Financial Emergence vs. Indian Economy

Dr. Partap Singh,
NC College of Engineering
Israna, Panipat, Haryana

Abstract
There is no fear that the Indian economy appears to be getting into a crisis, similar to the one that it faced in 1991, has begun to gain ground. Till now financial emergency has not been declared in India even once. India survived near-crisis situations twice in the 1990s.There was some condition arose in 1990-91 which was avoided by putting the gold assets of India as collateral to get foreign credit. But in 1997-98 the contagion of the Asian financial crisis again threatened India.The paper analyses the key macro-economic parameters that explaining financial emergence in Indian economy in the year 2013. The paper briefly reviews the financial emergence situation in India 1991, 1998 and 2013 as well.

Key Words: Financial Emergence, Current Account Deficit, Fiscal Deficit, Foreign Exchnge and Financial crisis.

I. INTRODUCTION

The President can declare three types of emergencies: National emergency, State emergency and financial emergency. The first, National emergency (under article 352) is caused by war, external aggression or armed rebellion in the whole of India or a part of its territory. Such an emergency was declared in India in 1962 (Indo-China war), 1971 (Indo-Pakistan war), and 1975 (by Smt. Indira Gandhi). The second is State Emergency under Article 356. The state of emergency is also known as 'President's Rule and it is declared on failure of constitutional machinery in a state. The third is financial emergency under article 360 of the Constitution. Financial emergency imposed when there is financial crisis. Financial Emergency basically means that, when the President is satisfied that a situation has arisen whereby the financial stability or credit of India, or any part thereof, is threatened, he may by proclamation make a proclamation to that effect. If the President is satisfied that there is an economic situation in which the financial stability or credit of India is threatened, he or she can declare financial emergency. Such an emergency must be approved by the Parliament within two months.

India experienced a classic external payments crisis – high fiscal deficit, external borrowing to finance it, rising debt service commitments and resulting inflation, inadequate adjustments in the exchange rate and a deteriorating current account in 1991. From 1979 onwards the second oil shock, agricultural subsidies, and consumption-driven growth had pushed up the fiscal deficit. It further increased in the mid-1980s as defense expenditure was largely increased and direct taxes were progressively reduced.). Two immediate external shocks contributed to the large current account deficit in 1990-91. First, Iraq's attack on Kuwait in 1990 adversely exposed the Middle East's strategic relevance for India: it was vulnerable to shifts in global oil prices; hundreds of thousand Indians worked in the region sending home valuable foreign exchange. The Gulf crisis changed all that. Petroleum import costs in 1990-91 increased over 50 percent to $5.7 billion.

The government had to bear the additional burden of airlifting and rehabilitating 112000 Indian workers – the largest civilian airlift in history – as remittances from the region declined. The second shock was the slow economic growth in India's export markets. Growth in the U.S. – India's largest export destination – fell from 3.9 percent in 1988 to –1 percent in 1991. India was also suffering from internal political instability. The fragile National Front coalition faced a nationwide crisis in the summer of 1990 over its affirmative action policies, with upper caste students taking to the streets. By autumn a political campaign by the BJP (an upper caste-dominated coalition partner) to build a Hindu temple at the site of a 16th century mosque in Ayodhya resulted in widespread communal violence. When the BJP's president was arrested in November the party pulled out of the government, thus bringing it down. A new minority government received the Congress's external support. But when this support was withdrawn in February 1991, the scheduled budget could not be passed. In the midst of campaigning for the general elections former Prime Minister Rajiv Gandhi was assassinated in May 1991.In reaction, and in parallel, to these developments the economic situation worsened.

By September 1990 net inflows of NRI deposits had turned negative. Access to commercial borrowing had become more costly and difficult and by December even short-term credit, particularly Bankers' Acceptance Facility, was restricted. Foreign exchange reserves fell to $1.2 billion in January 1991. By the time a new government took over in June reserves could cover only two weeks of imports. India was close to defaulting on its sovereign debt for the first time in its history. India's current account position had also worsened. An increasing dependence on foreign oil imports, vulnerability to oil price fluctuations, declining remittances from abroad, strong domestic demand (a result of liberalization efforts in the mid-1980s and deteriorating fiscal balances), and rising interest payments on external debt contributed to a widening current account deficit which during 1985-90 it averaged 2.2 percent of GDP and was 3.1 percent of GDP in the year of crisis. India's export competitiveness had been adversely affected by a steady appreciation in the rupee's real effective exchange rate (REER): 20 percent between 1979 and 1986. From 1987 the rupee steadily depreciated but the real exchange rate remained overvalued until the year of the crisis. In order to finance the fiscal as well as current account deficit India also relied on external funds. Notwithstanding the weakening fundamentals, one key factor that reduced vulnerability was the absence of private sector external debt. Unlike many other countries, individuals and firms could not raise foreign currency-denominated debt and the banking sector was not allowed to hold financial assets abroad. One effect of this was that the private industrial sector's interests were more geared towards internal deregulation rather than support for external liberalization. In 1997 India was much less vulnerable, not just than it had been but than most East Asian economies. The current account deficit had fallen to 1.25 percent of GDP in 1996-97.
Speculative pressures on India persisted from August 1997 to February 1998. As a result of the nuclear sanctions, the pressures again increased from June 1998. Capital inflows sharply slowed down. The foreign exchange market was particularly volatile as the pressure on the rupee increased. Yet for all the pressures, India emerged relatively unscathed. By December 1998 foreign exchange reserves had reached $27 billion and by end-1999 they were actually higher than in the pre-crisis period, standing at $35 billion with a six-month import cover. These stories set up the puzzle. Pressures arose both in 1990-91 and 1997-98 despite the different circumstances During 1991-97, five key decisions namely devaluation, new exchange rate regime, carefully managed opening up to foreign investment, financial sector reforms, and IMF programme were taken to tackle the problem of financial emergence. No doubt, the current macro-economic scenario is grim, but there is not in a 1991-like situation.

Objective of Paper

The objectives of the study are:

- To analyze the comparative financial emergence situation during 1991, 1998 & 2013 in Indian economy.

RESEARCH METHODOLOGY

The present paper is based secondary data. Secondary data was collected from internet, various journals, books and newspapers etc. The some key macro-economic parameters have been used to analyze the situation of financial emergence in India. These parameters are: (i) Gross domestic product (GDP) growth, (ii) Foreign exchange reserve, iii) Fiscal debt, iv) The current account deficit, v) Export-import, v) inflation & Unemployment, vi) External debt, vii) Budget deficit, viii) Depreciation of Indian value of rupee, and x) Corruption, xi) Savings to GDP ratio, an xii) Investment to GDP ratio, A comparative analysis regarding key economic parameters during 1991, 1998, 2008 and 2013 has been made so that financial emergence situation can be studied during these periods. A comparative analysis regarding key economic parameters has been made with BRICs counties as well.

RESULTS & DISCUSSIONS

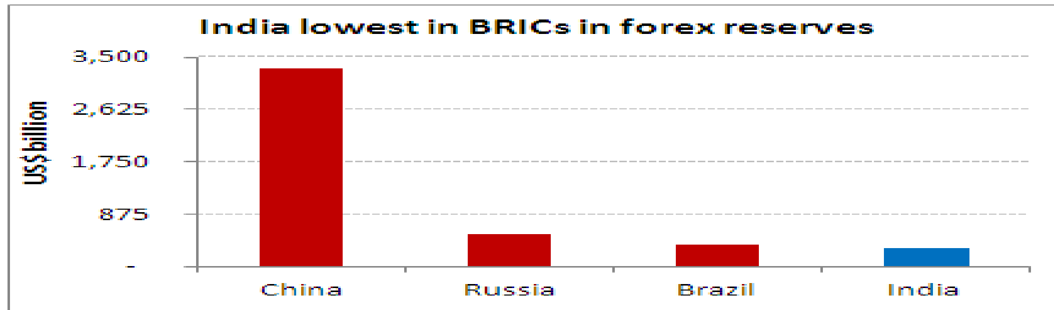
Gross Domestic Product (GDP)

From the year 2002-03 to the year 2012-13, India's GDP grew at average annual growth rate of around 7.56% with growth rate as high as 9.57% in FY 2006 and 9.32% in more recent year 2011 to as low as 3.99 % in 2003 to 4.96% in the latest year 2013.
As per The Economist,(April 17, 2013), India's GDP has been forecasted to grow 5.7 percent in 2013 greater than Brazil (3%), Russia (3.4%), and South Africa (2.8); but less than China ((8%) among the BRICs countries. Further, International Monetary Fund (IMF) estimates for 2014 the Indian economy to grow 6.2 percent while China will likely grow by 8.2%, Brazil (4%), Russia (3.8%), and South Africa (3.34)

Foreign Exchange Reserve

As per Financial express(on March 16,2013), shown in the chart, India has the lowest level of forex reserves in the BRICs peer set which does not portray a good picture for India. This means that the Indian central bank has lower resources available to support the Indian Rupee in the global currency markets as compared to its BRIC peers.

Chart 1: India lowest in BRICs in Forex Reserves as on March, 16, 2013



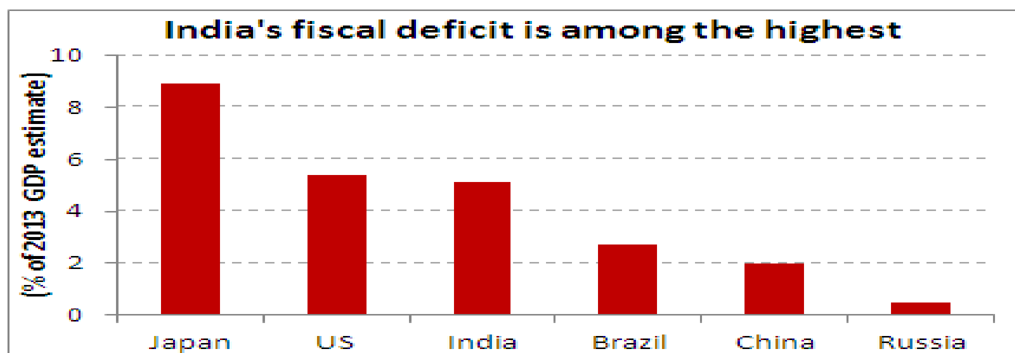
Source: Financial Express

.

Fiscal Deficit

The good news is that India's fiscal deficit, as a percentage of the GDP has come down from a high of 7 per cent in 1990-91 to 4.8 per cent in 1997-98.The lowest fiscal deficit figure in the last decade was in 2007-08 at 2.54 per cent since 1991.In 1991-92, the fiscal deficit fell considerably to 2.54 per cent in 2007-08, but jumped in the next two years to touch 5.99 per cent in 2008-09 and 6.40 percent in 2009-10. Thus, after 2007-08, India's fiscal deficit has been rising continuously. India's fiscal deficit during 2012-13 financial years was 5.06 percent of the nation's gross domestic product. India's fiscal deficit continually is high because in the corporate sector, bailouts are becoming common and subsidies are being high. The money that the government earns through non-tax revenue is not big and the money it earns from taxes is not enough

Chart 2: Showing India's comparative fiscal deficit with BRICs countries as on May 7, 2013



Data Source: The Economist

Current Account Deficit

Current Account is the sum of the balance of trade (exports minus imports of goods and services), net factor income (such as interest and dividends) and net transfer payments (such as foreign aid). India's current account deficit reached alarming levels in the year 2012-13, and it had a deficit on its current account of nearly US $89.9 billion in the year 2012-13. Since 2004-05, the current account deficit (CAD) has increased at a very rapid rate.

Export & Import

The excess of import over export has been increased continuously and it has jumped two times more in 2013-14 than 2007-08. Further, it has increased nine times more in 2012-13 than 2007-08.

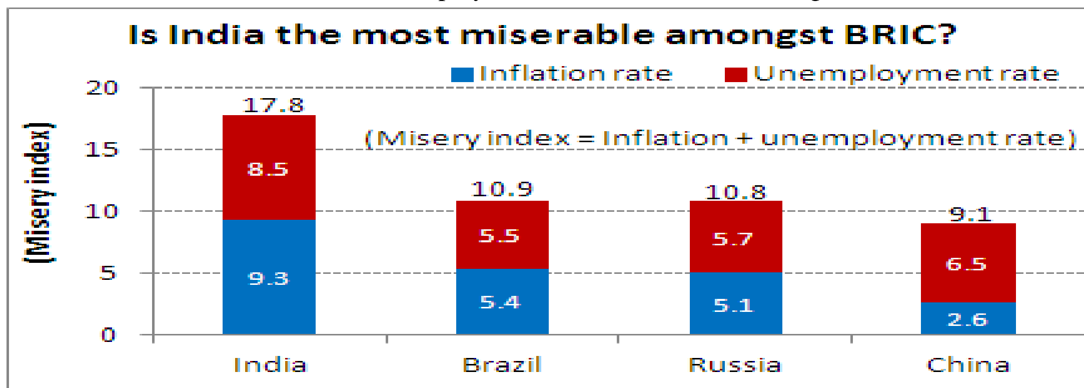
In the period up to 2003-04, exports and imports followed a similar rising path. 2004-05 onwards, even robust growth in software exports has been unable to compensate for the rapidly climbing merchandise trade deficit.

Imports have been growing at a compounded annual average growth rate (CAGR) that is 4 per cent higher than that of export over the same period. This is the cause of India's rapidly increasing current account deficit.

Inflation and Unemployed rate

Inflation rate in India has increased 4.8 percent in 2007-08 from 3.4 percent in 2002-03. Further, it has increased two times more in 2012-13 than 2007-08. As for the lot of the Aam Aadmi, the less said the better. Double-digit inflation in food prices and high interest rates are eating into their savings, forcing them to put off investments, purchases and even to pare kitchen budgets. Onions selling at Rs 100 a kg and tomato at Rs 60 a kg are enough to bring tears to their eyes. Jobs are not being created; worse, more people are losing their jobs and more than 40 lack people have lost their jobs.

Chart 3: Inflation and unemployment rate in India as on 29 August 2013



Source: merabharosa.com

As the chart highlights, with both inflation as well as unemployment being the highest in India, its misery index is way above other BRIC countries. Clearly, the flow of bad news on the economic front seems endless as of now for India. Fortunately, the situation is not irreversible. All we need are few strong reforms oriented measures and we could be back on track

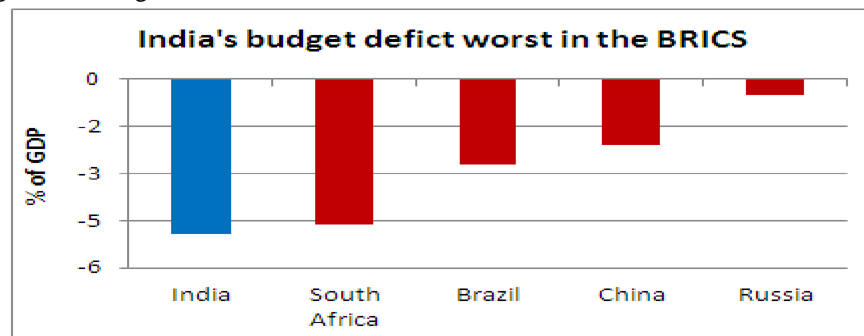
External Debt

India's external debt has increased continuously from 2002-03 which were 3.5 times more in 2012-13 than 2002-03 and has 60.61 percent growth rate over 2007-08.

Budget Deficit

As per The Mint, India's budget deficit stood at 4.9% of GDP in 2013(See Chart…) b. This makes it the worst on the BRICS list. In fact India has fared badly even on other economic parameters. Inflation is high, its current account gap is increasing, growth has slowed down drastically and the fiscal mess is getting worse. This is a poor reflection on the country's government

Chart 4: Showing India's budget deficit worst as on 12 June 2013



Source: The Mint Source: The Mint

Devaluation of Indian rupee

The table reveals that the value of Indian rupee declined around three times in 2013 as compared to 1991 and around double in 2008.

Table 1: Showing devaluation of Indian rupee

Year	1991	1998	2008	2009	2010	2011	2012	2013
INR/USD	22.72	41.43	43.41	48.32	45.65	52.22	55.74	66

Source: Ministry of Finance

Currently, the Indian rupee is trading in the market at Rs 66 per dollar, which is a historic low. In 1998 was the peak of the Asian financial crisis when the rupee had come under pressure.

Corruption

India has a series of scams from 2007-08 to 2013. 62% of Indians have reported having to pay a bribe to public officials to get jobs done. Corruption exists everywhere from high ranking government officials to teachers in local schools. This has an adverse affect on the reputation of India as a place to do business and could put off potential foreign investors

Key Economic Parameters in BRICS

According, "*The Economist (*Tue, Jun 11 2013)*" International Journal,* emerging markets is under pressure. The BRICS countries are now growing at between 4 to 6 percentage points below those peak levels in 2007. The South-East Asian countries are either very close to their 2007 growth rates or are even surpassing them, as the examples of the Philippines and Thailand show. India has the highest consumer price inflation in the 10 countries that have been considered here. Brazil, Russia and South Africa have high inflation as well. Vietnam has the most effervescent prices east of our borders. But inflation is moderate in other countries in South East Asia.

Table 2: Sowing Macro Economic Parameters in BRICS

Countries (%)	CAD	Budget Deficit	Inflation (consumer price index)	GDP growth (2007)	GDP growth (2013)
China	1.7	-2.3	2.4	14.2	7.7
India	-4.1	-4.9	9.4	10.1	4.8
Brazil	-3.1	-2.7	6.5	6.1	1.9
Russia	2.3	-0.5	7.4	8.5	1.6
South Africa	-5.3	-4.6	5.9	5.5	

Source: The economist, IMF

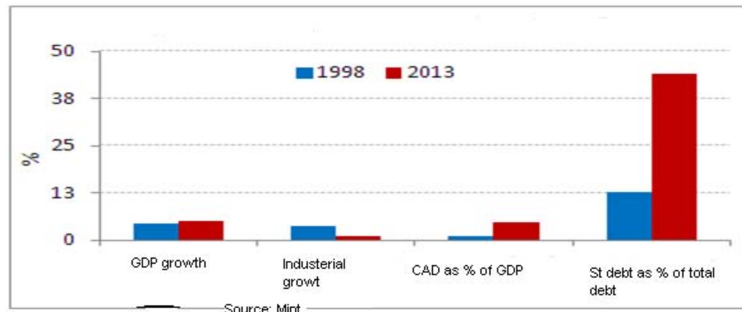
Another indicator is the current account deficits. Russia and China have surpluses with the rest of the world, though the Chinese surplus has declined over the years as its government has tried to rebalance its economy. India, South Africa and Brazil have large current account deficits The other Asian countries have either current account surpluses or very modest deficits. The story is slightly more complicated when it comes to budget deficits. India, South Africa, Vietnam and Malaysia have the worst budget balances. The others are far better off.

India comes out poorly on almost all parameters, perhaps other than growth. Its economic imbalances—consumer inflation is still close to double digits, the growth trajectory is far lower than before, the current account deficit is way above safe levels and the fiscal mess continues.

Macro- economic parameters: 1998 vs. 2013

As seen in the chart, the statistics show that at the moment things are actually worse than what they were in 1998. Barring GDP growth, which is expected to be around 5%, every other number paints a gloomy picture. Industrial growth has slowed down. The current account deficit (CAD) is worse. India's short term debt as a percentage of total debt has surged, which means repayments and interest would be a problem. Unfortunately because of the structural issues being faced on the policy implementation front, things are not expected to improve any time soon

Chart 5: Comparative analysis of Economic parameters in 1998 and 2



Macro- economic parameters: 1991-92, 1997-98 Vs.2012-13

. In 1991-'92, India's gross domestic product (GDP) growth was 1.4 per cent, fiscal deficit 9.4 percent of GDP at current market price, rate of inflation 13.7 per cent, savings to GDP ratio 22.6 per cent, investment to GDP ratio 22.6 per cent, forex reserve US$ 9.2 billion, External Debt(as Percentage of GDP) 28.7, and Devaluation of Rupee(INR/USD) 22.72 . As compared to this in 2012-13, India's GDP growth has been 4.96 per cent, fiscal deficit 5.06 per cent of GDP, rate of inflation 17.8 per cent, forex reserve $292 billion, External Debt (as Percentage of GDP) 60.61, and Devaluation of Rupee(INR/USD) 66 and savings as well as investment to GDP ratio is expected to be in excess of 30 per cent.

On the other hand, As compared to this in 1991-92 and 2012-13, India's GDP growth has been 5.8 per cent, fiscal deficit 8.9 per cent of GDP, rate of inflation 5.9 per cent, forex reserve $7 billion, External Debt (as Percentage of GDP) 24.3, and Devaluation of rupee (INR/USD) 41.43 and savings as well as investment to GDP ratio is expected to be in excess of 30 per cent. Thus, on various macro-economic parameters the Indian economy appears to be in much better shape now than it was in 1991-'92.

Table 3: Showing a Comparative analysis of Macro- economic parameters between period 1991-92, 1997-98 and 2012-13

Macro-economic Parameters	1991-92	1997-98	2012-13
Gross Domestic Product (GDP)	1.4 percent	5.8	4.96 percent
Fiscal Deficit(Percent of GDP at current market prices)	9.4	8.9	5.06
Rate of Inflation	13.7 percent	5.9 percent	17.8percent
Savings to GDP ratio	22.6 percent	26.3	30 Percent
Investment to GDP ratio	22.6 percent	25.0	30 percent
Forex Reserve	US$ 9.2 billion	US$7 billion	$292 billion
CAD(US$)	-2.2(% of GDP)	27.9	89.6
External Debt(as Percentage of GDP)	28.7	24.3	60.61
Devaluation of Rupee(INR/USD)	22.72	41.43	66

Source: Ministry of finance

Findings

- The rupee is the most undervalued currency in the world market.
- But because of the slow rate of growth in exports and a simultaneous increase in imports, the CAD was rising continuously, resulting in more demand for foreign finance that started adversely affecting the value of the rupee. The imports were mainly on account of oil and gold.
- After a decade of infatuation, investors have suddenly turned their backs on emerging markets.

- In the BRIC countries – Brazil, Russia, India and China – growth rates have quickly fallen and current-account balances have deteriorated. The BRIC countries did not take advantage of the good years to improve the underlying state of their economic systems. China's banks are overleveraged (Walter 2012), and India suffers from most economic ailments. Its inflation is too high, and its budget deficit, public debt and current-account deficit are too large.

- India has been adversely affected by considerable Corruption and Poor Business environment.

- Indian economy in 2013 is in a much better position than in 1991. But, it is worse in 2013 than in 1998.

- The Indian economy is on the threshold of a crisis. India comes out poorly on almost all parameters, perhaps other than growth among BRICs. Its economic imbalances—consumer inflation is still close to double digits, the growth trajectory is far lower than before, the current account deficit is way above safe levels and the fiscal deficit continues.

II CONCLUSION

The unfolding of macro-economic events, it is concluded that there is no fear that the Indian economy appears to be getting into a crisis, similar to the one that it faced in 1991, has begun to gain ground. No doubt, the current macro-economic scenario is grim, but we are not in a 1991-like situation. Undoubtedly the reckless current account deficit of $339 billion in the nine years of the UPA rule has directly hit the Rupee unconscious. The CAD is the proximate cause of the Rupee's disgrace, but not the only cause. Fiscal deficit is as much a culprit. The deadly combination of huge current account deficits and high fiscal deficits has put the Rupee on the ventilator. Inflation and unemployment rate is at highest level. Besides, Indian economy is in a much better position than in 1991.
There is no need to resort to measures which put a question mark on policy continuity and speak of the government's inability to manage balance of payment situation. It is time that the government worked with the opposition to build consensus, like they did in 1991, to tackle this serious situation which has the potential to develop into a financial emergency. India's success can be attributed to five sets of decisions taken during 1991-97: devaluation, engaging the IMF, floating the exchange rate while increasing the central bank's autonomy to intervene against speculative pressures, opening up the external sector while maintaining asymmetric capital controls, and liberalizing the financial sector

Reference

Dr. Partap Singh. 2013. Depreciation of rupee in Indian economy: an analysis. International Journal of Innovations in Engineering and Technology (IJIET).Vol. 2 Issue 4 August 2013 332 ISSN: 2319 – 1058

K. Johnson .2010. The effects of devaluation of rupee on economy. International Innovative Journal of Finance, Vol. 7, p. 45-56

Sharma Konak.2006.Reforming the retail sector. Yojana, July, P.41-44 Economic Survey, 2011-11

Harish Damodaran. India's GDP growth estimate. Business line. Feb 3, 2013

Acharya, Shankar. 2002a. "Macroeconomic Management in the Nineties." *Economic and Political Weekly* 37(16): 1515-1538.

Ahluwalia, Montek S. 1999. "India's Economic Reforms: An Appraisal." In Jeffrey D. Sachs,

Ashutosh Varshney, and Nirupam Bajpai, eds. *India in the Era of Economic Reforms*. New Delhi: Oxford University Press.

Balasubramanyam, V. N. 2001. *Conversations with Indian Economists*. New Delhi: Macmillan.

Bhaduri, Amit, and Deepak Nayyar. 1996. *The Intelligent Person's Guide to Liberalization*. New Delhi: Penguin.

Nayar, Baldev Raj. 1998. "Political Structure and India's Economic Reforms of the 1990s." *Pacific Affairs* 71(3): 335-358.
Nayyar, Deepak. 1996. *Economic Liberalization in India: Analytics, Experience and Lessons*. Calcutta: Centre for Studies in Social Sciences. , 1998.

Reddy, Y.V. 1997a. "Capital Flight: Myths and Realities." Lecture at the Centre for Economic and Social Studies, Hyderabad, 21 June. Reprinted in Y.V. Reddy, *Monetary and Financial Sector Reforms in India: A Central Banker's Perspective*, New Delhi, UBSPD, 2000.

Towe, Christopher. 2001. "India and the Asia Crisis." In Tim Callen, Patricia Reynolds, and Virmani, Arvind. 1991. "Demand and Supply Factors in India's Trade." *Economic and Political Weekly* 26(6).

Newspapers:
The Economics Time, August –September, 2012
The Business Line, July- September, 2012
The Hindu, Septermber, 2012
The Tribune, August-Septmber, 2012

Website
www.equitymaster.com
www.indiastat.com
www.tradeindia.com
www.urwealthy.com
http://indiabudget.nic.in
http://indiatogether.com/2013/aug/eco-deficit.htm#sthash.HVIaUiAY.dpuf