GS SCORE
ESSAY TEST SERIES 2015

Essay

Time Allowed: 1½ hrs.   Max. Marks: 125

Instruction to Candidates

Excellent !
Good structure
Logical /Analytical
All encomp using organically linked
Just keep it up !

- Attempt one essay

- The test carries 125 marks.

- Write the essay in about 1000-1200 words.

- Any page left blank in the answer-book must be crossed out clearly.

(Examiner will pay special attention to the candidate's grasp of his/her material, its relevance to the subject chosen, and to his/ her ability to think constructively and to present his/her ideas concisely, logically and effectively).

$$\frac{67}{125}$$

1. Invigilator Signature _____

2. Invigilator Signature _____

Name _Ishan Pratap Singh_

Mobile No. _____

Date _26/09/2015_

Signature _Islapsif_

1. We don't see things as they are; we see them as we are.

2. Credit Rating Agencies have proved that the only function of economic forecasting is to make astrology look respectable.

(2)

It was in the winters of 2013, India's Central Bank Governor Doctor Raghuram Rajan was taking a memorial lecture in his Alma Mater and one of the premier institutes of country, IIT Delhi. Question answers were pouring in from inquisitive and visibly dazzled students as India was in midst of a slowdown. Suddenly Mr. Rajan stopped abruptly and looked at his watch. With a grim face, he apologised to his audience as he had to go to an urgent meeting which could possibly decide the fate of investments in next few years. It was not with the head of states but representatives of credit agencies. This is the kind of influence these organisations have on the economic future of the country in modern interconnected economic world. They hold great power and leverage but as they say, with great power comes great responsibility but though indispensable in modern frameworks of investments, the record of economic forecasting has been visibly shady at best.

Economic forecasting is nothing new to the state policy makers and economists. In search of predictibility both players in economic framework and investors look for a forecast. The "bandobast" of Todarmal in Akbar's regime & price policy of Allauddin Khalji aimed to provide a sense of stability and pattern. In ~~this~~ the modern world this role is largely played by credit rating agencies. They are national or International organisations which rate the investment options both government and private on the basis of investibility on certain parameters. The rise of international financial markets and coming of exceedingly complicated products have made their jobs quite complex. ~~nevertheless~~

But their jobs is not only complex, its exceedingly important too. The recent ~~days~~ unfortunate demise of great mathematician and founder of game theory, John Nash is a grim reminder of the importance of information in a capitalist market. Information assymetry or availability of information to some and not to others impedes the most efficient

distribution of resources. Credit Ratings play important part by giving information about future to investors. They alleviate risk and induce confidence and thus prevent the money going to visibly safe assets like gold to more productive ones like government bonds for infrastructure. In doing so they provide impeccable inputs to enterprises and countries themselves and keep them on ~~the~~ their feet.

Though, it was in 2008 when New York Stock Exchange collapsed and television channels across the world showed moving pictures of teary eyed pensioners whose life long savings dissolved, when they had invested in Most top rated financial instruments in the opinion of all major agencies. Corporations collapsed and all major banks faced stresses and pressures. Till very recently, some "in recession" economies like Cyprus, Greece and Spain were shown to have better ratings than emerging countries like India. But, it is not only limited to credit agencies. Economic forecasting has

been a shady exercise always. When was the last time that all predictions and targets of a five year plan in India came true. Leave planning, even in budgets forecasts have been grossly inaccurate raising concerns and demands for better fiscal marksmanship.

Though it is acceptable that unlike Astrology which is non scientific, forecasting is based on established and tested statistical models yet their job is inherently difficult. Firstly economics itself is a fast changing and unpredictable pursuit as the recent Chinese market collapse will show. Secondly, when there is an economic bubble of overpriced assets and enhanced risks waiting to burst, credit agencies like all other economic actors find themselves inside it thus being unaware as well as having stakes in it. Thirdly, Credit rating agencies in particular and economic forecasting in general use data as feedstock and if government and corporations manipulate that as Greece did, Credit agencies and forecasters can hardly be blamed and finally government engages in an unpredictable way

with economic system. Quantitative easings and pullouts can hardly be predicted and so is their impact...

But, it can hardly be said that all vagaries of economic forecasting are based on bona fide mistakes. As the 2008 crisis showed, forecasters like moody and S&P were themselves in a coterie and nexus with major players like banks and insurance companies. what can be a better example of conflict of interest when forecasters engage in investing in same instruments that they rate. It is also a complete irony that forecasting which seeks to allay an important deformity of free markets ie Information assymmetry is plagued by another ie monopoly. All credit agencies more or less act in Pandem. Not only that, collectively they don't act as independent observers of markets but active agents of developed world pushing conditions on developing countries to mould economies in particular way and predicting economic future and growth rates which a lot of time don't come true.

Said that, everything is not completely wrong

with forecasting. While ~~step~~ exceptions are visibly too loud and frequent, majority of times these forecasters have been upto the task. From keeping countries on their toes for fiscal discipline bringing positive reforms like Fiscal Responsibility and Budget Management Act in India to warning investors about potential risk and problems in particular products, they have done indispensable work. They have also been great learners by providing invaluable statistical impuls to reforms like Basel norms for banking to make economic structure of world safe and reliable.

It is a safe assumption, thus, that forecasting cannot be done away with but it can surely be reformed. Better oversight from intergovernmental panels and groupings like G20 will help to inculcate good practices. Bringing more competition especially by raising domestic credit rating agencies like CRISIL in case of india is great step forward. It will ensure that customer has multiplicity of imputs to chose. Along with that a consultative mechanism

to make transparent not only ratings but methodology is an important step which needs to be taken by countries in collectivity.

It was the same Raghuram Rajan mentioned in introduction that predicted the onset of 2008 recession as IMF chief economist, before anyone could think of it, making an example of fact that economic forecasting, if done honestly has an indispensable place in economic infrastructure. What it lacked then and it does so now is giving same heed to multiple voices. Credit Ratings must not become the sole criterion of investment nor they should be seen as singular forecasters. It is only by enhanced regulation, oversight and perhaps more importantly by more and equitable competition that it be ensured to have these organisations play on the side of consumers and investors instead of in coterie and nexus with developed world and big players of financial markets enhancing trust, reach and quality of economic forecasting.

Credit Agencies + Economic Forecasting.   John Nash

Is it Impossible
* Raghuram Rajan
Predicted crisis.   India → given Bad rating   Ratio

                              ROUGH

* Dependence   credit Rating Agencies ——→ ② Why is their job difficult   ① Intro.
on Int.   ① what they are   ① Economics itself an   ② Historical
Agencies.   unpredictable pursuit.   Anecode
                                  Interconected Eg Chinese Market   ③ Why is it
                                  world.   Comp.
                                              ② when Economic bubble   ④ Bad
                                              Exists they are themselves   performance
                                              inside the bubble.   │
          ②   why is it Important!   ③ Data depend on countries   India Internation
                                              Companies etc   ally
               ① Risk Manureering   ↳ Conflict of Interests   ⑤ why is their
               ② customer Information   ④ Govt. engages in an   Job difficult
                         │   unpredictable way.   ⑥ Malafide
                   Investors   Intentions
               ③ Increase Investment   ⑦ But
               by allaying Risk factor infact countries depend on it.   largely done
                                                                              well + frame
          ③ why is it been Shady   of reference
①Story of Int. Crisis 2008.+ ② Indian planning Experience very rarely   ⑧
               projections have been accurate.   ↳ cannot be
                                                                              replaced
          ⑤ Mala fide Intentions ┌① Lobbying │ Too many bonuses   reform
                                 ├② Coterie │ conflict of Interest.   ⑨ Conclude
                                 └ Nexus
               Agents of developed countries → push for reform.
                                              ┌ keep erring countries upto the task.
          ⑥ Perform good work too ┤ ┌ give viable information generally.
                                      └ while exeptions exist they are rare.

          * should be at side of Customer instead of being
You cannot │ part of Enclosed coterie
do away with them   ↳ reform + competition   Conclude ⑧   do well?
⑦   another inefficiency monopoly