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Globalization and Consumer Protection of Financial Products

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ABSTRACT: The Asian Financial Crisis of (1997) underlined the fault lines of unfettered flow of hot money, i.e. foreign institutional investments (FII) in triggering fund outflow, unemployment and economic recession. The US subprime crisis (2007-08) reiterated the uncertainty associated with foreign investment in dubious financial instruments like Collateral Debt Obligations (CDOs) and lack of proper regulatory mechanism in USA. While globalization has certainly fostered greater economic prosperity amongst Emerging Market Economies (EMEs), such financial crises have dented the financial stability of small time investors and severely made consumers highly vulnerable. Recognizing this, the Indian Parliament introduced the Consumer Protection Bill (2015). The Financial Sector Legislative Reforms Commission (FSLRC) also brought out how there is a need to beef up our regulatory mechanism; particularly in financial products. This paper brings out how the existing bill suffers from several pitfalls; both in terms of its legal contours but in terms of its effective redressal impact. It also makes strong case to have a unified regulator to protect consumer interests in goods, services and E-commerce more effectively. As the Consumer Protection Bill is yet to be passed, the paper reiterates the need to have a proper regulatory mechanism in place to check malpractices in e-commerce and financial products on the digital platform.

Keywords: FII, CDO, EMES, FSLRC, E-COMMERCE

I. INTRODUCTION

The comparative advantage theory of David Ricardo (1817) was the forerunner for free trade in goods and services globally. The world witnessed unprecedented spurt in growth due to free trade from 1814 to 1914, prompting John Maynard Keynes to call this period as the golden century of globalization. The intervening years (1914-44) witnessed two World Wars, Great Depression of the 1930s and hyper inflation in Germany; thereby greatly undermining the global harmony. Countries indulged in "beggar thy neighbor policy" through competitive devaluation. The end of World War II brought sanity and UNO was created for peace, IMF for ensuring exchange rate stability and World Bank to extend medium term loan to the war ravaged economics. The Ricardian dream of a tariff free global world was revived through the establishment of GATT (1948) and in its subsequent avtar as World Trade Organization (WTO) (1995). The World Trade Organization, of which India is a member, inked major legislation like TRIPS, TRIM and GATS, to bring in an effective regulatory process to control endemic IPR infringement, and also institute a more effective dispute resolution mechanism where each country has an equal say. This has set the footprints of globalization on firm grounds. USA has emerged as the sole global hegemony prompting Prof. Jagdish Bhagawati to comment that "globalization is in essence Americanization of goods, services and capital movement". While globalization has improved connectivity between countries, fostered higher growth through dissemination of knowledge and technology, it has also ushered in increasing vulnerability in the financial markets, financial contagion and irrational risks that investors indulge in and wanton exploitation of labour and environment. The East Asian crisis in 1997-98 and the US financial crisis during 2007-08 are testimony to this. The consumer of modest means have been particularly affected the most in such times of financial crisis which often leads to large scale unemployment and dip in investment sentiments. While India was not affected in 2008 as much as China, due to its lesser exposure to capital mobility, all the same we cannot be oblivious of the dark contours of globalization and be impervious to consumer vulnerability. However, the Indian financial system play an important role for smooth activities in era of globalization (Sharma, 2014).

This paper attempts to analyze (a) The genesis of globalization and its impact (b) Consumer protection legislation so far (c) Global experience in consumer protection and their effectiveness and (d) The way forward.

The Genesis of Globalization and its Impact

Adam Smith (1776) is credited with the dictum that free market will maximize wealth creation of a country "by an invisible hand which will promote welfare of all". David Ricardo took it forward with his theory of comparative advantage which promotes free trade of goods and services. John Maynard Keynes considered (1814-1914) as the golden century of globalization. However, the idyllic century gave way to two World Wars, Great Depression of 1930s and hyper inflation in Germany (1914-44), greatly undermining the smooth harmony between countries in terms of exchange of goods and services. It encouraged each country to resort to competitive depreciation; thereby upsetting the fixed exchange rate arrangement, which was the hallmark of gold standard.

With the end of World War-II, the warring countries realized the importance of sustainable peace and harmony and stable trade relations. Three institutions were created viz. UNO, IMF, & IBRD in 1944 to act as international intermediaries for peace, exchange rate stability and medium term loan assistance, GATT was setup on 1948, to address the issue of tariff reduction in the domain of goods. It was followed by the WTO (1993) which included the services in its ambit and ensured an IPR regime through TRIPS, TRIM & GATS. WTO was also an effective dispute resolution mechanism for trade matters. In a sense, 1995 has been the watershed for resurgence of globalization and massively encouraged proliferation of Transnational Corporations (TNCs) across the globe; which account for nearly 30% of global wealth.

The 1970s witnessed the cocktail of TNCs, consumerism and cartelization by OPEC countries, who hiked the price crude oil prices astronomically. This set the foot prints of a hawkish monetary policy of Milton Friedman and resurgence of neo classical economics which called for a minimal role for the government, and openly supported the cause of big corporate with sizeable tax cuts. Reganomics became the toast of the western world, with Margaret Thatcher following suit in UK with a strong privatization policy.

In a spirited book "In Defense of Globalization" Prof. Jagdish Bhagawati brings out the myriad benefits that globalization has ushered in viz. diminishing poverty, greater gender equality, fostering democracy and most importantly improving the workers' wages significantly. Drawing on the Indian experience, which changed its policy thrust from import substitution to export promotion in the 1990s, Prof. Bhagawati brings out how India's higher growth trajectory of 8% now has been significantly contributed by its export sector, whose share has increased to 25% of the GDP compared to 10.3% in 1991.

Prof. Joseph Stiglitz in a stinging riposte to Jagdish Bhagawati writes how the global financial institutions have not helped the developing countries but sub-serve the commercial interests of multinational corporations. Jeffrey Sachs observes that the conditionality's of international financial institutions like World Bank and IMF have been insensitive; it's like asking "poor people to tighten their belts who cannot afford one". Globalization has also led to wanton exploitation of cheap labour in countries like China and East Asia carbonization of the environment. TNCs typically look for investment in countries increased which are authoritan in character and have lax labour standards and poor record in environmental regulation. The global manufacturing hubs in China, Thailand and Bangladesh are testimony to the ineffectiveness of organizations like ILO to prevent such wide spread labour exploitation. In this backdrop, it would be useful to take note of the genesis of Global Financial Crisis (2007-08) and the lessons that one can draw from reorienting our public policy to preempt consumer vulnerability.

Growth of Consumerism in India

The following table would bring out details of our growth trajectory against different parameters before and after economic liberalization of the 1990s.

Table 1: India's Growth Story after Liberalization

Parameter	1990-91	2015-16
GDP Growth %	5.6	7.6
Savings as % GDP	19.5	31
Export as % GDP	10.3	25
% Below Poverty Line	37	23

Source: Economic Survey 2015-16 & Montek Singh Ahluwalia

As it will be seen, dismantling of License Permit Quota Regime (LPQ) has lifted people below poverty line, who constituted 37% to 23% i.e. a reduction of nearly 184 million people. The real wage offered by the TNCs, has increased significantly and at much higher levels than the domestic wage levels. There is also an absence of gender discrimination in employment opportunity, which has helped to reduce gender inequality. Most significantly, with liberalization of our FDI policy, sectors like telecom, pharmaceutical and automobiles have become the signing lampposts of our growth story and improved our global presence. The proliferation of ICT has contributed significantly to this globalization process. The cheap services available in global communication is because of ours being part of the GATS arrangement.

Global Financial Crisis (2007-08)

Paul Mason, the Economic editor of BBC, in a very perceptive analysis (2011) has brought out how the genesis of the financial crisis is a classic case of greed, lack of regulation and conflict of interests. With the dismantling of the Glass-Steagall Act 1935, which made a distinction between banking operation and investment function, shadow banking has contributed majorly to the crisis in the financial sector. The derivatives and future contracts have become a parallel economy. By no longer considering gambling as an offence, the future market has brought an enormous amount of speculation and instability into the system. To quote Prof. Mason "if you extol the money changer, exhort them to make more money and hail the ascendency of speculative finance, it's a sure recipe for financial disaster". The subprime mortgages in US, which encouraged the unemployed to take subprime loans at higher interest rate created the housing bubble with high defaults. Toxic instruments like Collateral Debt Obligation (CDO), which package different debts and bonds into one for sale as assets, promising interest of 2-3% more than normal bonds, make them unsustainable. The Credit Defaults Swaps (CDS) is another product innovation which encourages reckless risk taking. The failure of the credit rating agencies in exercising proper check through blandishments by institution to improve their rating has made their credibility suspect.

Prof. Joseph Stiglitz who headed a commission to enquire into the crisis made an interesting observation: "In the Middle Ages the alchemist attempted to transform base metal into Gold. Modern alchemists try to transform risky subprime mortgages into to AAA rated products". Mr. Raghuram Rajan, was one of the earliest, to forecast that the US economy is heading towards such a financial crisis by observing "The sausage makers held too many sausages for their own consumption, when they knew what went into them". The urge to drop regulatory safe guards and celebrate the free spirit of the market has made many countries to opt now for full capital convertibility without ensuring proper regulation.

In this backdrop, it would be useful to take stock of various consumer protection laws that seek to minimize consumer vulnerability in times of crisis and against sellers' misuse of the advertising platform.

Consumer Protection Act (1986)

While India was not affected as much due to its lesser exposure to the US financial market, all the same given our huge dependence for importing oil and other critical machinery and electronic parts from the Western Countries, we can ill afford to be complacent about our lack of vulnerability to external shocks. The worst affected would be the consumers. The Consumer Protection Act 1986 was, therefore, enacted to provide a simpler and quicker access to redressal of consumer grievance by providing machinery by which the consumer can file his compliant before a consumer forum. It provides for a group of laws and organizations designed to ensure the right of consumers as well as fair trade, competition and accurate information in the market place. While defining consumer rights, it provides what constitutes safety in terms of its not being hazardous to life and health. The Act gives the right to be informed about the price, quality and quantity, the right of choice, right to heard and right to redressal and consumer education. The Act provides for a redressal forum in every district. The orders of the consumer forum are enforceable like a decree of a court. While these are laudable objectives, in practice the Act has been weak in protecting consumers from misleading advertisements, defective products health hazards and enforcing recovery from suppliers.

Consumer Protection Bill (2015)

The proliferation of E-commerce and the need to have a proper regulatory authority therefore impelled the Ministry of Consumer Affairs to introduce a Consumer Protection Bill in 2015 the Parliament. The proposed Consumer Protection Authority would be on the lines as in USA and European Union, where the product liability, recalling of product and cancellation of licenses are enforced if a valid consumer complaints to the appropriate adjudication authority. This new bill provides for mediation as an alternative route for dispute resolution just as in case of contracts. It provides for creation of a regulatory authority with powers to recall products and initiate suit against defaulting companies including e-tailors. India is in the vortex of rising consumerism. The present bill seeks to fill up the present gap in the Consumer Protection Act of 1986 by including E-commerce. In this backdrop it would be useful to glean through the global experience particularly USA in ensuring consumer protection.

The Consumer Protection Bill, 2015, has attracted comments from analysts like Prof. Akhileshwar Pathak of IIM Ahmadabad, who observed that the present bill would need to mesh with Contract Act and Sale of Goods Act. He brings out instances of unfair contract practices like Excessive Security Deposit in the Housing Sector, right of seller to terminate contract at will and hefty damages charged compared to actual loss suffered. Therefore, the bill has to be more buyers sensitive. The present provision envisages the right to cancel contract within 30days. Prof. Pathak brings out how such cancellation takes place with 3 to 14days in European countries and suggests that our provision should reduce the time period to 15 days.

Global Experience in Consumer Protection

The Food and Drug Administration (FDA) department of USA owes its origins to the writing of Upton Sinclair's book "The Jungle" (1905) where he recounted the deplorable condition of American meat packing industry. President John F. Kennedy's initiatives in consumer protection and the Great Society Progress experiment of President Lyndon B. Johnson and activism of Ralph Nader (1959) for plugging safety design weakness have set up the architecture of disruption free market place. While FTC does not have power to bring criminal charges, its innovative method to regulate telemarketing has been an outstanding achievement. In USA, establishment of a registry where consumers can register to preempt unwanted tele-market calls has witnessed 132million people registering. This has brought down intrusive marketing calls significantly and has been working successfully since 2005. The Frank Dodd Act 2009 after the US financial crisis also highlighted the importance of having proper regulatory process for financial products. In this backdrop, the recommendations of the Financial Sector Legislative Reforms Commission, 2013 headed by Justice B.N. Srikrishna are really salutary. The Commission recommended for creation of a unified regulatory authority with front ends in every district to enable the consumer to file complaints. The FSLRC brings out how the present strategy in Indian finance is focused on the doctrine of Caveat Emptor i.e. let the buyer be aware. However, the Commission does not want to push the onus on to the buyer alone and recommended adoption of a consolidate non-sector specific consumer protection framework for the entire financial system.

Need for Unified Regulatory Authority in India

The financial system mechanism proposed by the FSLRC will replace the existing financial sector specific ombudsman system such as banking ombudsman and insurance ombudsman. However, the effective dispute resolution body needs to be designed in a manner that ensures access, convenience, efficiency and speedy remedies. It has to function as a technologically modern organization that will carry video hearings, digital handling of documents, online registration of complaints and maintenance of a high quality electronic database and online tracking of compensation payment. An order by the adjudicator may provide for a award of consumer to the retail consumer subject to limits specified by the regulator. A party dissatisfied with the adjudicator will have the right to appeal before the Free and Secure Trade (FSAT) and the final review will lie before the Supreme Court.

The Way Forward

India Today is inching towards Smart Cities and Digital India where the emphasis is on bolstering ICT and improving our digital connectivity. After demonetization, the thrust is now for a cashless economy with intermediation from agencies like Paytm, paying a dominant role. The government has taken several initiatives to implement Srikrishna Commission Report like putting a Monetary Policy Committee in place, unifying the Forward Market Commission (FMC) with the Securities & Exchange Board of India (SEBI) and bringing in a new Bankruptcy law. However, it is yet to implement the major recommendation; i.e. to have a unified regulator for goods, services and financial products by having a common IT platform with front ends in every district and is ineffective dispute resolution mechanism. India can ill afford the unsatisfactory institutional arrangements like ombudsman for banks and insurance which have outlived their utility. In our quest for higher economic liberalization, we must not allow unfettered short-term capital movements to come into our country and discourage dubious investments; regulate the speculative real-estate sector properly. It has a high potential to generate high volume of black money. The thrust must be to have more long-term involvements partnership in sector like infrastructure, social sector and in research with reputed foreign manufacture and design houses. This will create lasting viable assets and promote human capital and skilling India to reap the true benefit of globalization in terms of better employability, higher real wage etc. and minimize consumer vulnerability. We also need to get the Consumer Protection Bill, which is presently with the Standing Committee on Food & Consumer Affairs, passed by the Parliament without further loss of time. With the proliferation of e-commerce and financial products on the digital platform, proper cyber security and an effective legal architecture to safeguard the interests of the consumers at large is a crying need. It will be a good complement to the GST Act, which has fostered cooperative federalism and has the potential to make one India, one Market.

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