



ASPEN INSTITUTE INDIA

# Luncheon Meeting with Michael Spence

Nobel Laureate in Economics 2001 and  
Professor, Stanford Graduate School of Business, Stanford University



**7 September 2009: New Delhi**  
**Meeting Notes**

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## PARTICIPANTS

#	Name	Designation	Organization
1.	Tarun Das	President	Aspen Institute India
2.	Chandrajit Banerjee	Director General	Confederation of Indian Industry
3.	Sanjaya Baru	Editor	Business Standard Ltd.
4.	R C Bhargava	Chairman	Maruti Suzuki India Ltd.
5.	Kiran Karnik	Former President, NASSCOM	
6.	Sudhir Kapur	Managing Director and CEO	Country Strategy Business Consultants
7.	Rajiv Kumar	CEO	ICRIER
8.	Som Mittal	President	NASSCOM
9.	T N Ninan	Editor and Publisher	Business Standard Ltd.
10.	Amb. Kishan Rana		
11.	Marut Sengupta	Senior Director	Confederation of Indian Industry
12.	Roberto Zaghera	Executive Director	The World Bank

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## MEETING NOTES

Analyzing the gripping global economic crisis that is casting a shadow on global trade and investments, Prof Michael Spence shared his thoughts with a select group of industry members and intellectuals at an interactive session organized by Aspen Institute India on 7 September 2009 in New Delhi.

Essentially, the slowdown indicates a failure on part of the all major participants in the system:

- 1) Regulators: Failure of regulation, governance, checks
- 2) Academics: Failure to be able to "see it coming" through existing academic theories
- 3) Customers: Failure of rational consumer behavior

As the consumers took unnecessary risks, the financial sector kept backing up their actions as if they could foresee unlimited growth. Academics were not able to predict the crisis through their existing theories and concepts. The huge wastage in the American economy also may have had an impact in worsening the situation. It was a collective failure of three stakeholders in the financial system, who assumed that the systems are self-regulatory.

At the macro level, the financial theories and ratios are now skewed and at the micro level, we don't have the models to practically understand and efficiently cope with the crisis. While the system is eternally dynamic with evolutionary characteristics, a remodeling is still necessary, even with an imperfect understanding. A re-regulation of sorts is required, which will be focused on restoring the fiscal balance. Over \$1 trillion are going to be pumped in the US economy to fuel demand, which will cause further global imbalances, besides adding to the cost of capital and a raised deficit. But that is a small price to pay to trim the overhang of unemployment.

However, it is worrisome that as the crisis passes, the pressure on re-regulation will also decline and lose momentum. Slipping back into the existing system, with its lapses and loopholes would not be a very stable or sustainable state for the global financial architecture.

It is astonishing that "all the money" literally disappeared in thin air with deflated marketable security values; and it is possible that going forward, there will be a complete rejection of western theories and philosophies in shaping financial policy. In fact, the European model may be a better one to follow- given that it makes ideological sense and seems like a rational response to the current crisis.

The impact in India has been visible. India has become unduly cautious about its lending programs. Since the contemporary pattern of consumption is based on advance spending, it may now become a challenge to secure financial support in India for further growth of business. However, most probably the lines of credit will open up with slightly greater financial stability. Lending may become a little more expensive but will not be cut off. It is notable that the first code of self governance for businesses was initiated by CII and members voluntarily adopted

the code in a spirit of self regulation; the government stepped in at least three years later. But after the Satyam fiasco in India, coupled with the global financial crisis, the corporate sector is dragging its feet.

Despite the dented Western influence, it is important not to get carried away and “throw the baby out with the bathwater”. Changes are needed in every sphere, especially within academia, that will cause us to try and do a better job at balanced regulation in the financial sector. Young intellectuals may have fresh perspectives of the overly complex financial system and be instrumental in bringing about simplifying structural changes.

The ideal financial situation for any developing country is perhaps based on 3 pillars:

- 1) Have sufficiently reserves to sit on
- 2) Have savings equal investments- to be able to finance your own growth
- 3) Have a small fiscal deficit

The major positive factor in India is that it is emerging as an increasingly large and resilient player- partly due to its private sector playing a big role in accumulating greater assets and partly due to the Reserve Bank of India, who knows what it is doing in setting the levels of monetary and fiscal policy regulations. The looming negative factor is that while the “license raj” may be long gone, the government is only halfway through in “getting its paws off”.

In comparison, China is a very corporate- driven country. They choose their corporate and foreign policy objectives behind closed doors, where high level policy oriented study and strategy is designed. They reward people who live by the defined objectives, in spite of the prevalent corruption and connections. China, even as a large player in the field, is very nimble and can change directly very quickly even while moving at breakneck speed.

The G20 also considers the restructuring of the economic and financial sphere to be on high priority. The IMF did not have enough resources to be able to deal with the crisis situation efficiently. China and India will be among the first economies to bounce back. But China has the maximum capacity to restore the financial balance in the market. As of 2007, China had 12% current account surplus on \$3.3 trillion economy. Just by getting rid of excess savings, China could pump \$450 billion in the global economy.

But it is important for the US to make a distinction between how it relates to India and China on issues like trade, security, growth etc. It is time to stop clubbing the two countries. Ideologically and politically, the US is much closer to India and yet, democracy, as a value, is often pushed under the table at official forums. To that effect, CII has always positioned India as the world’s fastest growing free market democracy. The international media has projected India as a bigger villain than China in collaborating on issues like climate change and international trade, in spite of India’s tremendous efforts and growing contributions on the world stage.

The anxiety about India, going forward, is how efficiently it will be able to bridge the gaps within its society. While the private sector is going great guns and the corporate keep getting richer by the day, there are 600 million people living in a sea of poverty and there is a huge disconnect there. Indian businesses can contribute so much more- whether it is in education or healthcare or skill building, which are the primary services required by the large Indian population. The corporate sector needs to be more forthcoming on the domestic “inclusion” agenda, without losing out on its global competitiveness factor.

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