RESILIENCE OF THE INDIAN ECONOMY

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Despite the financial meltdown and global economic slowdown following the US sub-prime lending crisis of 2007, the Indian economy exhibited a relatively modest slowdown and in recent years has registered a comparatively faster growth recovery. That this has happened against the backdrop of increasing openness and globalisation of the Indian economy itself bears testimony to its growing resilience. The present article investigates the various dimensions of this resilience and finds that it is largely attributable to the strong macro-economic fundamentals coupled with the deliberate and cautious policy measures adopted by the policy-makers in India. The superior growth performance per se is, however, no guarantee of its fairer distribution among the masses especially the downtrodden and vulnerable sections of the society. 'Growth inclusiveness' therefore continues to be the major challenge of policy making in India particularly in the light of the fact that the achievements of public policy in this regard have not been as satisfactory in recent years.

1.1 Introduction

In its Third Quarter Review of Monetary Policy 2009-10 released in January 2010, the Reserve Bank of India (2010a) had observed that the Indian economy showed a degree of resilience as it recorded a better-than-expected growth of 7.9 per cent during the second quarter of 2009-10.

More recently, in its Mid-term Appraisal of the Eleventh Five Year Plan released in July 2010, even the Planning Commission of India (2010) has testified the establishment of resilience of the Indian economy in terms of its ability to manage a downturn despite greater openness.

In view of this growing recognition of the resilience of the Indian economy, it becomes pertinent to take a closer look at it not only in terms of its meaning and significance but also its underlying causes and likely sustainability so as to derive useful policy insights. Against this backdrop, the present article goes deeper into the various aspects of the multi-dimensional concept of resilience in the next section. The purpose is to examine as to what extent the Indian economy has indeed acquired resilience in recent years.

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The following section thoroughly analyses the main factors leading to this observed resilience thereby exploring its viability in the times to come. The major implications of the growing resilience of the Indian economy and the prominent areas of concern for the future in this regard are presented in the subsequent sections. And finally the main conclusions for policy making are derived in the concluding section.

1.2 Facts and Figures: Is the Indian Economy really Resilient?

The 'resilience' of an economy refers to its capacity to withstand shocks without getting destabilised. What this essentially means is that whenever a resilient economy faces an external shock such as the one arising either on supply or instead demand side at the international level, it first of all does not get too much adversely affected by it. That is to say, a resilient economy by definition has the capacity to by and large insulate itself from the unfavourable effects of external events. Moreover, whatever little adverse impact an international demand or supply shock leaves on a resilient economy, it is powerful enough to absorb it and thus in a position to avoid any long-term enduring influence of it.

Evidently, in the contemporary regime of globalisation characterised by strong economic inter-linkages between the various nations of the world, it has become exceedingly difficult for any country pursuing liberal and open economic policies to exhibit this kind of resilience in the strict sense of the term. For, the whole world in the present age has practically been reduced to a 'Global Village' wherein owing to the rapid advancements in information technology and strong economic ties among nations, an economic crisis in any part of the world could easily spread like an epidemic or wild fire across the globe in a very short span of time.

Under such a scenario, if an economy still exhibits resilience, it implies and testifies the inner and deep-rooted strength of that economy which could only come through deliberate and well thought-out policy measures. This is precisely what seems to have happened in the case of Indian economy in recent years. For, the Indian economy has recently manifested strong resilience in tackling a global economic crisis and recovering from it.

More specifically, as Rakshit (2009) has observed, the world economic crisis first surfaced in the US sub-prime mortgage market in August 2007. It then spread to the markets for other securities not only in the US but elsewhere thereby culminating into a huge financial meltdown within a few months. The net result was a string of bankruptcies and a sharp economic slowdown in practically all industrialised countries.

To be specific, from a trend rate of 2% to 2.5% per annum, the annual rate of growth in most of the advanced economies declined to –2% to –3%. That is to say, instead of a positive growth, the industrialised economies actually experienced deceleration in their output of the order of 2% to 3% thereby signifying output contraction by 4 to 5.5 percentage points. It is worth noting that against the backdrop of such exceedingly sharp contractions in output in the industrialised world, the annual growth of Indian economy declined by only about 2 Percentage points over the same period.

It must further be pointed out that at the absolute level, the growth rate of the Indian economy was already quite high *vis-à-vis* the rate of growth exhibited by the advanced industrialised countries prior to the global financial crises. Consequently, a comparatively lower decline in growth by only 2 percentage points instead of 4 to 5.5 percentage points clearly implied that *India's growth rate remained relatively robust in comparison to the developed world despite the global meltdown.*

More specifically, the Indian economy registered an annual growth rate of over 9 percent during 2007-08 and this momentum was interrupted during 2008-09 when the rate of growth declined to 6.7 percent per annum due to the global financial crisis. It must however be realised that even a declined annual growth rate of 6.7% is quite high and commendable in contrast to the growth deceleration of the order of 2% to 3% observed in the case of developed economies in the face of the global financial crisis.

Owing to the monetary accommodation and fiscal stimulus provided by the Government of India in response to the global recession, however, the annual growth rate of the Indian economy rebounded to about 7.4 percent during 2009-10. It must be realised that such an impressive growth recovery took place despite the economy being hit by a severe drought and the agricultural sector registering a negligible growth rate of 0.2 percent per annum over the same period. This clearly shows and bears testimony to the fact that the Indian economy has gradually acquired a high degree of resilience by virtue of which it can wriggle out of even major shocks as serious as the global financial meltdown and recessionary tendencies without any major long-term damage or loss.

This evidently raises the basic question whether this recently observed resilience of the Indian economy would eventually turn out to be short-lived or instead be enduring in nature. In order to investigate this likely sustainability of the resilience of the Indian economy in the times to come, let us now explore the underlying causes or reasons behind this resilience.

1.3 Main Factors Leading to the Resilience of Indian Economy

Ever since the outbreak of the recent global financial crisis, expectations and hopes were being expressed that the so-called Emerging Market Economies (EMEs) especially the larger ones from Asian region such as India and China would not only remain relatively insulated from the crisis but also play a prominent role in moderating the global downturn. In retrospect, however, we find that such an expectation does not seem to have fully fructified in as much as the EMEs could hardly pave way for a worldwide recovery. In this context, Rakshit (2009) has admitted that since September 2008, such a "decoupling hypothesis" has proved seriously wrong.

It must nevertheless be acknowledged that as opposed to the advanced industrialised economies, the Emerging Market Economies of India, China and East Asian Region have suffered less from the global downturn and recovered comparatively faster. For instance, in this connection, even RBI (2010a) has observed that of late, the global economy is showing increasing signs of stabilisation with the Asian region experiencing a relatively stronger rebound. It is further recognised that the EMEs are generally recovering faster than advanced economies on account of a higher government spending.

On closer examination, however, we find that in the case of Indian economy it would be an over-simplification to contend that this better growth recovery is essentially driven by government spending alone. For, the fact of the matter is that the resilience shown by the Indian economy in the face of the global financial crisis is attributable to a multiplicity of mutually reinforcing and policy-induced factors. It is in fact by virtue of these factors that the observed resilience of the Indian economy can be reasonably expected to sustain even in the future.

More specifically, despite the openness and globalisation of the Indian economy in the contemporary context, the degree of reliance on exports as a demand side driver has remained very limited in India. This is largely because in recent years the remarkable growth exhibited by the Indian economy has essentially been propelled by domestic demand in general and domestic investment in particular. Consequently, the recent global meltdown was not able to hamper India's growth prospects to a very large extent and hence the growth rate declined by a relatively lower magnitude.

As the underlying macro-fundamentals especially public savings and gross fixed capital formation continued to remain quite strong throughout the crisis period, the impact on India's growth performance turned out to be comparatively meagre. This was further supported by a satisfactory accumulation of foreign exchange reserves that imparted increased strength and resilience to the economy.

Most importantly, the main credit for the increased resilience of the Indian economy must be given to the cautious and conservative approach of the policy makers as regards the liberalisation of capital flows and short-term debt coupled with the prudential regulation of the financial system. It was on account of such regulations being put in place that the Indian economy and Indian financial sector remained practically insulated from any dubious or toxic assets that could potentially lead to a financial crisis of the dimensions as severe as observed in the advanced industrialised countries. In this context, Mohan (2009) has observed that the direct effect of the sub-prime crisis on Indian banks/ financial sector was negligible because of limited exposure to complex derivatives and other prudential policies put in place by the Reserve Bank.

1.4 The Prominent Areas of Concern for Policy-Making

The recent achievements of the Indian economy on the growth front and its resilience during the crisis period of a global economic slowdown notwithstanding, it must nevertheless be realised that there is no room or ground for complacence as far as public policy making is concerned. This is largely because the growth of the Indian economy is still lop-sided and has not yet become sufficiently broad-based. To be precise, certain *inter-sectoral, inter-personal* and *inter-regional* disparities lie hidden behind the apparently satisfactory growth figures in aggregative terms.

For instance, the agricultural sector of the Indian economy is almost approaching stagnation in as much as it has registered a negligible annual growth rate of just 0.2 percent during 2009-10. In view of the pre-dominantly agrarian nature of the Indian economy and excessive reliance of a large proportion of population on agricultural and allied activities as a source of livelihood, such a pathetic situation becomes a serious area of concern for policy-makers. Moreover, the poor agricultural performance also raises serious policy-concerns for achieving the desired objective of *food security* in the Indian economy.

In the context of this poor performance of the agricultural sector of the Indian economy, even the FICCI i.e. the Federation of Indian Chambers of Commerce and Industry (2010) has observed in its report on Current State of Indian Economy released in June 2010 that despite high growth in the economy, concerns over growing imbalances due to niggardly performance in agriculture for the second year in succession have increased. Further, as the Indian economy has been hit by a severe drought during 2009-10, the situation on the agrarian front is likely to worsen in case suitable corrective measures are not immediately undertaken by policy-makers thereby accentuating *food shortages* and *generating inflationary expectations*.

This coupled with already high commodity prices and oil prices in the international market could quite conceivably put an upward pressure on the general price level thereby generating severe inflationary tendencies in the domestic economy. Bringing inflation under control has, therefore, become a serious concern and top-priority area for the planners and policy makers in India. In this connection, even the Reserve Bank of India (2010b) in its First Quarter Review of Monetary Policy 2010-11 released in July 2010 has admitted that with growth taking firm hold, the balance of policy stance has to shift decisively to containing inflation and anchoring inflationary expectations.

Side-by-side it must also be realised that though Indian economy has been able to achieve an impressive growth rate in the recent past, the distribution of the fruits of this growth among masses has by no means been equally impressive. For, this growth has essentially failed to effectively percolate down to the vulnerable, marginalised and downtrodden sections of the society as is evident from a high rate of unemployment, poverty and inequalities along with a poor state of preventive and curative health, education, rural infrastructure and provision of other basic minimum needs in the country. This becomes a serious area of policy-concern particularly in the light of the fact that 'Inclusive Growth' is one of the prominent aims of the ongoing Eleventh 5 Year Plan.

1.5 Conclusion

There is no denying the fact that in recent years, the Indian economy has exhibited a high degree of resilience in the sense that first of all it did not get significantly affected by the global economic slowdown following the US sub-prime lending crisis in 2007. Moreover, as opposed to the advanced industrialised countries, the Indian economy has recovered much faster during 2009-10 since despite openness its growth has by and large remained driven by domestic demand rather than exports. It is noteworthy that the macro-fundamentals of the Indian economy continued to remain very strong and sound throughout the crisis period. To a large extent, the credit for this impressive growth performance of the Indian economy over the concerned period goes to the cautious and conservative policies pursued by the policy makers as regards regulation of the financial system, short-term debt and international capital flows.

But as the distribution of this growth among masses has not been as impressive in India, 'Growth Inclusiveness' continues to remain one of the major areas of concern for the policy makers especially the provision of employment and basic minimum needs such as health and education to the poor and downtrodden sections of the society. Another serious area of policy concern is the near-stagnation of the agricultural sector that endangers *food security* in India and raises serious doubts about the efficacy of the policy of controlling prices in India. Putting inflationary tendencies under check, therefore, becomes still another area of serious concern for the policy-makers in India.

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