bank borrowing seems to have an advantage over other ways of financing investment in India.

Finally, Keshab Bhattarai in his paper evaluates alternative macroeconomic models – standard econometric models (structural and time series) and stochastic dynamic general equilibrium models – for policy evaluations. It is clearly understood in the literature that the early macroeconometric models lack proper microfoundations and known to perform poorly while estimated for policy evaluations and forecasting. Yet, using large-scale econometric models were very popular until Lucas critique became a standard criterion in judging them, making way for the development of pure time series models, which although performed better but remained small in dimension. Subsequently, Dynamic Stochastic General Equilibrium (DSGE) framework initiated by real business cycle researchers with solid microfoundations became the standard approach. In this framework, given policy shocks, an artificial macromodel generates time series that mimic real economy in terms of various moments. Interestingly, the author in this paper claims that the standard econometric models and the stochastic general equilibrium models could be complementary to each other in macroeconomic policy evaluation exercises.

Overall, the papers in this special issue focus on questions related to fiscal and private finance for growth and stability, and aim to contribute to the broader debate about designing the appropriate economic policies in emerging and low-income developing economies. The diversity of issues analysed in the papers provide us with a rather good insight into the problems facing governments in low-income economies. The papers included in this issue are indeed topical with the application of cutting-edge econometric methodologies. Besides, the papers reflect the current challenges facing the global economy, providing relevant evidence with appropriate policy implications to improve the future growth potential of the emerging market economies.
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Note

1Publication of a selected set of papers presented in the conference is part of a larger exercise. Apart from the six being published here, six more have been published in a special issue, ‘Emerging issues in Development and Sectoral Performance’, of the International Journal of Economic Policy in Emerging Economies (Vol. 3, No. 3, 2010) and four are under consideration at the Journal of Quantitative Economics. All accepted papers have gone through anonymous peer-reviewing.