2011 ARTICLES

Global Financial Crisis, Its Impact on India and the Policy Response

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DOI
https://doi.org/10.7916/D85T3TQI

India could not insulate itself from the adverse developments in the international financial markets, despite having a banking and financial system that had little to do with investments in structured financial instruments carved out of subprime mortgages, whose failure had set off the chain of events culminating in a global crisis. Economic growth decelerated in 2008-09 to 6.7 percent. This represented a decline of 2.1 percent from the average growth rate of 8.8 percent in the previous five years. To counter the negative fallout of the global slowdown on the Indian economy, the federal Government responded by providing three focused fiscal stimulus packages in the form of tax relief to boost demand and increased expenditure on public projects to create employment and public assets. India's central Bank — the Reserve Bank of India (RBI) took a number of monetary easing and liquidity enhancing measures to facilitate flow of funds from the financial system to meet the needs of productive sectors. From all accounts, except for the agricultural sector initially as noted above, economic recovery seems to be well underway. Economic growth stood at 8.6 percent during fiscal year 2010-11. GDP growth for 2009-10 was placed at 8 percent. When compared to countries across the world, India stands out as one of the best performing economies. Although there was a clear moderation in growth from 9 percent levels to 7+ percent soon after the crisis hit, in 2010-11, at 8.6 percent, GDP growth in nearing the pre-crisis levels and this pace makes India the fastest growing major economy after China. Considering the current inflationary strains, the as yet excessive pre-emption of the community's savings by the government, the potential for crowding out the requirements of the enterprise sector, and rising interest payments on government debt, it is extremely essential to reduce the fiscal deficit, and more aggressively, mainly by lowering the revenue deficit. Correction of these deficits would, inter alia, require considerable refocusing and reduction of large hidden subsidies associated with under-pricing in crucial areas, such as power, irrigation, and urban transport. Food and fertilizer subsidies are other major areas of expenditure control. Be that as it may, the process of fiscal consolidation needs to be accelerated through more qualitative adjustments to reduce government dissavings and ameliorate price pressures. The step-up in India's growth rate over much of the last two decades was primarily due to the structural changes in industrial, trade and financial areas, among others, over the 1990s as the reforms in these sectors were wide and deep and hence contributed significantly to higher productivity of the economy. Indeed, there is potential for still higher growth on a sustained basis of 9+ percent in the years ahead, but among other things, this would require the following: 1) revival and a vigorous pursuit of economic reforms at the center and in the states; 2) a major effort at raising the rate of domestic savings, especially by reducing government dissavings at the central and state levels through cuts in, and refocusing of, explicit and implicit subsidies, stricter control over non-developmental expenditures, improvements in the tax ratio through stronger tax enforcement, and strengthening incentives for savings; 3) larger investments in, and better performance of, infrastructural services, both in the public and private sectors; and 4)

greater attention to, and larger resources for, agriculture, social sectors and rural development programs to increase employment, reduce poverty and for creating a mass base in support of economic reforms.

Geographic Areas

South Asia

Subjects

Economics   South Asians

Files

CGCSA_Working_Paper_5.pdf   application/pdf   494 KB

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Academic Units	Columbia Global Centers--Mumbai
Publisher	Columbia Global Centers--Mumbai, Columbia University
Series	Columbia Global Centers--South Asia Working Papers, 5
Published Here	September 13, 2012