

Globalization and Consumer Protection in Financial Sector

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Abstract

Globalization has become the buzzword; with TNCs proliferating all across the world, marketing their products and services. This has spurred growth, improved real wages and brought in more FDI and technology to India. However, the global financial crisis (2007-08) has underscored the need to be wary of shadow banking, toxic products like CDOs and conflict of interests of Rating Agencies. Consumers at the lower end of the income spectrum are particularly vulnerable in such unstable systems. The paper brings out the features of the Consumer Protection Act 1986 and its update in the Consumer Protection Bill 2015 and FSLC recommendation for a FRA in the financial sector. It draws upon the experience of countries like USA and European Union who have been brought in a high modicum of consumer protection. The paper calls for unification of all regulatory agencies to ensure a holistic regulation of goods, services, E-commerce and financial products with ICT as a force multiplier. It also underscores the importance of competition and need for CCI to work in tandem with the unified regulator to make consumer protection truly effective.

Keywords: FSLC, CCI, ICT, FRA, WTO, EMDF, CDO, FDI

INTRODUCTION

The comparative advantage theory of David Ricardo (1817) was the forerunner for free trade in goods and services. The world witnessed unprecedented spurt in growth and trade from 1814 to 1914, prompting 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; greatly undermining this global harmony. The end of World War II brought sanity to the war ravaged nations and created UNO for peace, IMF for exchange rate stability and World Bank for extending medium term loan for repair and rehabilitation. Establishment of GATT (1948) and World Trade Organization (1995) have inked the architecture TRIPS, TRIM and GATS to have a proper regulatory process to control IPR infringement. This has set the firm footprints of globalization. While globalization has improved connectivity between countries, fostered higher growth and ensured greater transfer of knowledge between countries, it has also brought in increasing vulnerability in the financial markets, financial contagion and irrational risks leading to the East Asian crisis in 1997-98 and the US financial crisis during 2007-08. While India was not affected as much due to its lesser exposure to the external vulnerability, all the same we cannot be oblivious of the dark contours of globalization and be impervious to consumer vulnerability. The Consumer Protection Act (1986) thus provides a simple and quick access to redressal of consumer grievance by providing machinery by which the consumer can file his complaint before a consumer forum. The Lok Sabha also passed the Consumer Protection Bill 2015, with a view to putting in place a regulatory authority on similar lines as in USA and European Union. With the massive increase of E-commerce, the present bill tries to ensure the redressal of consumer grievance against possible misuse of the IT platform is also available. This paper attempts to analyze **(a) The genesis of globalization and its pros and cons (b) Genesis of the Consumer Protection Act 1986 and need for Consumer Protection Bill 2015 and FRA (c) Effectiveness of the provisions in minimizing vulnerability of consumer in the financial sector.**

THE GENESIS OF GLOBALIZATION AND ITS PROS AND CONS

Adam Smith (1776) is credited with the dictum of wealth maximization with free market which “**as if by an invisible hand, will promote welfare of all**”. David Ricardo took it forward with his theory of comparative advantage. This was the forerunner to globalization which Keynes considered (1814-1914) the golden century of globalization. However, the subsequent years (1914-44) witnessed two World Wars, Great Depression of 1930s and hyper inflation in Germany, greatly undermining the smooth harmony between countries. It encouraged each country practicing competitive devaluation and forsaking the time tested gold standard mechanism which ensured exchange rate stability. With the end of World War II, sanity was restored and three institutions were created viz. UNO, IMF, & IBRD to act as international intermediaries for peace, exchange rate stability and medium term loan assistance, GATT, setup on 1948, addressed the issue of tariff reduction in the domain of goods. **It was followed up by WTO which included services and ensured an IPR regime through TRIPS.**

WTO was also an effective dispute resolution mechanism.

PERSPECTIVES ON GLOBALIZATION

In a spirited book “In Defence of Globalization” Prof. 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 which share has increased to 25% of the GDP now compared to 10.3% in 1991.

The critics of globalization are essentially the left wing ideologues or neoliberals. The French philosopher Derrida and Rosa Luxemburg consider globalization as “legitimizing the anarchy of capitalist production”. Flaying the invisible hand of Adam Smith, Luxemburg writes that “**the invisible hand has a hidden agenda- to favour the rich**”. Michael Sandel in his book “What Money Can’t Buy” brings out how the Kyoto protocol for environment regulation favours rich countries like USA who are the major contributors to environmental pollution. The marketing of carbon credits enables USA to buy such credits from Brazil, who actually earns it, and show them as US credit without reducing their emission levels.

Prof. Joseph Stiglitz in a stinging reposte to Bhagawati writes that the global financial institutions have not helped the developing countries but sub-serve the commercial interests of multinational corporations. The global manufacturing hubs in China, Thailand and Bangladesh are testimony to the ineffectiveness of organizations like ILO in preventing wide spread labour exploitation by the poor do not get protected by either by the ILO; or the WTO, whose singular focus is to bolster uninterrupted trade in goods and services from countries like USA & EU.

In this backdrop, it would be useful to take note of the genesis of Global Financial Crisis (2007-08) and the lessons that one draws for reorienting public policy.

GLOBAL FINANCIAL CRISIS (2007-08)

Paul Mason, the Economic editor of BBC, in a very perceptive analysis (2011) brings out how with the dismantling of the Glass-Steagall Act 1935, the distinction between banking and investment function was blurred shadow banking has seriously dented 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 ascendancy of speculative finance, it’s a sure recipe for financial disaster**”. The subprime mortgages in US, which encouraged the unemployed to take loans at higher interest rate, created the housing bubble with high defaults. Toxic instruments like Collateral Debt Obligation (CDO), and promised interest of 2-3% more than normal bonds make them unsustainable and spread the contagion globally. The failure of the credit rating agencies in exercising proper check and often being paid by institutions to improve their rating has made their credibility suspect.

CONSUMER PROTECTION ACT 1986

While India was not affected as much due to its lesser exposure to the external vulnerability, all the same, we can ill afford to be complacent about our lack of vulnerability to external shocks. The Consumer Protection Act 1986 was, enacted to provide a simpler and quicker access to redressal of consumer grievance by providing machinery by which the consumer can file his complaint 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.

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.

CONSUMER PROTECTION OF FINANCIAL SECTOR

While consumer vulnerability in goods and services has been provided in the above Act and Bill the financial services remains extremely vulnerable. 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. This will empower and require regulators to pursue consumer protection for the financial activities regulated by them. The court will approach the problem of consumer protection on two front viz. prevention and cure. While prevention requires regulation making and enforcement across the entire financial system, the creation of a Unified Redress Agency with front ends in every district of India will enable consumers of all financial products to submit their complaints. Availability of modern technology will connect these front ends to a centralized adjudication process. The Commission has suggested six types of protection for all consumers' viz. right to professional diligence, protection against unfair contracts terms, unfair conduct, protection of personnel information, requirement of fair disclosure and redressal of complaints.

NEED FOR UNIFIED REGULATOR

The financial system mechanism proposed by the FSLC 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 FSAT and the final review will lie before the Supreme Court.

One of the critical links for consumer protection is the role of healthy competition in financial markets for ensuring best interests of the consumer. While perfect competition may be utopian, an atmosphere that fosters competition in tandem with a sound and well functioning consumer protection framework will be a powerful tool to enhance the consumer welfare. The Competition Commission of India has today the responsibility of fostering greater competition in all areas of the economy. However, there has to be a structured mechanism through which cooperation between the CCI and the financial regulators can be established to ensure consumer protection in a holistic manner. There is also a need to look at the market not in compartmentalized manner of goods, services and financial products but in a unified manner; to be regulated by a unified regulator.

WAY FORWARD

India Today is inching towards Smart Cities and Digital India where the emphasis is on bolstering ICT and improving digital connectivity. It is, therefore, necessary that complaint registration and redressal happen on the IT platform. The Consumer Protection Bill, 2015, has attracted comments from knowledgeable sources like Prof. Pathak of IIM Amhedabad, who feels that the new bill should be Buyer-centric. 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 being charged compared to actual loss suffered. The present provision envisages the right to cancel contract within 30days. Prof. Pathak suggests this should reduce to 15 days based on provisions in EU. Of late, the controversy over Maggi highlighted how MNCs have duality in safety standards. Sunita Narain had also brought out the serious irregularity in case of Coke and Pepsi earlier. The TNCs have a propensity to intrude into with a singular goal of profit maximization. The Bhopal Gas tragedy disaster was a testimony to our weak and inept legal architecture to bring to books such flagrant violation in safety standards. The global financial crisis 2007-08 also clearly brought out how predatory TNCs and lax regulation of capital movement across the countries can be debilitating for Emerging Economies like India. **The need of the hour is to encourage competition, improve consumer awareness and create institutional arrangements which improve the faith of the common man in the fidelity of our market operators, quality of product of supplier and their accountability in the event of default.**

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