Indian Economy in Recession: A Challenge ahead

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ABSTRACT

The global economic and financial crisis has sent Tsunami ripples and wave shocks across the different socio–economic and political institutions in the present global environment. Tension is mounting everywhere as job cuts are on the increase, while many global corporate organizations are shutting down their operations and a few are declaring bankruptcy. The down turn that appears to have begun in the USA in September, 2008 have some negative impact on Indian economy. The most immediate effect of this global financial crisis on India is an out flow of foreign institutional investment (FII) from the equity market. This withdrawal by the FIIs led to a steep depreciation of the rupee. The banking and non-banking financial institutions have been suffering losses. The recession generated the financial crisis in USA and other developed economies have adversely affected India's exports of software and IT services. For fighting this crisis, government of India responded through its monetary policy by pumping the liquidity into the system rather than using effective fiscal policy i.e. public expenditure and investment to face the recession. No doubt, government has introduced three fiscal stimulus packages for stimulating demand in the economy but it was not sufficient, the larger government expenditure should be oriented towards agriculture and infrastructure. Although India has revived to high growth, this new growth should have to come not from some new speculative bubble but from enlarged government expenditure that directly improves the livelihood of the people. The present paper is an attempt to analyze the impact of recent global financial & economic crisis on Indian economy.

Keywords: Economic Recession, Depreciation, foreign institutional investment (FII), global financial meltdown, India, recession, Unemployment.

Introduction:

Experts around the world believe that a true economic recession can only be confirmed if Gross Domestic Product (GDP) growth is negative for a period of two or more consecutive quarters. In other words, when the value of goods and services produced decreases for six months in a row. While the "two quarter" definition is accepted globally, many economists feel that definition does not factor in other important economic change variables. For instance, current national unemployment rates or consumer confidence and spending levels are all a part of the economic system and should be taken into account when defining a recession. The agency that is officially in charge of declaring a recession in the United States is known as the National Bureau of Economic Research, or NBER. According to the NBER, a recession is a "significant decline in economic activity lasting more than a few months."

The global financial crisis is unique in its kind. What started off as a sub-prime crisis in the US housing mortgage sector had turned subsequently into a global banking crisis and then into a global economic crisis. Housing is commonly cited as a fixed asset. It is ironic that this ‘fixed asset' is the one that has triggered the greatest economic crisis since the ‘Great Depression' of 1930s.

The world economy went into a steep recession in the last three months of 2008 with global real GDP dropping at a 6 percent annual rate. This was clearly the worst decline in world output and also in world industrial production and world trade of the post World War II era, with virtually all countries getting affected by the downturn and many registering record declines in GDP. Since the United States dominates the global economy, this had led to slowing down of economies of all major countries. Many economists and experts foresee a global recession lasting well into 2010. However almost all believe that whatever may be the duration of the recession, the recovery is going to be slow.

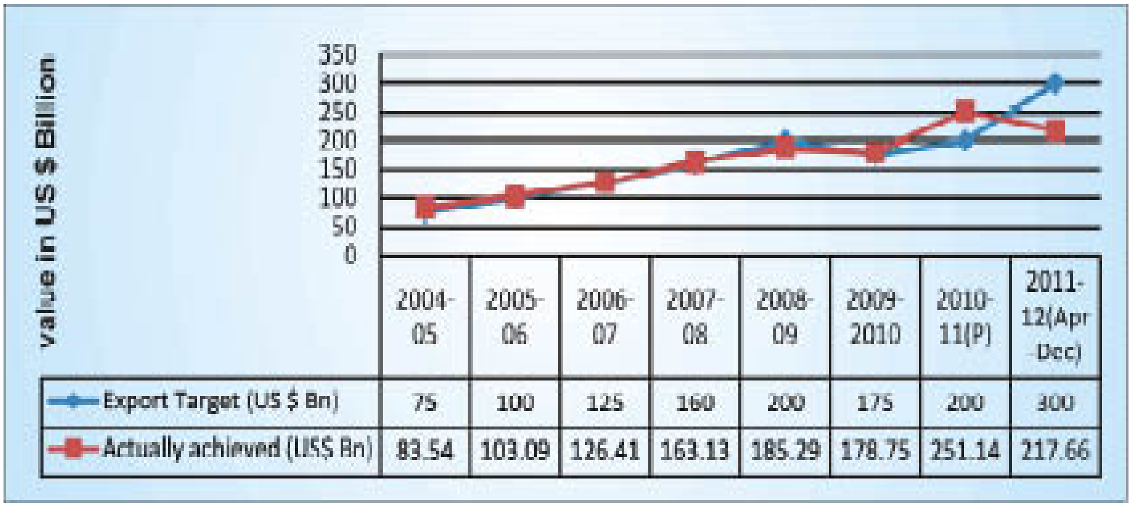
The Indian economy looked to be relatively insulated from the global financial crisis that started in August 2007 when the ‘sub-prime mortgage' crisis first surfaced in the US. In fact the RBI was raising interest rates until July 2008 with the view to maintaining the growth rate and to contain inflationary pressures. But as the financial meltdown turned into a global economic downturn with the collapse of Lehman Brothers on 23 Sep 08, the impact on the Indian economy was almost immediate. Credit flows suddenly dried-up and, overnight, money market interest rate rose and remained high for the next month. The impacts of the global economic downturn, the first in the center of global capitalism since the Great Depression, on the Indian economy was still unfolding. Even the common man is discussing the US financial crisis and its impact on developing countries, like India. Economists, industrialists and even the common man have been shocked at the mere thought of recession in India at this time and, that too, one caused by the most powerful nation of the world. High inflation, reducing job opportunities and industrial production, ‘austerity measures' and decreasing purchasing power parity, are a few of the topics being discussed even over cups of tea. There is a famous saying that, "When the U.S coughs, rest of the world gets bronchitis"! However in today's world of globalization, this may not at all be the case. Our Finance Minister's statement that "India has strong fundamentals" is very much correct and not merely a political statement. The Reserve Bank of India has also expressed the same thing over and over again.

Many economics experts around the world feel that the impact of a possible slowdown in the US will not be much on countries like India and China. The experts also feel that, Indian economy is not following the pattern of world economy, but has become capable of sustaining high single-digit growth rates for times to come. India may not be impacted largely by the US recession, mainly because today's India is very different and more robust than what it was three decades back.

While the prevalent global economic recession may not have huge impact on Indian economy, but it will affect our growth rate and it is visible in the first two quarters of 2009. Therefore it will be prudent to understand what happened, how it affects India and what the measures our government must take to keep this impact to the minimum.

Exports

India’s merchandise exports reached a level of US $ 251.14 billion during 2010-11 registering a growth of 40.49 percent as compared to a negative growth of 3.53 percent during the previous year. India's export sector has exhibited remarkable resilience and dynamism in the recent years. Despite the recent setback faced by India's export sector due to global slowdown, merchandise exports recorded a Compound Annual Growth Rate (CAGR) of 20.0 per cent from 2004-05 to 2010-11.

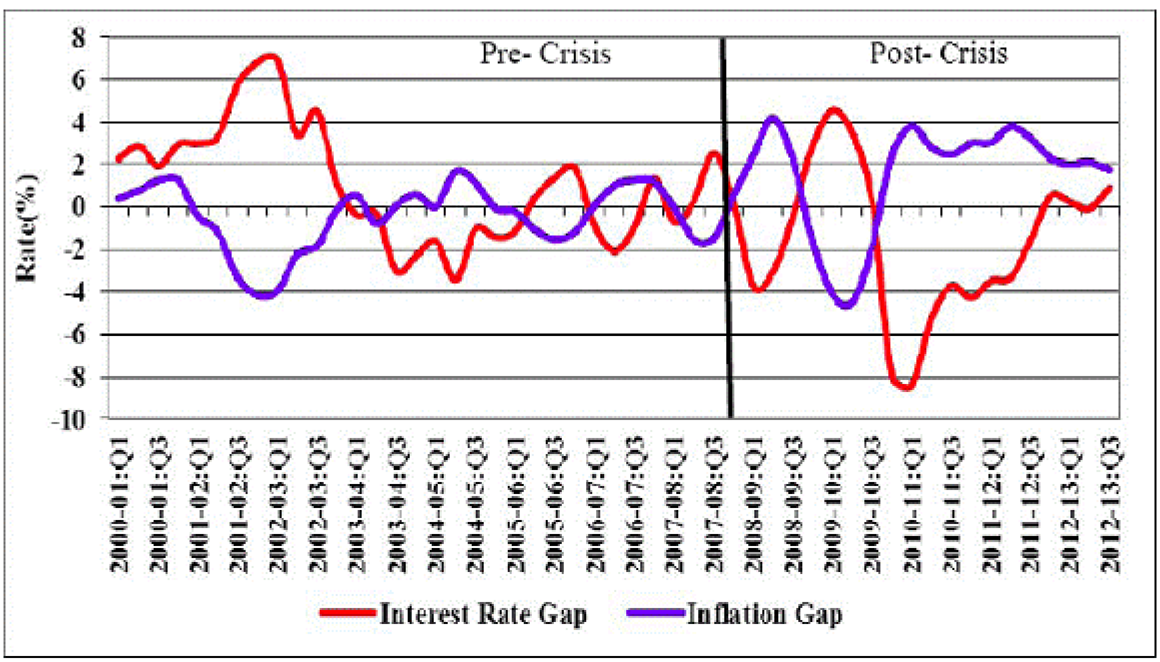


	2004-05	2005-06	2006-07	2007-08	2008-09	2009-2010	2010-11(P)	2011-12(Apr-Dec)
Export Target (US $ Bn)	75	100	125	160	200	175	200	300
Actually achieved (US$ Bn)	83.54	103.09	126.41	163.13	185.29	178.75	251.14	217.66

Source: Ministry of Commerce and industry, Annual Report 2011-2012.

Inflation

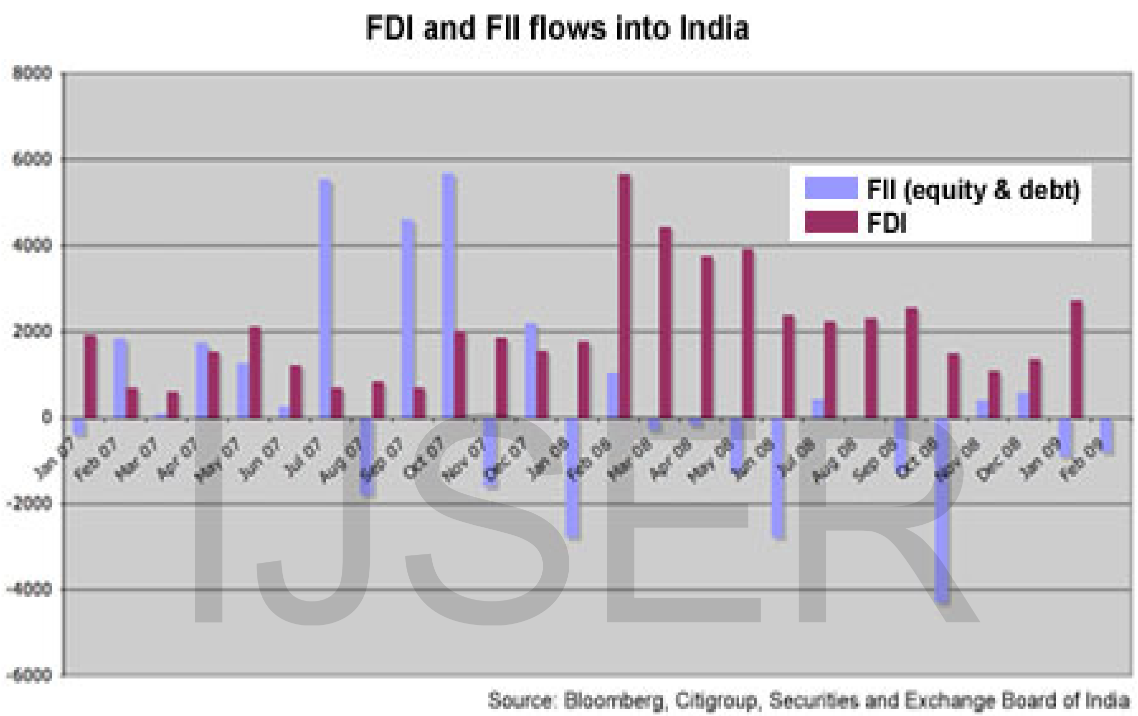
Inflation in India turned negative 1.61 percent for the first time in 32 years. However the prices of various commodities like food and oil were still higher than last year. It started showing a positive trend in Sep 09 but so did the food inflation which crossed 20 percent in Dec 09.



Source: rbi.org.in

Job Losses
According to a report released by the Union Government in Aug 09, 1.71 lakh had lost their jobs in various sectors. The textile industry was worst hit.

Pull Out' by FII
The most immediate effect of that crisis on India was an outflow of foreign institutional investment from the equity market. Foreign institutional investors (FII), became major sellers in Indian markets.



Depreciation of Rupee
The financial crisis also created a shortage of money supply and India was also facing a credit crunch especially in terms of foreign exchange and the Indian Banking sector and forex markets were facing tight liquidity situations. This liquidity crisis along with FII sell off forced the Indian Rupee to devaluate like never before and the Indian Rupee slipped from around Rs 40/US $ to Rs 55/ US $.

Fall of Stock Market
On 21 Jan 08, the Sensex saw its highest ever loss of 1,408 points at the end of the session on Monday. The Sensex recovered to close at 17,605.40 after it tumbled to the day's low of 16,963.96, on high volatility as investors panicked following weak global cues amid fears of the US recession. On 22 Jan 08 the Sensex saw its biggest intra-day fall when it hit a low of 15,332, down 2,273 points. The Bombay Stock Exchange benchmark Sensex witnessed its second-largest fall ever losing 900 points to close at 16,677.88. On 18 May 06,The Sensex registered a fall of 826 points to close at 11,391, following heavy selling by FIIs, retail investors and a weakness in global markets. The markets crashed by 801 points to close at a low of 10,528.
<u>Other sectors which have been worst hit were:-</u>

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(i) Tourism
(ii) Services sector (Air travel, Mutual funds and Insurance)
(iii) Outsourcing services
(iv) Steep rise in food prices. As luck would have it, India had a poor monsoon season in 2009.

CONCLUSION AND SUGGESTIONS:

India has been hit by the global meltdown, it is clearly due to India's rapid and growing integration into the global economy. The strategy to counter these effects of the global crisis on the Indian economy and prevent the latter from any further collapse would require an effective departure from the dominant economic philosophy of the neo-liberalism. The first such departure should be a return to Food-First doctrine, not only to ensure food security of the large population but also due to the fact that food production will be more profitable given the current signs of a shrinking market for export oriented commercial crops. The other important initiative that needs to be adopted is the building of institutions based on the principle of cooperation that will provide an alternative frame work of livelihood generation in the rural economy as opposed to the dominant logic of markets under capitalism. Institutions like cooperative markets and credit cooperatives can go a long way in addressing the lack of economically viable producer prices and loaning credit availability for economic activities in the primary sector. Such an alternative policy to tackle the consequences of the financial crisis will require effective Keynesian policies in the form of increased public expenditure at the rural and urban infrastructure. We see that government's engagement generally arrives very later to solve the financial crisis by which time many financial firms are near insolvency. This generates larger cost for the economy and exchequer. Our key goal today should be to avoid these costs through rapid action. The need of today is not just the pumping of liquidity in to the Indian economy but also in addition the injection of demand. This can occur only through direct fiscal action by government. In India, larger government expenditure has to be oriented towards agriculture, rural development, health, human resources and infrastructure to make inclusive and balanced growth. The biggest challenges before India are to ensure monetary and fiscal stimuli work, returning to fiscal consolidation, supporting drivers of growth and managing policy in globalizing world. There is also need to study the viability of fiscal stimulus in India and economic policy makers should shift their attention from crisis management to providing the basis for a return to fast growth. Over the next year, sources of growth should shift to manufacturing and possibly a recovering agriculture. No doubt, India has come back to high growth but this new growth should have to come not from some new speculative bubble but from enlarged government expenditure that directly improves the livelihoods of the people and that is geared towards improving the production of food grains through a changing of peasant agriculture and not through corporate farming since that would reduce purchasing power in the hands of the peasantry and perpetuate its distress. In short, the new paradigm must entail infrastructure and food grain-led growth strategy on the basis of peasant agriculture sustained through larger government spending towards the agriculture and rural sector, which can simultaneously sustain the growth and remove the food crisis in India.

The Indian economy is also expanding, but so far the process of transferring cheap labour from low value agriculture to higher value manufacturing industry has been slow. This is mainly due to relatively weak industrial growth and unfavourable labour laws that have created a strong incentive for firms to use more machinery and hire fewer workers. India may choose to follow the East Asia model to attract foreign investment and beef up its manufacturing industry. At the same time, India will continue expanding its strong service sector in business and engineering services that has drawn major global firms to outsource their operations to India and has the potential to continually drive India's foreign trade.

India's strength is based on its knowledge-based sectors such as IT and pharmaceuticals, intelligently developed financial markets and a more robust private sector.

India has given enough indications that they have come out of this crisis with flying colors, although the end is still a fair bit of distance. Our Finance Minister's words that “India has strong Fundamentals” are proving out to be true. Indian recovery has a lot to owe to the stimulus package that the government put into force. However, the regulatory bodies like the RBI, typical foreign investment rules, banking regulations and even India's foreign policy had their role to play. Indian government needs to look into future and carve out comprehensive policy to make our economy as recession proof as possible.

The government's policies towards providing adequate liquidity have worked but now it has to decide as to when to remove these and let the economy take its natural course. This is important because if the liquidity is further increased, there are chances that the government will be fighting another evil which is already showing its fangs - inflation. However, RBI's governor, Mr D Subbarao's statement that now is not the right time to remove the stimulants has some weightage.

India's National Association of Software and Service Companies (NASSCOM) estimates that by 2020 India's share of the offshore market for engineering services - of a projected value of more than US$ 1 trillion - could be 25-30 per cent - up from the current 12 per cent - provided that the capacities, capabilities, infrastructure and the international reputation are in place. Business services and software have boosted Indian trade since 1990s and now a few of Indian firms in those areas are among the largest in the world. Abundance of well trained, English-speaking cheap labour is a big asset for India and can be better employed. Services are by far the largest part of the Indian economy (50 per cent) with some sub-sectors performing better than others. There is still much scope for improved productivity and increased investment.

The Indian economy has taken a turn and has stood up to the test that the recent global recession had to offer. Our country has shown the world that ours is not a fairytale success story but one with hard work and intelligent thinking. The world, in turn, has acknowledged it and this is clearly visible from the fact that the foreign investments were back in India with the same speed they exited when the recession first surfaced. It will not be wrong to say that India has earned its pride of place in the eyes of the entire world.

Recommendations

(a) The economic growth needs to be inclusive. Though the government always states this, it is important that some more steps are taken to increase the percentage of people above poverty line.

(b) The labour laws and laws for foreign investments need to be modified so as to ensure that, like China, we also enjoy the benefits of cheap labour to the fullest.

(c) India needs to improve the infrastructure and improve it fast. Many foreign companies, it is known, choose China over India mainly due to better infrastructure like transportation, work space and so on.

(d) India is strong in IT, services sector and agriculture. It needs to expand it arena by giving tough competition to China in manufacturing sector as well. Having better infrastructure and labour laws will certainly help.

(e) Schemes like NREGS are really good. However the central government needs to have better regulatory rule mainly because the success of this scheme vary from state to state. There has to some authority at central level which can ensure uniformity.

(f) RBI's control over Indian banking system should remain.

(g) Stimulants have proved that there is enough potential in our economy. Even if the FIIs and FDIs dry out, the domestic consumption can still make it grow.

(h) Import of sub standard goods, especially Chinese, should be banned and the government should encourage domestic industries to come out with the solutions.

(j) A good thing in the Indian Armed Forces' procurement procedure is the introduction of the ‘Offset Clause'. However our industries need to gear up for utilising the complete benefits of this. Our government needs to take some firm steps to enable the ‘Navratnas' and other private companies to be up for the challenge.