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INDIA – THE FASTEST GROWING ECONOMY IN THE WORLD

Dr. Roshankumar M. Bhigania
Yeshwant Mahavidhyalaya, Nanded.

ABSTRACT:

India clearly is one of the fastest growing emerging economies of the world, next to China, having the potential to overtake China in the medium-term. Though in recent times there has been a sharp deceleration in growth of India but these are for domestic reasons rather than global compulsions. The latest advantages have to be leveraged by India to reap the benefits of a double digit fastest growing economy. As financial perspective, the role of RBI and its responsibilities would have to radically change as India enters a globalized world. This is what the council should do to provide the interface and not earn the status of a 'super regulator' in the economy. It should only be platform for providing interface with other regulators of the economy. Neither should the council allow emergence of a super regulator in the economy. It places great responsibilities on the shoulders of the government and RBI of leading from the front, and make India a front runner amongst the emerging economies in the future. The changing global axis towards the emerging economies is seen as a welcome feature of the new world order. However, it will require sustained efforts, desire to overcome, collective political will and above all a realization, on the part of the government, of their criticality and fundamental in reshaping the Indian economy. Foreign Exchange Reserves is country's gold reserves, contributions made to the IMF and the FTP and all the foreign currency assets, denominated in USD, held by the RBI. However, over 90 per cent of the reserves comprise of different foreign currencies, but denominated in USD held by RBI. In case of India, exchange rates are manages and any capital inflows would be mopped up by RBI to prevent rupee from appreciating, thus resulting in building-up reserves.

KEYWORDS: *Global Perspective – Emerging Issues – Reserve Bank of India- Challenges- Foreign Exchange Reserves.*

INTRODUCTION

Global Perspective – India And China:-

First, the outlook from a global perspective, India clearly is one of the fastest growing emerging economies of the world, next to China, having the potential to overtake China in the medium-term. Though in recent times there has been a sharp deceleration in growth of India but these are for domestic reasons rather than global compulsions. Some of the distinct advantages which India has over China are:

(1) India is the largest democracy in the world, elected government, participative and collective wisdom within the government moving up the economic ladder slowly but consensus-driven and with long-term sustainability.
India with its young population would contribute to the global workforce.
(2) It has the largest number of English-speaking workforce outside the US.
(3) Annually, India produces 6

lakh engineers, some world –class from the IIT and some mediocre. Even if 25 per cent of them are world-class it would mean one lakh engineers a year which is impressive by any global standards.

India is a way ahead of China in respect of market –determined exchange rate, fairly open capital account besides already having current account convertibility.

(4) India's financial sector is fairly liberalized, transparent accounting practices, standardized income recognition, asset classification norms, with high levels of capital than that prescribed by the international standards.

a) Indian banks were the first, amongst emerging economies to have already implemented the Basel II accord.

(5) There is a freedom of speech, freedom to express opinions on important issues besides relatively a free media. This provides for internal checks and balances and also testing of policies and consensus building on sensitive economic issues.

(6) In recent times, China with its high growth earlier has started showing signs of an overheated economy with infrastructural constraints surfacing, increase in unemployment and the pinch of inflationary pressures.

India on other hand, is better placed in these areas as inflationary pressures have already peaked and have begun their down-turn.

However these latest advantages have to be leveraged by India to reap the benefits of a double digit fastest growing economy.

Emerging Issues:-

(1) The government will have to relook at the unfinished agenda of economic reforms and pursue with the right vigour as that displayed during 1991.

(2) It will have to reshape itself becoming more professional in its approach from a 'driver' of growth to 'management' of growth, which is allowing growth itself to grow with its own momentum, by playing the role of a facilitator.

(3) This would require the government to create an enabling environment, within which the growth not only increases but is allowed to spread more evenly across the economy.

(4) It has to embrace electronic governance, provide for technology and innovation intensive investment, aimed at newer technologies, at affordable prices, benefiting the masses.

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(6) It has to look at newer ways of '3 Es' Envisioning Empowerment and their smooth and seamless Execution.

(7) It cannot lose sight of the problems of poverty and malnourishment of a vast section of population.

(8) Skill formation has to be given properties by strengthening the institutional framework and that sufficient skills are available to meet the growing output of the economy.

(9) It will require a better understanding of its role changing to creating an enabling environment for all the sectors to deliver.

Finally from a financial perspective, the role of RBI and its responsibilities would have to radically change as India enters a globalized world.

ROLE OF RESERVE BANK OF INDIA:-

The RBI would have to play the role of ensuring seamless transition of the Indian banks to the internationally prescribed Basel III norms. It would have to build better risk assessment capabilities, risk appetite and sufficiency of capital, in the Indian banking system, in the wake of the global financial fallout. The government has set up an apex level financial Stability Development Council(FSDC) for addressing issues of financial stability, inter-regulatory coordination, financial literacy and financial inclusion.

Though this council is still at a nascent stage but RBI would be required to play a major role with other regulators providing inputs. It role should not be that of excessive regulations but to provide a domestic oversight mechanism to financial and other sectors and a conduit to pass on global financial developments. RBI would also need to understand that while credit contraction or expansion by banks lies within its purview, it is not answerable for any deceleration in industrial growth, arising out of credit contraction.

This is what the council should do to provide the interface and not earn the status of a 'super regulator' in the economy. It should only be platform for providing interface with other regulators of the economy. Neither should the council allow emergence of a super regulator in the economy. As a super regulatory would only make the other regulators in the economy meaningless and ineffective, defeating the very purpose of a regulator.

It should also have to take critical decisions especially in respect of exchange rates in determining the levels and timing of its intervention to manage exchange rates. Another aspect would be managing the capital inflows. We had previously discussed about the 'impossible trinity' of being able to manage any two, between exchange rate, open capital account and an independent monetary policy. This would be the biggest challenge for the RBI in future.

Overall, the Indian Economy has bright outlook, from all the angles, but still requires first, conversion of advantages as opportunities and then their encashment. It places great responsibilities on the shoulders of the government and RBI of leading from the front, and make India a front runner amongst the emerging economies in the future.

CHALLENGES AHEAD:-

While India is a global prospect, full of opportunities, a potentially fastest growing economy and larger global presence it has some inherent stiff challenges. The first challenge, as outlined previously of the ability of converting advantages into opportunities and subsequent encashment or translation into increased investment, output and income. The second being, the global outlook still has many question marks and uncertainties of the following:-

(1) Recovery of large economies post-crisis.
(2) Fears of double-dip recession.
(3) Uncertain future of Euro and Eurozone.
(4) Smaller economic ability to destabilize global economy.
(5) Implications of growing sovereign debt of large economies, Implications of a different international reserve currency other than USD.
(6) These uncertainties impose greater challenge for countries such as India and China for lifting global output.

The changing global axis towards the emerging economies is seen as a welcome feature of the new world order. There are two aspects to understand in this shift, one of the axis being 'pulled' towards the emerging economies, and the other, of the axis being 'pushed' towards the emerging economies. Which is happening 'pulled or pushed?'

The global crisis is pushing the axis towards emerging economies as the only way going forward. It is not that something dramatic has happened in these emerging economies, especially India. As we have seen previously, the unfinished agenda before the government the pause on economic reforms only re-affirm the aspect of being pushed rather than being pulled.

Thus, the larger question of countries such as India is it 'prepared' for such structural shift of the global economy? Capital inflows into these economies was seen as good for them, but large surge inflows recently, has been seen as potentially destabilizing and has triggered currency war situations. Most economies have resultantly imposed restrictions of such inflows. India has restrained so far but for how long?

The inflows are coming because of quantitative easing by the US and not due to any particular positive feature of the emerging economies like India. 'It is absence of an alternate window which is causing this surge in inflows.' However, such can also seep into real estate, commodities, besides the stock market and also corporate and sovereign debt market creating 'asset bubbles', which by definition, will burst when the economy is least prepared.

An equally greater challenge for countries like India would be how to manage outflows, asset bubbles bursting, if they happen, once an alternate window is available? Another belief of the new world order is the likelihood of increased penetration of countries, for example, India in the global economy with larger share of exports of goods and services.

Given the market imperfections in India, can it be globally competitive to achieve penetration? India's export sector continues to lack maturity of understanding the importance of moving up the value chain, rather than, exchange rate movements, as more fundamental, to achieve the levels of penetration. The integrated global economy would definitely open opportunities, but penetration, will largely rest on ability of countries like India to emerge as globally competitive.

Yet another aspect is that India and China by virtue of their large population are being seen as potential markets but do these markets have income or purchasing power to actually become market as widely believed? That is, besides the above challenges; it will also have a larger set of domestic challenges. They are as follows:

(1) The major challenge of an impoverished India, home to largest number of people living below USD 1 per day, of absolute poverty, malnourished and a large social sector outside the mainstream of development.

(2) A larger challenge as expressed by the eleventh five-year plan and would also get echoed in the twelfth five-year plan, of not increasing rates of growth, but of providing greater inclusive growth.

(a) The challenge is thus not growth but how to ensure they are evenly spread to provide broad-based benefits to masses?

(3) Then the issue of stagnant, traditional and livelihood agriculture. Is the agricultural sector capable and prepared to meet the needs of a growing economy with rising income levels?

(4) Despite all the talk about India as a new economy, India continues to be a country of villages; the soul of India is in the 6 lakh villages.

It is not about converting villages into towns. Villages are an essential fabric of the Indian economy, but how to make them self-contained in terms of basic amenities and also provide people in the villages, with a source of income?

We have seen earlier, the huge investment deficit especially in infrastructure sector like power. From where does one raise the huge resources required for bridging this deficit?

This is not to talk about rural infrastructure, which is already crumbing, requiring not only re-building but also fresh investment.

(5) Even the industrial and financial sectors where reforms have been centered, there is still a large presence of the public sector.

Will they be competitive and continue to be profitable, as a public sector, in the absence of their privatization, in a rapidly transforming market economy of India?

(6) India's growing dependence on imported crude petroleum will only increase with increased growth. However, how does India insulate itself from sharp volatility in international crude petroleum prices?

How does one build energy security in India? Are we concerned of our structural problems in the energy sector?

(7) In the recent past the government has been accused of a 'policy paralysis' but in reality it is more of 'policy uncertainties', absence of 'policy continuity' and fears of 'policy reversal'. These are far more critical, influencing the entire economy than policy paralysis. The biggest difference is that policy paralysis can be shrugged off, while others require restoration of faith and that is the challenge of restoration of faith in the government.

An attempt has been made here to highlight the challenges as India prepares to go into the future. These challenges are not insurmountable, but need to be overcome. However, it will require sustained efforts, desire to overcome, collective political will and above all a realization, on the part of the government, of their criticality and fundamental in reshaping the Indian economy.

FOREIGN EXCHANGE RESERVES (FEX) OF INDIA :-

Foreign Exchange Reserves is country's gold reserves, contributions made to the IMF and the FTP and all the foreign currency assets, denominated in USD, held by the RBI. However, over 90 per cent of the reserves comprise of different foreign currencies, but denominated in USD held by RBI.

India's FEX reserves have risen from a modest level of USD 5 billion during 1991 to reach around USD 275 billion in 2013 and inching towards the USD 300 billion mark. India's foreign exchange reserves scaled to touch UD 367.64 billion as on October 7, 2016. 386.4 billion as on 7th July, 2017.

Amongst the emerging economies China has reserves of USD 3.5 trillion, Japan USD 1.5 trillion, Russia USD 500 billion, and S. Korea USD 300 billion.

The importance of FEX reserves lies in the following aspects:

(1) As economies pursue open policies, with large cross –border inflows and outflows, it provides a buffer against global fallouts and prevents currency crisis-like situations.
(2) It helps economies to provide import cover, not met out of inflows, ensuring smooth imports, in terms of domestic requirements.
(3) It gives the freedom to run higher current account deficts which could otherwisr become a limiting factor for open economies.
(4) It is helpful for economies to retire their high cost foreign currency debt or in meeting short-term foreign currency debt.
(5) It strengthens the confidence of the government for greater openness of economies and bolder reforms.
(6) It increases international credibility and stature of economies.
(7) In importance also lies as fundamental requirement for emerging economies by providing them a 'hard currency'.

How do reserves build-up in emerging economies? In the previous section, we had discussed about India's reserves and it may be interesting to note that it essentially comprises of Asian economies.

What about US or Europe? These economies already have a hard currency in circulation, thus obviating the need for any forex reserves. The reserves are required, as said previously for the emerging economies unlike the stronger economies of the US or Eurpoe, which in complete adverse circumstances, can print their hard currency, unlike emerging economies which can borrow but cannot print hard currency.

There is yet another reason for reserves not being built-up in these economies, which is that these economies have market-determined exchange rates and convertible currencies. All inflows and outflows are matched through changes in the exchange rate.

Let us see how this works? For example, in Europe there is a huge inflow of USD. That is, more USD is coming than what is being demanded in Europe. This would make the Euro appreciate and depreciate the USD and this will continue till the inflows get discouraged as it would be getting lesser and lesser Euro with a depreciating USD.

Any intervention by any central bank in this free flow foreign exchange market, either in the form of pegged exchange rats or in the absence of convertibility, or even both, would imply build-up of reserves by the central bank.

The other can be if there are surpluses in the capital account over and above the current account deficit. These surpluses would result in increasing reserves of the central bank as overall BOP would require outflows balanced out by inflows. If the current account is in surplus it will straight away go s additions to forex reserves.

In case of India, exchange rates are manages and any capital inflows would be mopped up by RBI to prevent rupee from appreciating, thus resulting in building-up reserves. Further even though India has a current account deficit there were, until recently, sufficient inflows on the capital account to cover the current account deficit and surplus going to increase the forex reserves.

This will be true for all economies which do not have either market-determined exchange rate or convertible currency or both, in the wake of surge in foreign currency inflows into such economies.

This build –up of reserves also happens in economies which lack absorption capacity of foreign currency or economies running current account surplus but with pegged exchange rates or non-convertible currencies. This is why there is build –up reserves in China and Japan.

More than the build-up of reserves, the large inflows are seen as opportunities for the large overseas investors, besides providing the emerging economies with buffer of foreign exchange for handling adverse global fallouts.

Can India's reserves accumulation be said to be 'sufficient' for warding off any crises?point needs to be clarified first, is the fact, that crises are known for their unpredictability and their magnitude of impact or the extent or damage they could inflict upon economies are variables. It is also about the government's perception about sufficiency seen qualitatively rather than quantitatively. Each of the successive crises in the past has only raised the bar of sufficiency of reserves.

However, over a period of time, with experience gained, it has now been possible to prescribe some international benchmarks to gauge sufficiency of reserves, especially for the emerging economies, like India.

(1) **Import Cover:-** the reserves should be able to provide an import cover of at least three months. Against which reserves in India provide a cover of seven months (it has come down presently but earlier it was as higher as fifteen months).
(2) **External Debt Cover:-** the reserves to provide cover for at least 75 per cent of the external debt and 100 per cent of short-term debt. India's level presently is much higher than that prescribed of being at least 50 per cent.
(3) **Guidotti Rule:-** in terms of this rule average reserve holding to short-term debt during a year should be a minimum of one. Against this in India it is five.
(4) **Liquidity at Risk (LaR):-** this is the most prevalent and widely acceptable given by Alan Greenspan, the earlier Chief of the Federal Reserve, US.

The irony is India is investment starved but the reserves cannot be used to bridge this investment deficit or directly use it for infrastructure funding in the country. Realizing the limitation, the government had set up the Deepak Parekh Committee to examine how the reserves can be used for infrastructure development in India.

Based on the recommendations made and accepted by the government, the India Infrastructure Finance Co. Ltd., wholly owned by the government would borrow USD 10 billion from the RBI and set up two wholly owned subsidiaries (WOS) overseas one at London and the other at Singapore.

The WOS at London would provide loans to Indian companies raising fund overseas for capital imports directly for use in infrastructure in the country. The WOS at Singapore would invest in AAA rated paper of global companies and from the returns generated provide a credit wrap or a monocline insurance, an insurance against defaults, to Indian companies accessing the overseas market for infrastructural development domestically.

There could yet be certain other set of options before the government for utilization of the reserves which are as follows:-

(1) **Sovereign Wealth Funds (SWF):-** many countries such as China, Japan and Saudi Arabia have deployed part of their reservews for setting up SWF which look at maximizing returns rather than currency stabilization. However, all the SWFs lack transparency and modus operandi not known except the objective behind SWFs.

- However, given the volatility of inflows, fragile BOP, high CAD, modest export growth it may be premature for India to look at the SWFs as an option for utilization of reserves unlike China and Japan whose reserves are many multiples more that of India.
- But more importantly their BOP is much more fundamentally stronger than that of India.
- In any case, India needs to use it for infrastructure and other proprieties which will not be possible by SWFs.

(2) Strategic Oil Reserves (SOR):- given India's dependence on crude petroleum and vulnerability to their prices, a part of the reserves could be used to create a SOR, in periods of sharp upward movement of international crude prices.

(3) Asian Development Fund (ADF):- China, Japan and India amongst themselves are holding USD 6 trillion as reserves of the USD 15 odd trillion of global reserves.

- If these countries could pool a part of their reserves to set up an Asian development fund (ADF), something like the IMF to provide assistance to the emerging economies, should they face problems on their currency.
- This will also be in line with the gradual shifting of global output and trade to the Asian economies.

However, this will require meeting of political minds, setting aside differences and more mature outlook of all these countries to make this a reality.

India's forex reserves since 1991 has come a long way giving it comfort on the external front and the confidence of weathering rurbulent domestic and global fall outs.

CONCLUSION:-

To reiterate, India has the advantage over other economies but the ability to harness them as opportunities and taping them, whether global or internal, is in the hands of India only. The fate of the Indian Economy in future is within our own hands, collectively and to shake up the government to make India realize its full potential, if not beyond usher in a new India, and restoring India to its past glory and stature, presently confined as leaves of history.

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Dr. Roshankumar M. Bhigania
Yeshwant Mahavidhyalaya, Nanded.